



***Lessons From the 1990s
Experience in Latin America***

*Hong Kong Institute for
Monetary Research*

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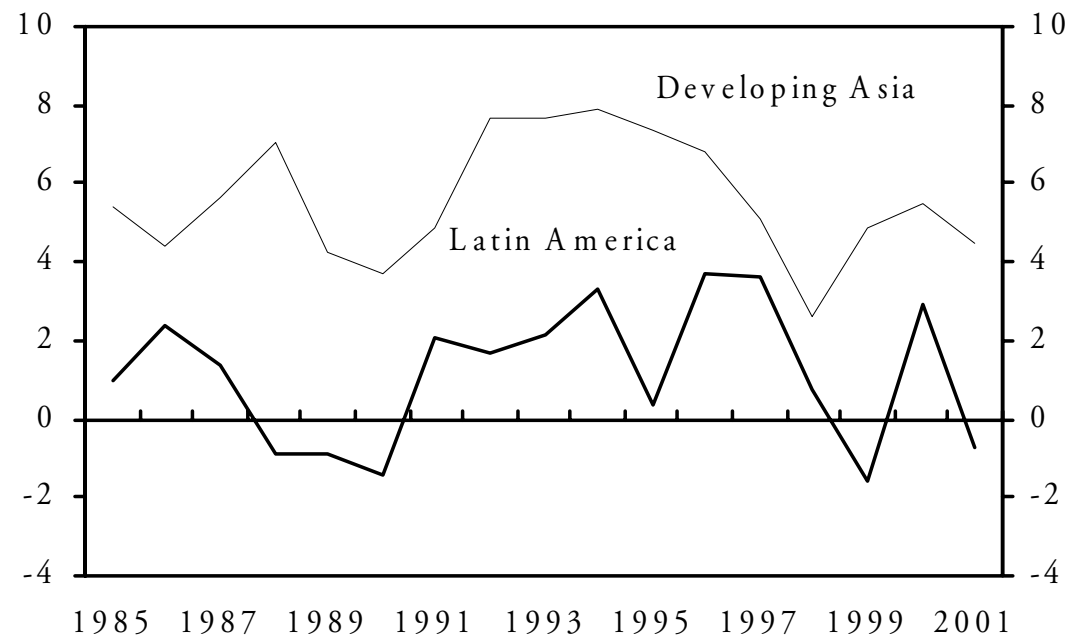


Reform programs ...

- Monetary stabilization – either exchange rate- or inflation-based objectives
- Privatization; deregulation
- Financial liberalization
- Debt restructuring (Brady plan) – normalized relations with external creditors

Growth picked up in early 1990s, but only temporarily ...

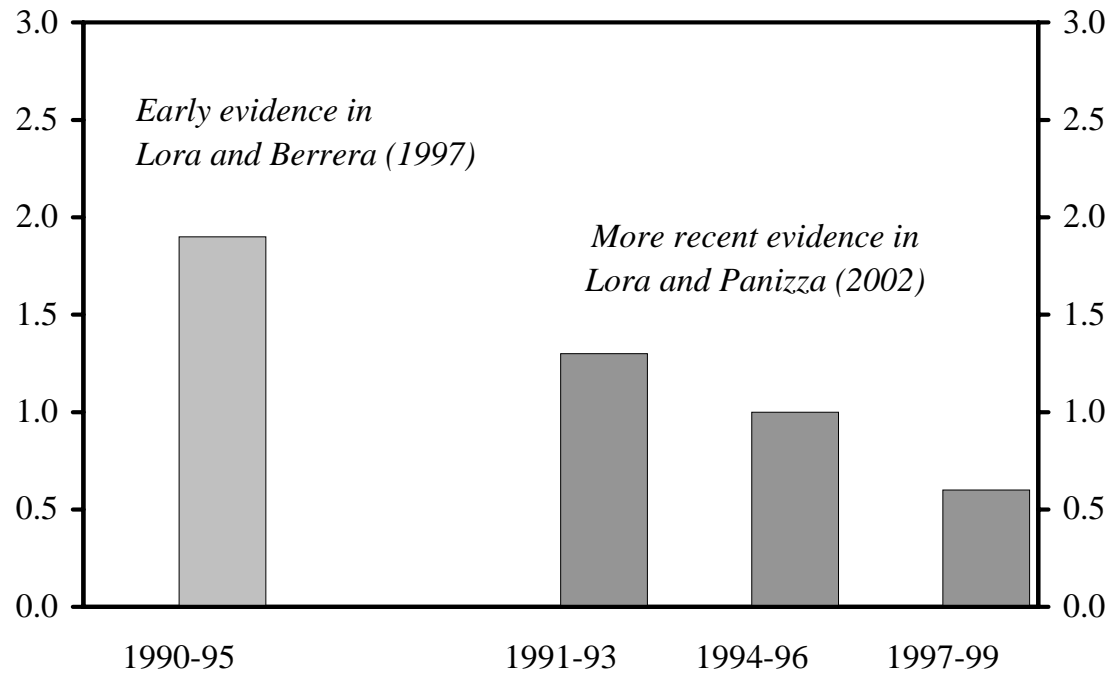
Figure 2.5. International Comparison:
Growth Performance
(Annual percent change in real per capita GDP)



Source: IMF, *World Economic Outlook*.

Irrational exuberance about reforms ...

