OCCASIONAL PAPER 238

Stabilization and Reform in Latin America:
A Macroeconomic Perspective on the Experience Since the Early 1990s

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INTERNATIONAL MONETARY FUND
Washington DC
2005

Foreword

The 1980s were described as a lost decade for Latin America and led to a spate of reform programs being introduced across the region at the start of the 1990s. In spite of this, the 1990s, too, were a decade of disappointment. Most countries grew at rates well below their potential, making poverty reduction as elusive as ever. There were capital account and currency crises in several countries.

This study is an attempt to analyze what went wrong and why, and to draw lessons for the future. Why have growth rates been so low? Why did so many countries in the region fail to maintain the confidence of the international financial markets? And what are the economic policy implications of the failures of the 1990s?

Latin America's short-term economic prospects currently look more promising than they have for some time. As the global economy strengthens, a pickup in activity is well under way in most countries in the region, after two years of weakness. This study comes at an important juncture, since it is easier to tackle underlying economic weaknesses and introduce reforms when the outlook is more buoyant.

But reforms need to be carefully targeted, to deliver macroeconomic stability that will increase resilience to outside shocks and so make it possible to sustain higher growth rates and thus reduce poverty. By identifying where reforms fell short, or where they were not followed through, this study should help policymakers to avoid the shortcomings of the 1990s and set Latin America on a path of sustainable, more rapid growth.

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Preface

This study was prepared by a staff team under the direction of Anoop Singh, Director of the Western Hemisphere Department. The other principal members of the team involved in the preparation of this report included Agnès Belaisch, Charles Collyns, Paula De Masi, Reva Krieger, Guy Meredith, and Robert Rennhack.

Many other staff members of the Western Hemisphere Department as well as of other IMF departments provided valuable inputs and technical expertise on a variety of issues, and helped in identifying and organizing data sources, at different stages of preparation. Among these, we would like to especially acknowledge Geoffrey Bannister, Nigel Chalk, Martine Guerguil, Lorenzo Giorgianni, Graham Ingham, Eliot Kalter, Hans Peter Lankes, Alex Lehmann, Saúl Lizondo, Ousmene Mandeng, Jorge Márquez-Ruarte, Steven Phillips, Markus Rodlauer, Alfred Schipke, Ricardo Velloso, Andy Wolfe, and Philip Young.

The authors are indebted to the research and administrative assistants in the Western Hemisphere Department and, in particular, to Lita Ali, Alfred Go, Elena Pinillos, and Carolina Worthington for providing outstanding administrative and organizational support, and to Victor Culiuc, Bruce Culmer, Genevieve Mendiola, and Gustavo Ramirez for excellent research assistance. Paul Gleason of the External Relations Department edited the manuscript and coordinated production of the publication.

The paper has been reviewed internally and externally. Without implicating these reviewers for the analysis and views expressed in the paper, we would like to especially thank and acknowledge the detailed comments received from Anne Krueger, Agustín Carstens, Guillermo Le Fort, Luis Martí, Murilo Portugal, and Roberto Steiner. In addition, this paper has benefited from discussions with former Managing Director Horst Köhler and, in its formative stage, with Eduardo Aninat, former Deputy Managing Director. We are also grateful for comments on the scope and content of the paper, at various stages of its preparation, from a number of distinguished experts outside the IMF, including Javier Comboni, Vittorio Corbo, David de Ferranti, Sebastian Edwards, Dennis Flannery, Pablo Guidotti, Arnold Harberger, Roberto Junguito, Guillermo Perry, and John Williamson.

The views expressed in this paper, as well as any remaining errors, are solely the responsibility of the authors and do not necessarily reflect the views of the International Monetary Fund, the IMF Executive Directors, or national authorities.

Executive Summary

Taking Stock

Initial results of policy reforms in the late 1980s and early 1990s were promising. Inflation was quickly brought down after stabilization plans were introduced, and this achievement has since endured (Table ES.1 and Figure ES.1). Real growth accelerated in the first half of the 1990s, and social indicators began to improve. The external environment in the early 1990s also contributed to the improved performance, as cyclical weakness in the industrial countries contributed to a surge in capital flows to Latin America.

These improvements were not sustained, however. Persistent macroeconomic volatility and recurring financial crises contributed to capital account reversals and a weakening in growth later in the decade, culminating in the crises of 2001–2002. Real per

Table ES1. Latin America: Policy Indicators, 1992 and 2002

	1992		2002	
	Number of countries	GDP share (percent)	Number of countries	GDP share (percent)
Inflation[1]				
Low < 10 percent	3	2.3	12	82.5
10–20 percent	2	1.9	3	3.0
High > 20 percent	12	95.9	2	14.5
Dollarization (share of dollar deposits)				
High > 50 percent	3	4.9	9	20.3
< 50 percent	14	95.1	8	79.7
Public debt/GDP (percent)				
High > 40 percent	9	50.4	15	97.9
25–40 percent	5	24.0	1	0.7
< 25 percent	3	25.7	1	1.3
Exports/GDP (percent)				
High > 25 percent	7	11.9	10	23.7
< 25 percent	10	88.1	7	76.3
Exchange rate flexibility[2]				
Inflexible	13	55.0	10	13.0
Flexible	4	45.0	7	87.0
Corruption Perception Index[3]				
More corrupt than sample median	13	81.9	12	52.8
Less corrupt than sample median	4	18.1	5	47.2

Sources: IMF, World Economic Outlook database; Reinhart and Rogoff (2002); and Transparency International.

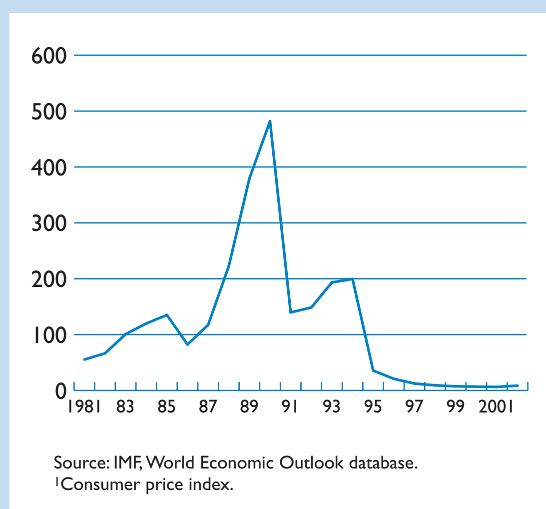
Note: Countries covered are Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, Uruguay, and Venezuela.

[1]The 1992 column reports average inflation during 1981–92.

[2]Based on Reinhart and Rogoff (2002) de facto reclassification of exchange rate arrangements. Flexible exchange rates include free floats and managed floats. Inflexible regimes include all other arrangements (i.e., formal dollarization, currency boards, fixed regimes, bands, crawling pegs, and crawling bands).

[3]Compiled by Transparency International. For 1992, the index is an average for 1988–92.

Figure ES1. Latin America: Inflation[1]
(Annual percentage change)



Source: IMF, World Economic Outlook database.
[1]Consumer price index.

capita GDP in the region stagnated over the period 1998–2003 (Table ES.2).

Trends in poverty and income inequality have not improved substantially over the past decade. Poverty rates initially declined from their peaks in the late 1980s, but progress was not sustained as economic activity stagnated (Table ES.3). Moreover, income inequality in Latin America remains very high by international standards, undermining support for market reforms and trust in government institutions.

These setbacks reflected both external shocks and domestic vulnerabilities. From an external perspective, the favorable conditions in the early 1990s deteriorated as rising interest rates in the United States and weakening investor confidence triggered a sharp reversal in capital inflows. With regard to domestic policies, on the macroeconomic side, inflexible exchange rate regimes were not adequately supported by fiscal and structural policies. They also encouraged balance-sheet mismatches and informal dollarization. Export growth did not keep pace with capital flows, exacerbating vulnerabilities. In combination, these factors created a macroeconomic and financial structure that was highly exposed to external and internal shocks, and sensitive to shifts in market confidence.