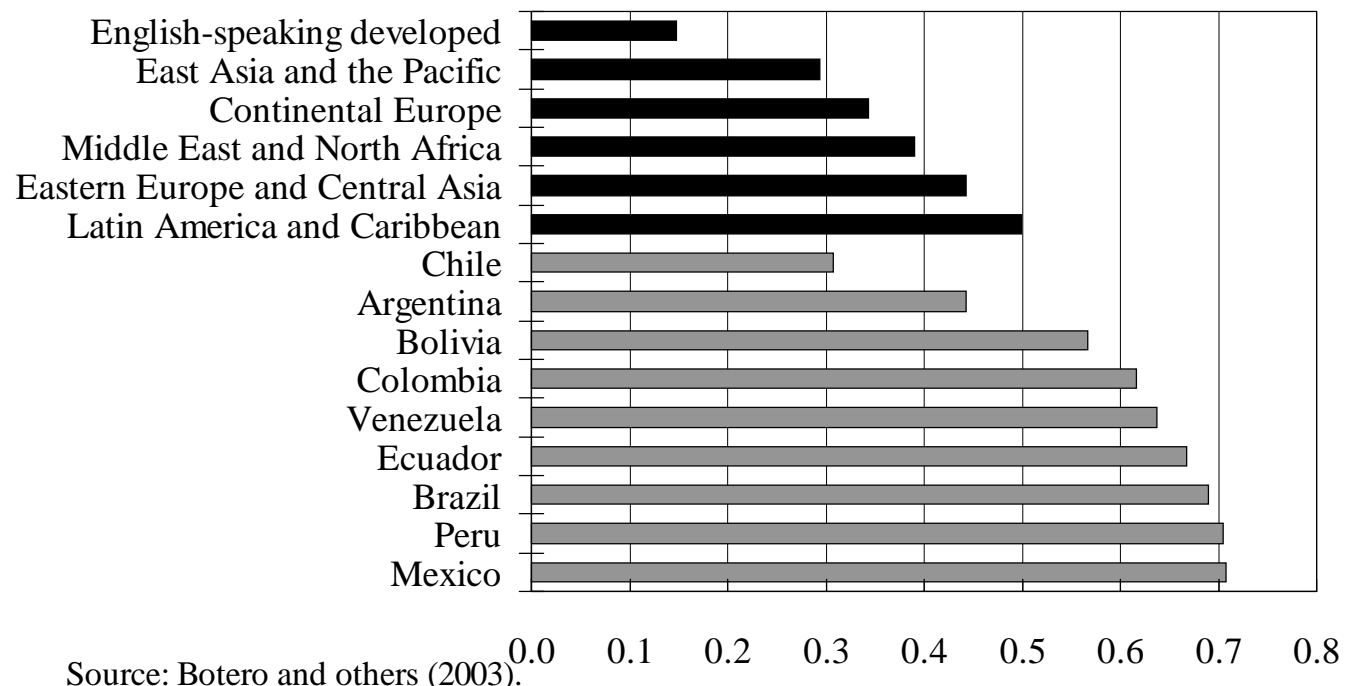
**Figure 2.6. Latin America:
Contribution of Reforms to Economic Growth**
(In percentage points)



Sources: Lora and Berrera (1997); and Lora and Panizza (2002).

But some fundamental measures were not taken ...

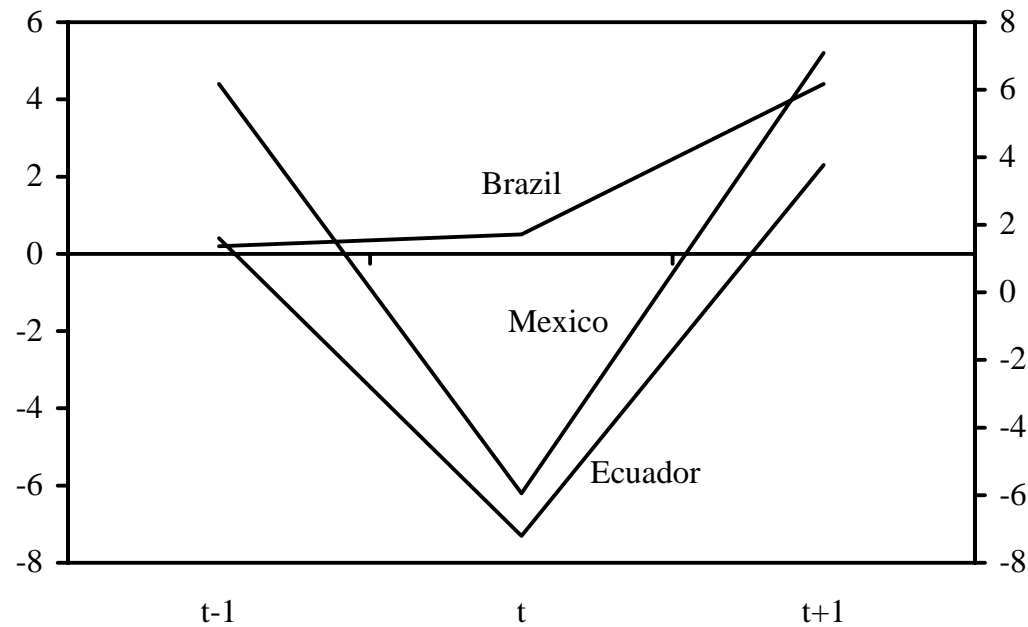
**International Comparison: Index of Labor Market Rigidity
(0=low, 1=high)¹**



¹The higher the index, the higher the level of labor market rigidities.

Followed by financial crises ...

**Figure 2.7. Consequences of Crisis:
Real GDP Growth¹**
(Annual percent change)



Source: Kochhar and others (2003).

¹ The year t refers to the onset of crises which were as follows:
Mexico (1995), Brazil (1999), and Ecuador (1999).

Different choices of stabilization plans had different endings ...