From an institutional and structural perspective, reforms were uneven and remained incomplete. More progress was made with measures that had low up-front costs, such as privatization, relative to reforms that promised greater long-term benefits, such as improving macroeconomic and labor market institutions, and strengthening legal and judicial systems. Insufficient emphasis was placed on ensuring that the benefits of reforms were broadly shared, thus jeopardizing popular support for them.

The consequences of incomplete reforms were felt in the latter part of the decade. The growth momentum slowed, as the transitory effects of earlier reforms waned. At the same time, external financing flows—an important element in fueling Latin American growth—dried up as the crises in emerging market financing were compounded by rising risk aversion. Persisting macroeconomic vulnerabilities, slowing growth, and limited popular support for corrective measures then undermined investor confidence, precipitating crises in a wide range of countries. Only Chile and Mexico, which had gone furthest in addressing underlying vulnerabilities, were able to successfully resist the difficult conditions.

The region is now recovering from the financial market pressures of 2002. Strengthening political resolve in many countries to address the immediate

Table ES2. Selected Latin American Countries: Real Per Capita GDP, 1998–2003
(Average annual percentage change)

Latin America	**–0.1**
Argentina	–2.6
Bolivia	0.1
Brazil	0.0
Chile	1.1
Colombia	–0.9
Ecuador	–0.3
Mexico	1.3
Peru	0.3
Uruguay	–2.7
Venezuela	–4.9

Source: IMF, World Economic Outlook database.

Table ES3. Latin America: Incidence of Poverty[1]
(Percent of population)

	1990	2000	2001	2002	2003
Poverty	48.3	42.4	43.1	44.0	44.4
Extreme poverty	22.5	18.1	18.5	19.4	20.0

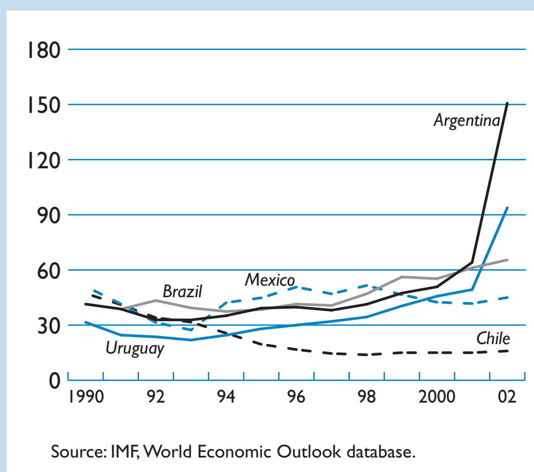
Source: United Nations, Economic Commission for Latin America and the Caribbean (ECLAC).
[1]Data for 2003 are estimates. Poverty rates are calculated using the cost-of-basic-needs method, which establishes a poverty line based on the cost of a basic food basket. For details, see ECLAC (2001).

macroeconomic vulnerabilities—combined with an ongoing global recovery, strong commodity prices, and favorable emerging market conditions—has contributed to the region's registering a strong growth performance in 2004.

For the recoveries to be sustained, however, these economies must be made more crisis resistant. Priorities include strengthening fiscal management, lowering public debt, consolidating inflation-targeting frameworks to sustain low inflation with exchange rate flexibility, deepening domestic financial intermediation, and pursuing trade liberalization. In each of these areas, crucial institutional building should be emphasized to assure the sustainability of policies.

Restoring growth momentum will also require giving renewed impetus to broader structural reforms. Emphasis must be placed on measures with longer-term growth payoffs, especially those encouraging the building of stronger institutions of governance. Improvements in the business environment and labor market reforms are also needed to raise investment and structural flexibility.

Figure ES2. Four Latin American Countries: Public Debt
(In percent of GDP)



Source: IMF, World Economic Outlook database.