Exchange rate-based

Argentina

Brazil

Mexico

Uruguay

=> financial crisis *finale*

Inflation-based

Chile

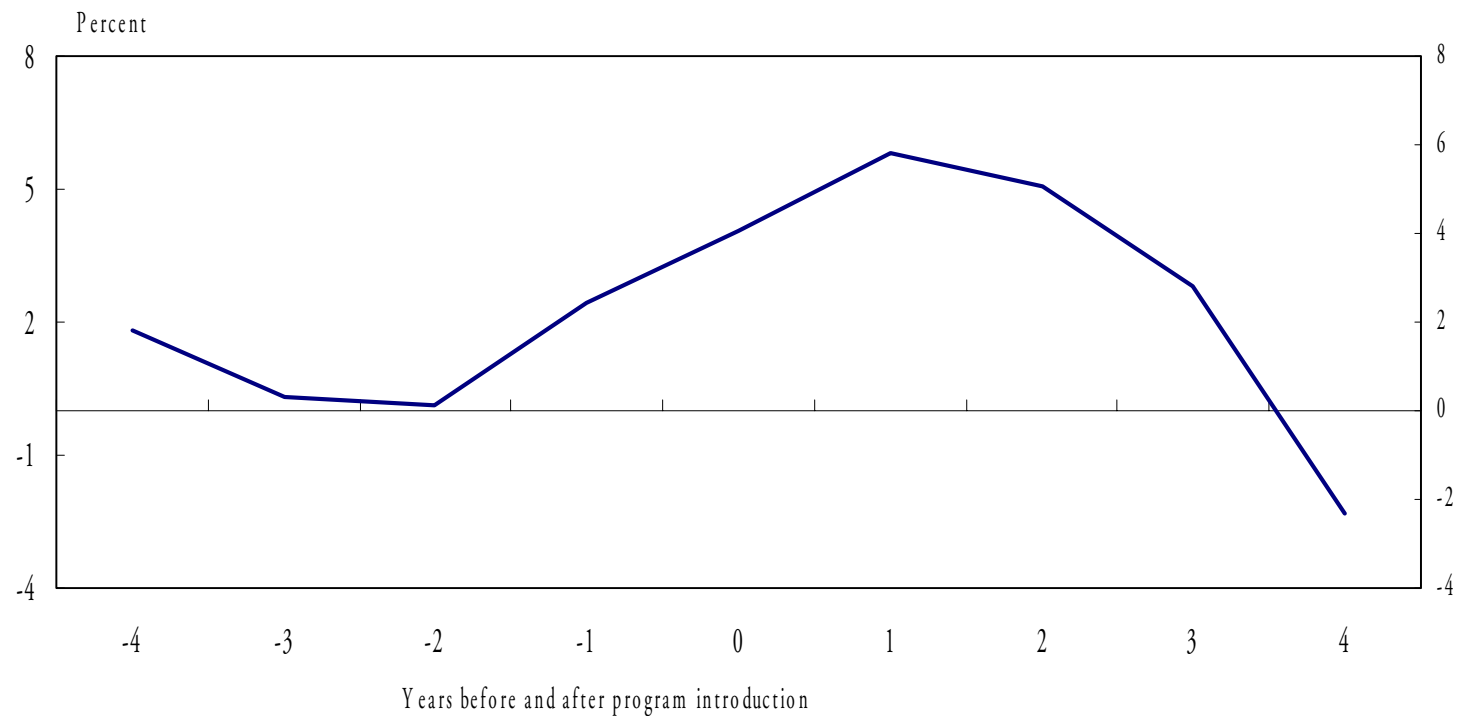
Colombia

Peru

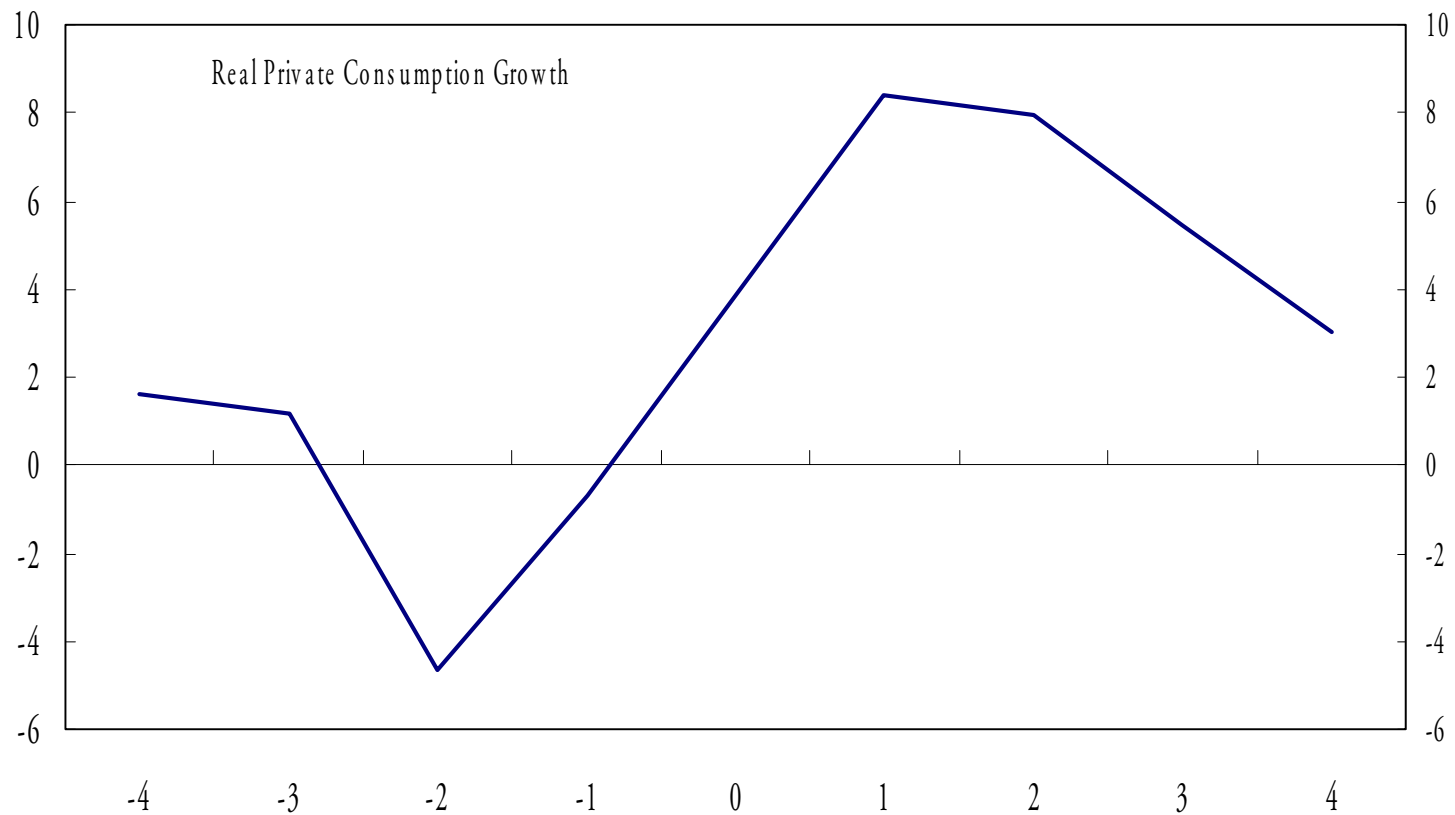
=> no crisis

Cyclical boom under ERBS ...