Fiscal Sustainability

Many countries in the region shared a common vulnerability in the 1990s—rising levels of public debt, weak financing structures, and a long history of debt crises. Although pre-crisis debt/GDP ratios in the range of 40–50 percent were not notably high by international standards, they concealed important weaknesses:

- debt ratios drifted up during the 1990s, even when economic conditions were good, owing to lack of immediate policy constraints and ambiguous criteria for determining sustainability (Figure ES.2);
- a lack of credibility led to reliance on dollar- or interest-linked debt, leaving debt stocks vulnerable to sharp jumps in the face of financial pressures and movements in real exchange rates;
- weak fiscal institutions impeded implementation of corrective measures; and
- government debt was also boosted by crisis support to financial institutions, realization of other contingent claims, and recognition of fiscal "skeletons."

Rising debt ratios were symptomatic of deeper weaknesses in fiscal systems:

- narrow revenue bases were combined with weak collection mechanisms and frequent tax amnesties (Argentina had averaged one amnesty per year since 1990);
- there were rigidities in current spending, including a large share of spending subject to earmarking and statutory floors, and generally inflexible arrangements with subnational levels of government; and
- weak fiscal institutions encouraged overreliance on ad hoc and temporary adjustment measures.
- These weaknesses increased the difficulty of undertaking fiscal consolidation. When such measures were taken, they often implied cuts in public infrastructure spending, increases in distortionary taxes, and compression of social spending (Table ES.4). These actions were detrimental to longer-term growth and popular support for reforms.

Table ES4. Selected Latin American Countries: Total Change in Public Infrastructure Spending, 1990 to 2000
(Percent of GDP)

Argentina	–3.6
Brazil	–2.7
Chile	1.6
Mexico	–2.1
Average for Latin America	–1.8

Sources: IMF, Fiscal Affairs Department; and International Finance Corporation.

Although countries have responded to the fiscal lessons of the 1990s at differing speeds and to varying degrees, many positive changes in fiscal policy are already under way and bearing fruit. The current cyclical upturn has afforded countries the opportunity to strengthen policies and has yielded stronger fiscal positions and room in budgets to provide additional support to the poor.

Thus, in the recent period, many countries have implemented important policy measures:

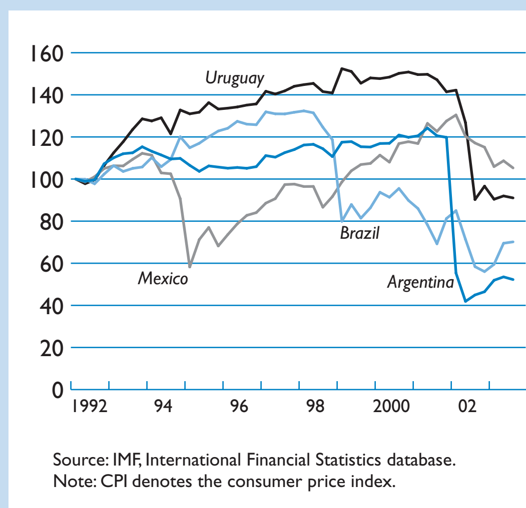
- A number of countries have increasingly sought to strengthen fiscal institutions by adopting fiscal rules and budget procedures as a means of ensuring fiscal discipline. For example, in Brazil, a series of reforms, including the Fiscal Responsibility Law approved in 2000, have improved fiscal transparency and encouraged fiscal consolidation.
- Countries are also taking a broader view of the fiscal situation so as to better measure and monitor the overall fiscal position, including the treatment of public/private investment projects. Moreover, the accounting treatment of public pensions has also improved, with several countries undertaking reforms to reduce the long-term fiscal burdens of aging populations.
- Countries are making progress in improving public-debt structures by moving toward longer-term, fixed-rate domestic debt that do not entail the types of vulnerabilities introduced particularly by foreign currency-denominated debt.
- Efforts are also under way in many Latin American countries to increase the flexibility of budget structures—by strengthening tax administration, reducing tax revenue earmarking, and curtailing the use of minimum spending floors—to eliminate the tendency for fiscal policy to be conducted on a procyclical basis.