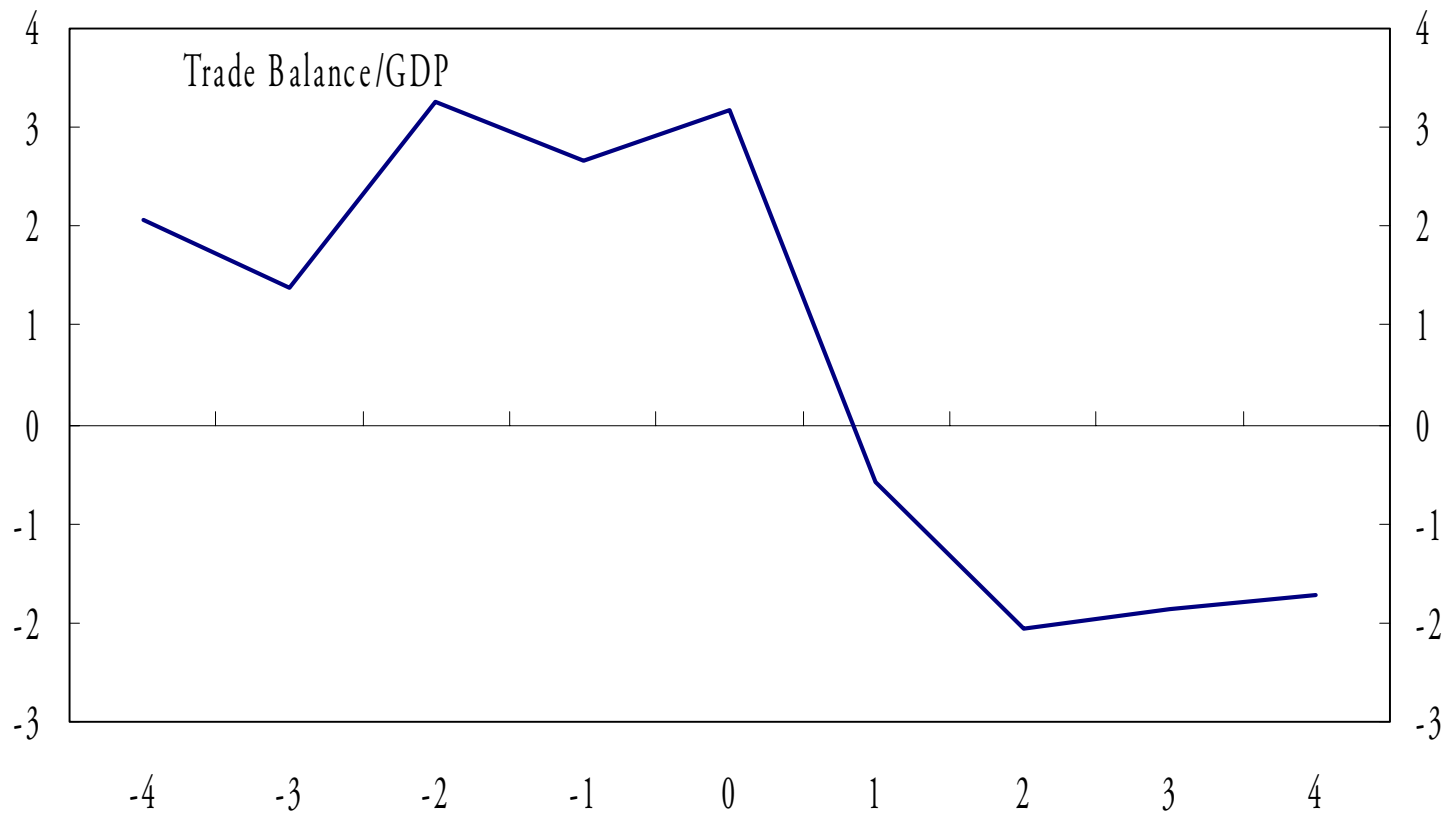
Latin America: Average Real GDP Growth
During Exchange-Rate Based Stabilization Plans



Led by private consumption ...

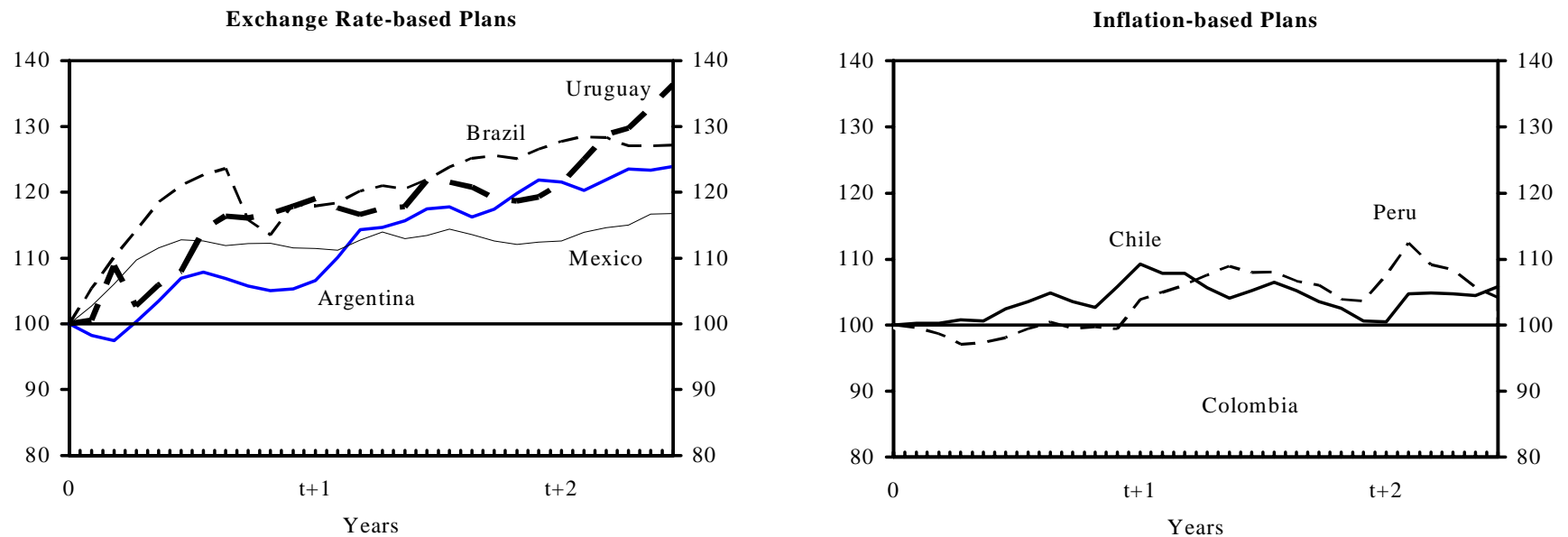


With a deteriorating external balance ...



Different paths for REERs ...