Monetary and Exchange Rate Regimes

The majority of countries in the region achieved inflation control by adopting exchange rate-based stabilization plans. By 1992, only a handful of countries had exchange regimes that could be considered flexible. Stabilization programs yielded initial success: inflation came down quickly from high levels, while output expanded in response to a consumption boom.

Inflexible exchange rate systems, however, lacked an exit strategy. Although economic activity initially increased as a result of capital inflows, competitiveness was undermined over time by real exchange rate appreciation (Figure ES.3).

Figure ES3. Four Latin American Countries: Real Effective Exchange Rates
(1992 = 100, CPI based)



Source: IMF, International Financial Statistics database.
Note: CPI denotes the consumer price index.

To be sustainable, exchange rate-based stabilization programs needed support in the form of highly prudent fiscal policies, greater wage and price flexibility, and trade deepening. In practice, however, the adoption of such exchange rate regimes did not, in itself, discipline other policies, and inconsistencies arose. Corrective actions to the exchange rate became increasingly difficult to take as financial pressures intensified, leading to crises and forced exits from the exchange regimes.

Inflexible exchange rate regimes hampered the implementation of other aspects of reform plans. Associated capital inflows reduced fiscal discipline, allowed unsound financing of deficits, and fueled lending booms that led to banking crises. They also limited the scope for offsetting the contractionary impact of fiscal adjustments through monetary easing. The effects of trade liberalization on exports were suppressed by overvalued real exchange rates.

Some countries instead pursued monetary stabilization by adopting objectives for inflation while allowing greater exchange rate flexibility. These approaches were often supported by measures to increase central bank independence. In these cases, reductions in inflation tended to be steadier than under exchange rate-based plans, since resulting imbalances and policy inconsistencies were less pronounced and crisis-driven changes in the monetary regime were avoided.

Overall, there are many reasons to be optimistic about the region's transition to a new, low-inflation

environment and the adapted policy frameworks for sustaining it.

- Many countries in the region have moved toward inflation-targeting frameworks. Combined with greater central bank independence and flexible exchange rate regimes, such frameworks have contributed to the credibility of low-inflation environments and have proven resilient in the face of turbulent external conditions, including contagion from neighboring countries.
- Inflation targeting is still evolving in Latin America, and there remain considerable challenges to ensuring that this approach becomes entrenched. For lasting success, it is important to have a well-established macroeconomic policy framework, policy instrument independence, and a sound and developed financial system.
- Latin American countries are making steady progress in putting in place these necessary conditions to support a full-fledged inflation-targeting framework. For example, there is continued movement toward new formal institutional frameworks that extend central bank independence and restrict or prohibit central bank financing of government deficits. Communications policies have also improved.
- Other key challenges for Latin American countries in implementing full-fledged inflation targeting include (i) the possible pressures to suspend inflation targets when growth is particularly weak; (ii) generally continued fiscal dominance; (iii) a high degree of sensitivity to exchange rate fluctuations, especially in conditions of high (spontaneous) dollarization, that could conflict with inflation-targeting objectives; and (iv) persisting vulnerabilities in many cases in financial systems.

Latin American Financial Systems and Financial Dollarization

Financial sector reforms in the early 1990s often focused on deregulation, privatization, and liberalizing foreign entry. Supporting prudential frameworks proved inadequate, however, since they were generally aimed at narrow definitions of balance-sheet matching and capital adequacy, as opposed to sound overall risk management.

Structural impediments to domestic financial deepening remained significant. They included heavy unremunerated reserve requirements, taxes on financial transactions, inadequate mechanisms for enforcing creditors' rights, and insufficient competition among financial intermediaries.

Regulatory forbearance, strong capital inflows, and weak risk-assessment mechanisms contributed to a series of banking crises from 1994 onward. Resolution of these crises often involved an increased concentration of bank assets in government securities. Subsequently, regulations have been tightened while credit to the private sector has remained stagnant.

Informal dollarization of banking systems rose during the 1990s in countries where macroeconomic policies lacked credibility (Table ES.1 and Table ES.5). Banks offset the immediate balance-sheet risk by lending in dollars, but borrowers generally lacked dollar income streams. Eventual exchange rate depreciation led to widespread loan defaults and a second series of banking crises. With bank soundness jeopardized, runs on dollar deposits could not be easily halted by central banks lacking sufficient foreign exchange reserves.

Full legal dollarization also entailed risks. In Ecuador, the adoption of this strategy has placed a heavy burden on maintaining fiscal policy discipline and taking steps to ensure a more flexible economic structure.

Latin America's experience since the early 1990s has demonstrated the importance of sound and resilient financial systems in reducing vulnerabilities and supporting sustained growth. Most Latin American countries are continuing their efforts to address the weaknesses in their financial system, revive and sustain credit flows, and create greater resilience to shocks:

- Most Latin American countries have continued to strengthen banking sector regulations and supervi-

Table ES5. Selected Latin American Countries: Foreign Exchange Deposits
(In percent of total deposits)

	1990	2001
Argentina	47	74
Chile	16	12
El Salvador	4	100
Guatemala	0	5
Honduras	2	33
Mexico	10	8
Nicaragua	40	71
Paraguay[1]	34	64
Peru	63	74
Uruguay[2]	89	92

Sources: Central bank statistical publications; and IMF staff estimates.
[1]For Paraguay, 1990 column refers to 1996 data.
[2]Loan ratio for Uruguay includes only lending to residents.

sion. In particular, loan classification and provisioning standards have been tightened; capital-adequacy levels have been raised; corrective-action frameworks are being introduced to ensure more rapid response to emerging problems; and the power and independence of financial regulators have been bolstered.

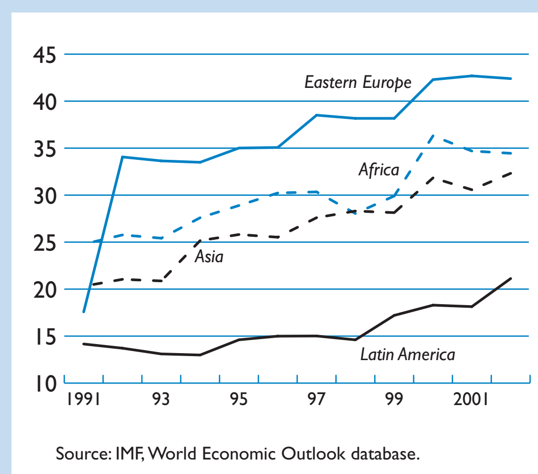
- It is also recognized that there needs to be greater reliance on market discipline to ensure prudent behavior, including by limiting coverage of deposit-insurance systems and improving financial transparency.
- For those countries where banking crises have erupted in recent years—for example, Argentina, Ecuador, and Uruguay—efforts must continue to rehabilitate or resolve failed banks.
- A broader range of initiatives is also needed and is under way to foster the expansion of efficient and long-term credit intermediation as well as to deepen capital markets.
- Dollarization has provided a means through which countries with low macroeconomic policy credibility are able to resist capital flight and hold savings within the domestic financial system. Highly dollarized countries are, however, subject to heightened liquidity and credit risks.
- Authorities in highly dollarized countries in Latin America have been addressing these risks by making efforts to achieve stronger macroeconomic policies so as to boost confidence in holding and transacting in the domestic currency. To address short-term risks of dollarization, some countries have built up international reserves and arranged lines of credit to be drawn on in times of stress. Also, some countries have amended prudential rules to reflect the risks associated with dollarization.

External Vulnerabilities

Although most Latin American economies liberalized trade in the late 1980s and early 1990s, the impact in terms of increasing openness was typically limited (see Figure ES.4):

- Tariff rates in the region declined substantially, but still-high tariffs and nontariff barriers and the need to liberalize trade in essential infrastructure services have meant that the region has made less progress than others in opening to trade.
- Increasing recourse to regional trade arrangements, including Mercosur, while encouraging intraregional trade, did not vigorously promote export growth outside of Latin America.

Figure ES4. International Comparison: Exports of Goods and Services
(In percent of GDP)



Source: IMF, World Economic Outlook database.