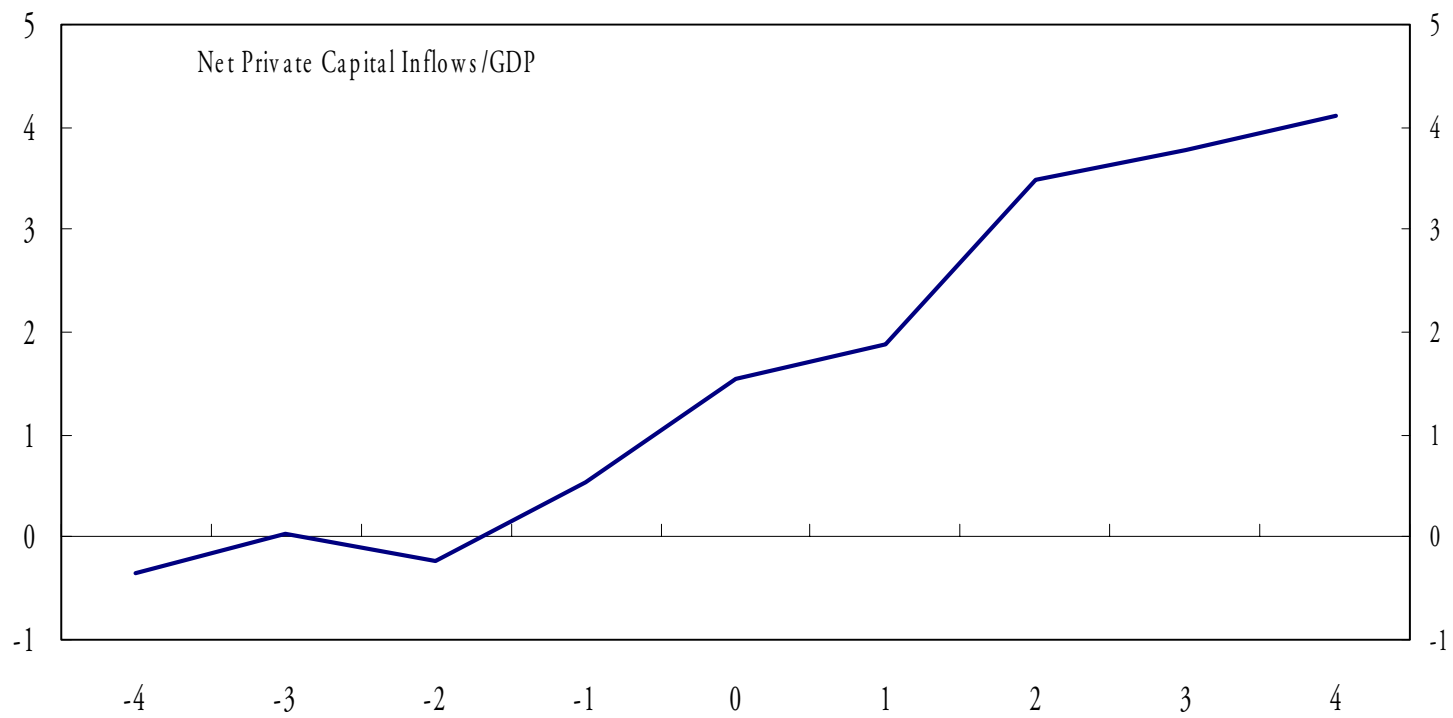
Figure 4.4. Latin America: Real Effective Exchange Rates¹
(Index=100 at start of stabilization)



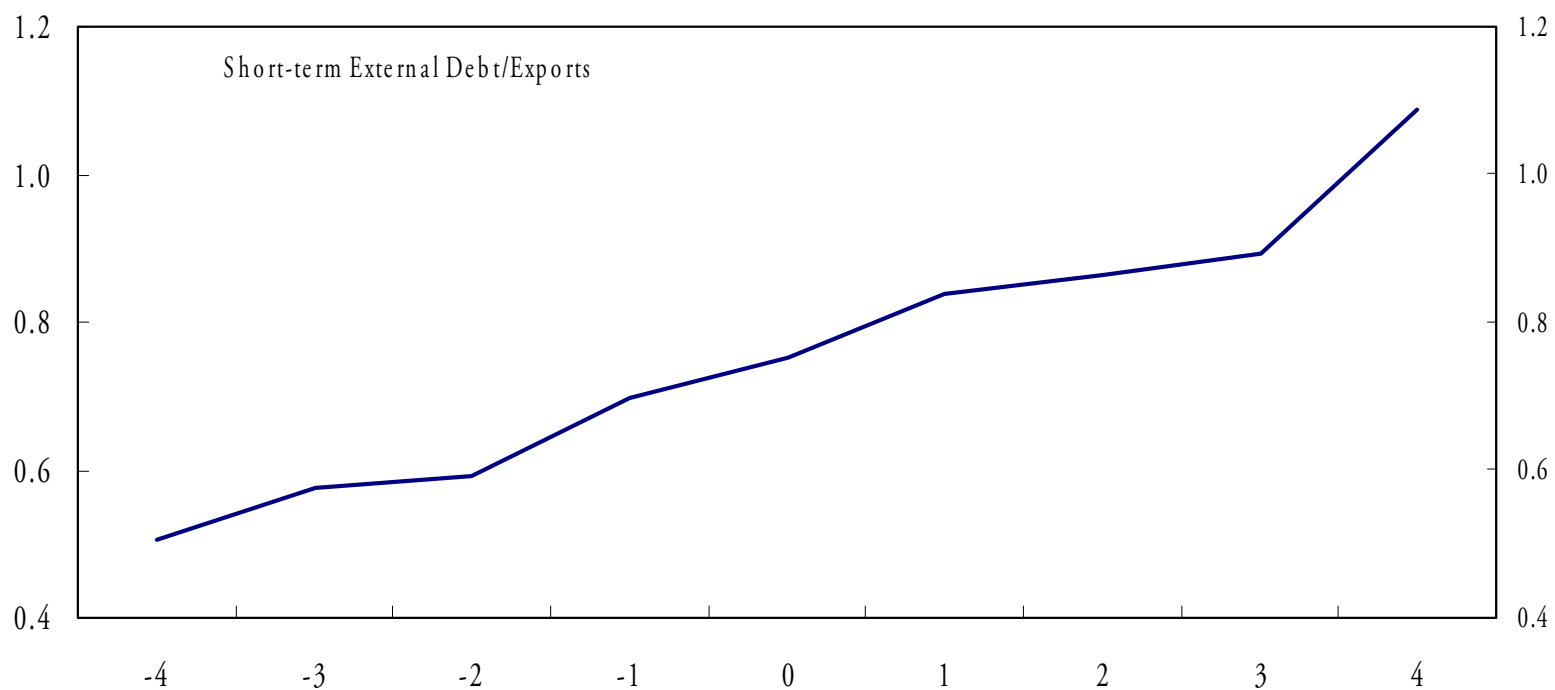
Source: IMF, *International Financial Statistics*; and staff estimates.

¹See text Table 4.1 for a discussion of stabilization periods.

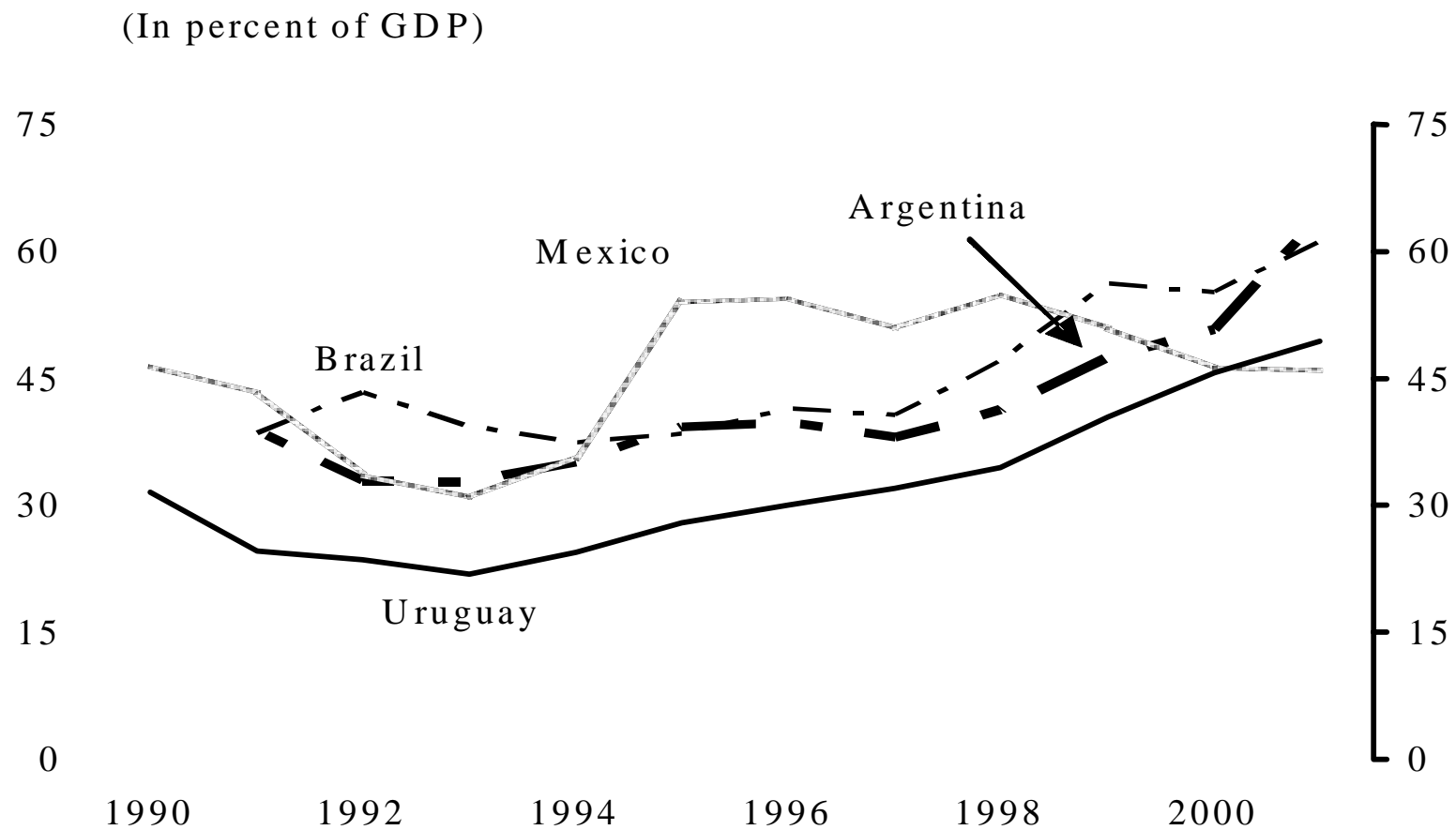
Capital inflows ...



And rising external debt/exports ...

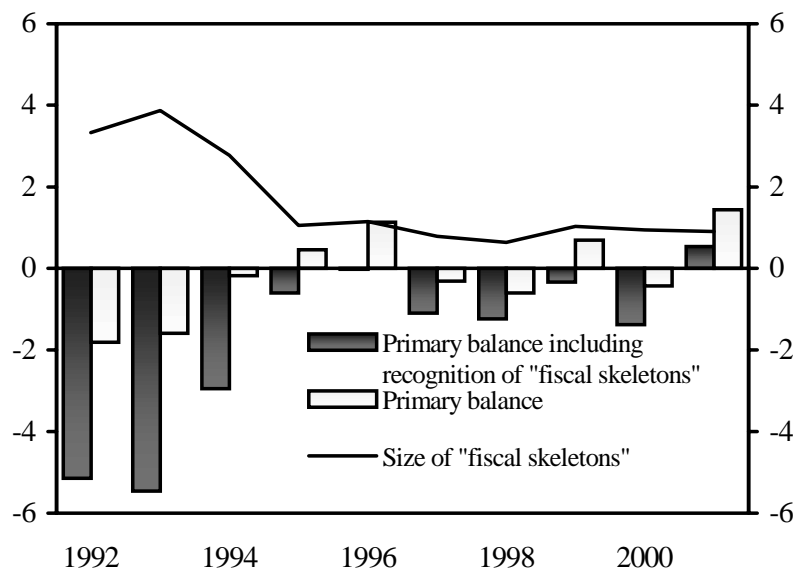


Public debt ratios drifted up – no “feedback mechanism” ...



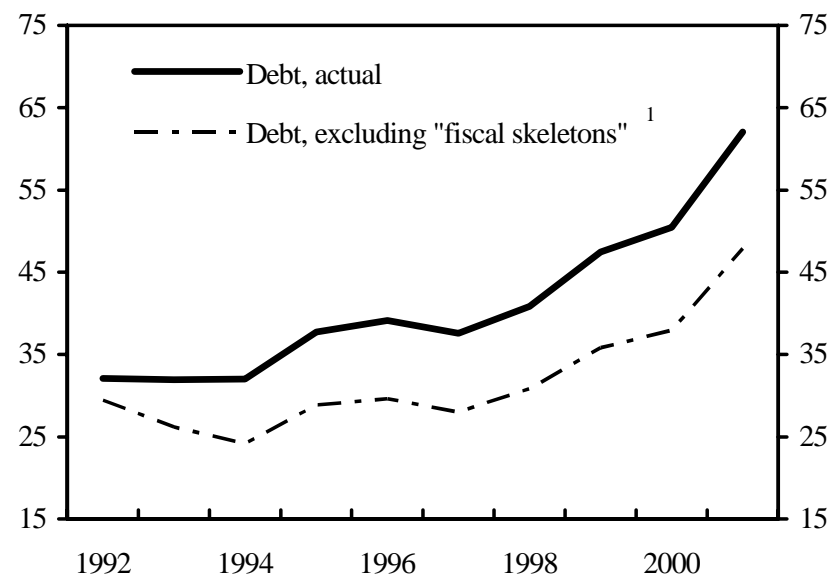
Compounded by fiscal accounting problems ...

Figure 3.8. Argentina: "Fiscal Skeletons" and Primary Balance
(in percent of GDP)



Source: IMF staff estimates from authorities' data.