- Latin American countries continue to face barriers to export to industrial country markets, particularly for agricultural products.
- Little progress was made in strengthening trade institutions and infrastructure—weaknesses that have tended to hinder trade.
- The region's weak and volatile macroeconomic environment discouraged trade and investment, and inflexible nominal exchange rates and real exchange rate appreciation limited incentives for export diversification.

The main exceptions to this weak trade performance were Chile—which has opened its economy aggressively and achieved sound macroeconomic policies at an early stage—and Mexico, which has benefited from the North American Free Trade Agreement (NAFTA) and other free-trade agreements.

Although the trade share of most Latin American countries rose only slowly in the 1990s, capital flows surged. This resulted in ratios of foreign debt and debt-servicing payments to exports that were among the highest in the world. Debt-servicing payments rose as market confidence waned, but, with low export/GDP ratios, large depreciations in the real exchange rate were needed to achieve offsetting improvements in the trade balance. Yet such depreciations themselves raised interest payments (in dollars) relative to domestic incomes, leading to a vicious circle.

Prudential guidelines in developed markets did not encourage differentiation among emerging market borrowers according to risk. In addition, lenders

tended to limit apparent risks by investing in short-term and/or foreign currency debt. Shifting these risks to borrowing governments did not reduce overall risk, however, but transformed it into (less visible) default risk. When the implications of this practice were belatedly recognized in markets, jumps in yield spreads fueled crises.

In recent years, considerable progress has been made by many Latin American countries in reducing the mismatch between low trade openness and high capital account openness. Their efforts have been centered on pursuing trade liberalization through multiple channels while building greater financial resilience.

- Latin American countries are actively participating in World Trade Organization (WTO) negotiations for a new development round; forging bilateral and regional agreements with the United States and the European Union; and continuing negotiations for the Free Trade Agreement of the Americas.
- Nonetheless, there remains considerable scope for Latin American countries to encourage trade opening—and to benefit thereby—by unilaterally easing their own restrictions, particularly with regard to tariff escalation, nontariff barriers, and restrictions on services trade.
- More broadly, continued emphasis on developing trade institutions is critically important for supporting trade growth and openness. Further development of transportation infrastructure—such as roads and ports—will help to alleviate bottlenecks in a number of countries.

Although volatile capital flows remain problematic for Latin America, progress continues to be made throughout the region in strengthening financial systems and underlying macroeconomic frameworks to create greater resilience to shocks.

- Many countries have taken steps to improve risk-management practices of financial institutions by adapting prudential regulations and improving supervision to conform with international best practices, and strengthening the broader institutional framework of the financial sector by improving accounting standards and auditing procedures.
- Adopting more flexible exchange rates in many Latin American countries has improved their flexibility in responding to external shocks.

Future Priorities and Role of IMF

In defining priorities for the future agenda, embracing institutional change is critical for the sustainability of policies. Strengthening of institutions is needed to successfully implement both macroeconomic and structural policies. This is consistent with recent research that points to institutional factors outweighing factor accumulation in explaining cross-country differences in per capita income.

In the macroeconomic area, there are two key priorities:

- Many countries have recently adopted inflation targeting, which appears to be a promising means of conducting monetary policy in the region. It will be important, however, for policymakers to reinforce the underlying institutional framework for inflation targeting by supporting central bank independence and setting out clear performance objectives. In other countries that choose to continue with inflexible exchange rate systems, owing to individual circumstances, fiscal and structural policies need to be strong enough to absorb shocks and sustain these systems.
- Debt in many Latin American countries remains high and needs to be brought down and its composition shifted away from short-term, floating-rate, and foreign currency-linked debt. To enhance the credibility of sustained fiscal policy, it is critical to strengthen fiscal institutions and fiscal transparency, and improve government expenditure management and tax administration. As experience has taught, without broader institutional change, efforts to bring down debt levels in an enduring way will be unsuccessful. A strong political consensus is needed to move in this direction, however, especially because constitutional change may be necessary to implement many of the related reforms.