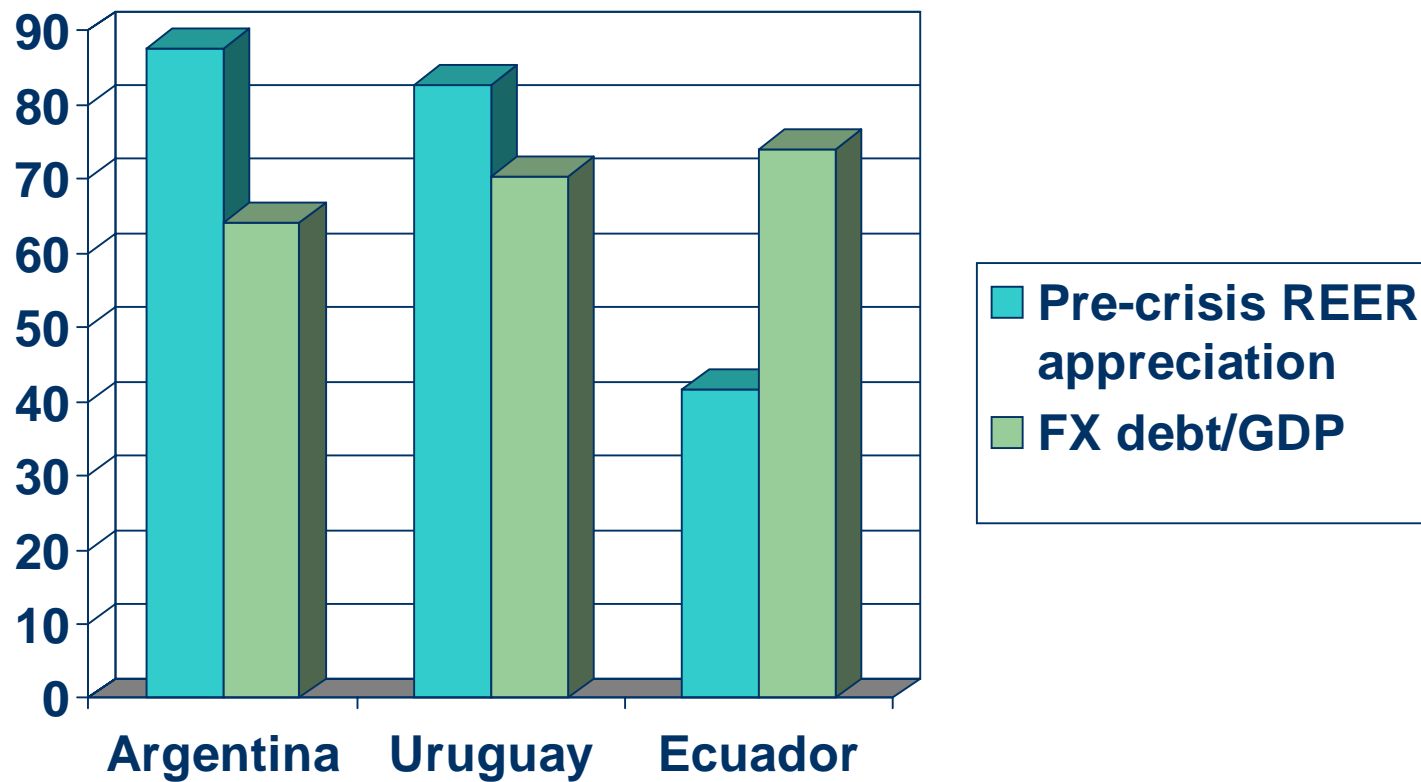
Figure 3.9. Argentina: "Fiscal Skeletons" and Public Debt Paths
(in percent of GDP)



Source: National authorities; and IMF staff estimates.

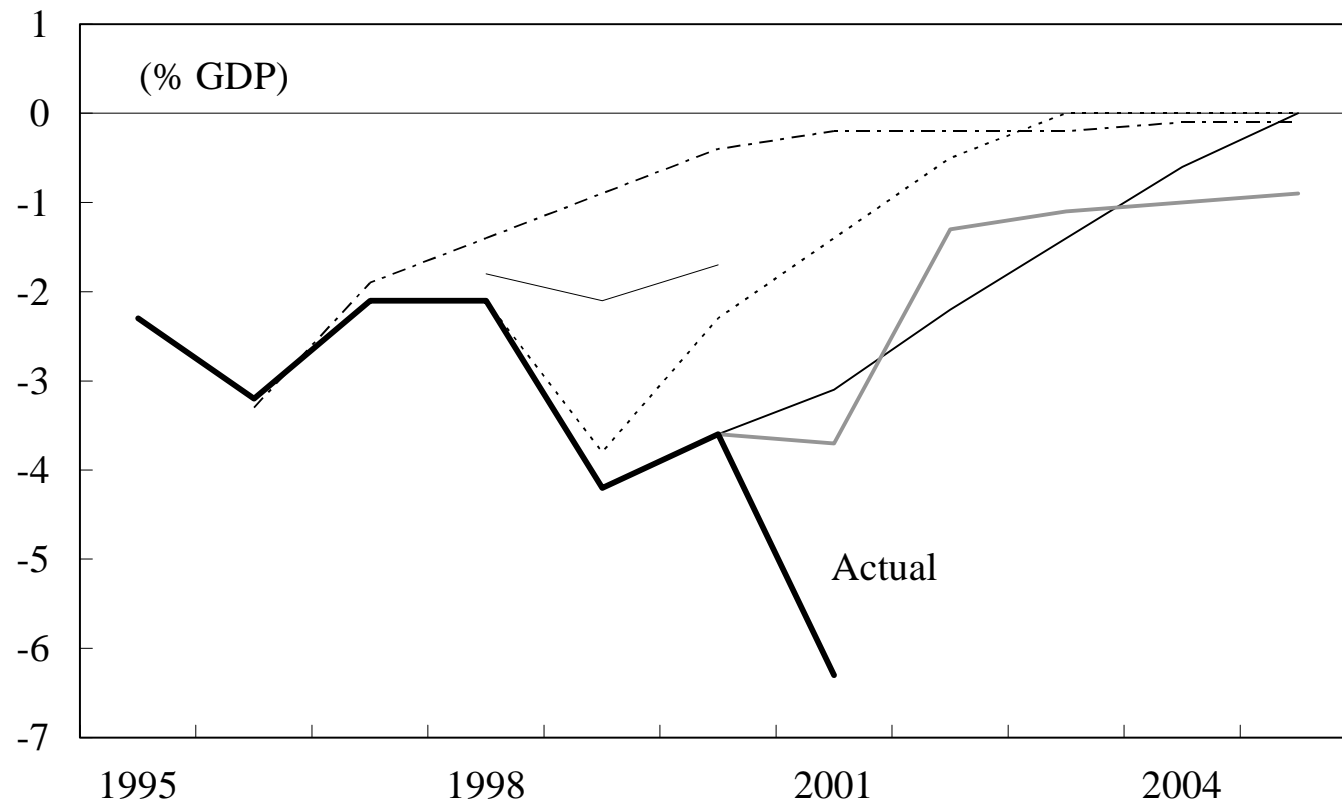
¹Simulated debt path excluding bond issuances for the recognition of "fiscal skeletons."