An agenda for broad-based structural reform—and, in particular, institutional reform—is needed to support macroeconomic policies. The priorities for the structural reform agenda include the following:

- Achieving sound and resilient financial systems in Latin America is a key element in reducing Latin America's vulnerability to crisis, reviving credit flows, and sustaining growth. There is continued need to improve financial sector regulation and supervision, and adopt measures to increase reliance on market mechanisms.
- Despite considerable efforts it made to liberalize trade in the 1990s, Latin America's trade opening proceeded relatively slowly. There is much scope to advance Latin America's trade openness through both domestic and international efforts. Internationally, the benefits of achieving multilateral liberalization through a successful Doha round cannot be overstated. Meanwhile, many

countries in Latin America are improving their market access through bilateral trade agreements. At the same time, there is clearly room—domestically—for countries in the region to curtail continuing protectionist practices and improve the competitiveness of regional trade agreements. For these initiatives to bear fruit, however, Latin American countries must also address remaining problems with trade-related institutions and infrastructure—particularly customs administration and legal uncertainties.

- Labor market reforms were notably absent from the structural reform agendas of the 1990s. Reforms are needed to amend institutional arrangements, such as high severance costs and restrictions on temporary hiring, that act as barriers to entry and exit as well as to ensure the availability of efficient social safety nets and educational programs to reengage workers. Labor market flexibility is especially necessary to facilitate the kind of intersectoral mobility needed to enable countries to benefit fully from globalization.

- An improved and more strategic role of the state is essential. Corruption and weak governance in Latin America have tended to undermine market activity, with the resulting burden falling most heavily on the poor. Further efforts to confront these weaknesses and remove costly distortions in the regulatory and incentive structure would improve the investment climate, help attract new private investment, and create a firmer foundation for economic activity.

Moving forward in both areas—macroeconomic and structural—will require popular support. Such support will be promoted by providing social safety nets and reducing corruption. Forging a deeper political consensus will be a sine qua non for moving in this direction. The IMF and the other international financial institutions, together with the broader international community, can play key roles in helping develop such a consensus.

In the wake of recent financial crises, the IMF has strengthened its role in crisis resolution and prevention. Much progress has been made in this regard, especially in drawing lessons from the crises in emerging markets and expanding the tools of crisis prevention, especially improving transparency; developing a new framework of internationally agreed standards and codes for monetary, fiscal, and financial policies; and deepening IMF surveillance of key risks and vulnerabilities. Crisis resolution has been helped by the growing acceptance of collective-action clauses. These initiatives have catalyzed improved transparency across the region and helped lessen contagion risks.

There is room to do more. Increased emphasis on the IMF's surveillance role will help these new initiatives become entrenched. An intensified surveillance role should include casting "a fresh pair of eyes" over the substance of the dialogue with country authorities and ensuring that the program's timetable is carefully adhered to, especially for countries involved in prolonged programs.

Reducing the risk and incidence of crises is only part of the essential agenda. Similarly, the IMF, working in close coordination with the other international financial institutions, can further sharpen its focus on policies that will deliver faster growth, raise living standards, and reduce poverty. As indicated above, such a policy agenda needs to emphasize institutional change and reform, and broad country ownership of such an agenda will be increasingly important.

The IMF and the other international financial institutions will need to do more to nurture the adoption of such an agenda, through adapting conditionality and developing an outreach strategy. The IMF, working in close coordination with the World Bank and the Inter-American Development Bank (IADB), can play a larger role in developing the broader consensus that is needed. There is room to be more proactive in working with government at all levels, legislatures, and the private sector to explain the lessons the IMF has learned from experience and building stronger country ownership of policies. At the same time, the IMF needs to persist with its strengthened surveillance of vulnerabilities stemming from public debt, balance-sheet exposures, financial sector weaknesses, and exchange rate arrangements. Helping the region increase investments in public and private infrastructure within a strong framework of debt sustainability is also a priority.

In addition, the international community needs to reflect on establishing sufficient external incentives or anchors that could catalyze the process of domestic institutional building. Greater trade openness and development of international agreements (such as NAFTA) can directly help remove domestic impediments to reforms and boost institutional development.