And undervaluation of foreign-currency debt ...



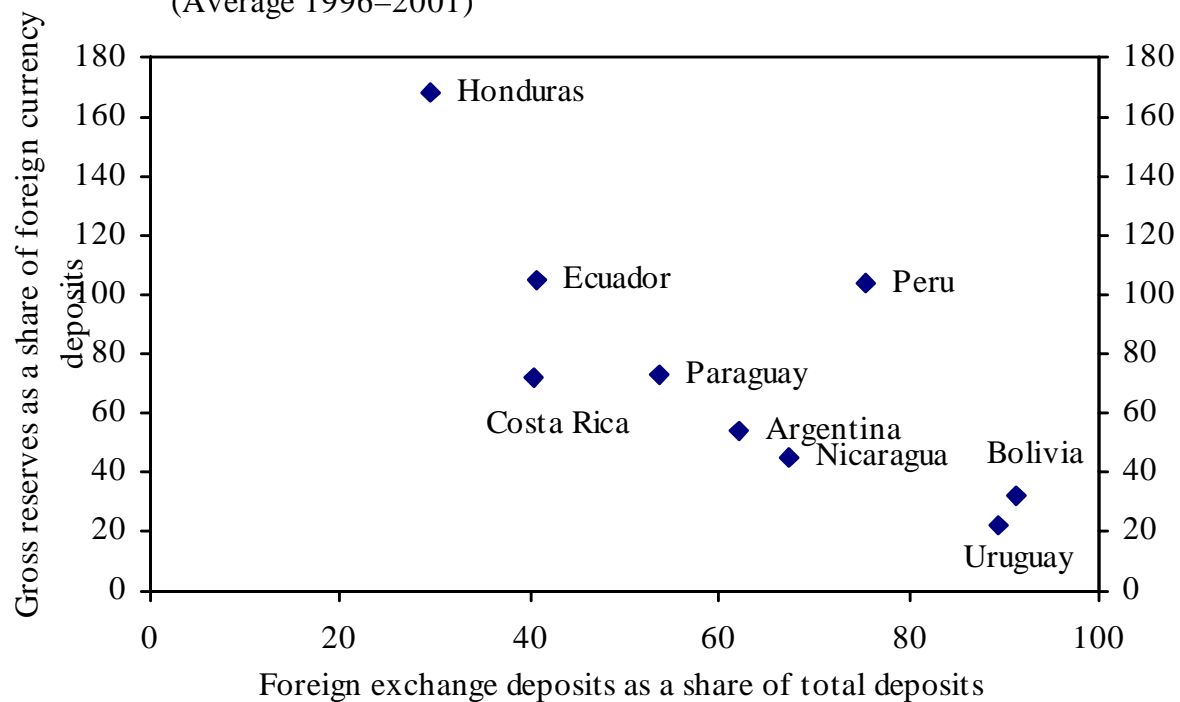
Where Was the Fund?

Argentina Fiscal Balance, Actual vs. Projected



Informal dollarization also created vulnerabilities ...

Figure 6.6. Reserve Coverage of Foreign Currency Deposits for Latin American Countries
(Average 1996–2001)

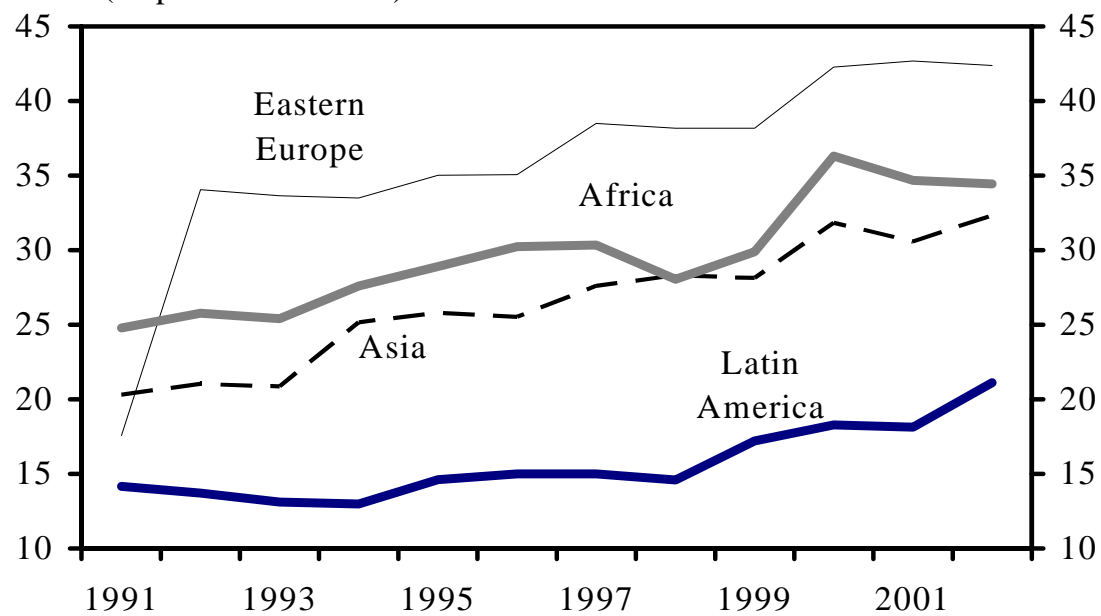


Source: National authorities; and IMF, *International Financial Statistics*.

While trade integration remained weak

.....

**Figure 7.3. International Comparison:
Exports of Goods and Services**
(In percent of GDP)



Source: IMF *World Economic Outlook*

Verdict on “ERBS”? ...

- Did bring inflation down quickly – and durably.
- Wasn't supported by other policies – especially fiscal -- but the lack of support was endogenous. Who's to blame?
- Choice of ERBS should be based on objective assessment of implementation of other policies.
- But an early exit strategy would have helped minimize costs.

General lessons ...

- Take time to do reforms right
- Debt has not played a useful role in these countries – fiscal policy needs to be anchored by conservative debt limits
- Fixed exchange rates don't discipline other policies
- Don't count on markets to force *ex ante* discipline on policies either
- Or on IFIs, for that matter!
- Hope for the best, but plan for the worst

Lessons for the Fund ...

- Less forbearance of slippages ...
- Combined with a credible exit strategy from programs that are off track
- Don't oversell our role, and avoid moral hazard
- Clearer identification of responsibility for going ahead with or stopping a program
- Feasibility of international system without an SDRM?

Lessons for Hong Kong?

- Avoid balance sheet mismatches
- No room for complacency
- Don't count on the peg to discipline other policies



End of presentation