I Introduction

Latin America's economic prospects heralded new promise in the early 1990s, as ambitious programs were introduced to promote macroeconomic stability and market-based reforms. In the context of increasingly democratic political systems, the adoption of policies broadly consistent with the so-called Washington Consensus reflected a broad shift away from the interventionist and inward-looking policies followed in the past.[1] At the beginning of the 1990s, Latin America also benefited from a "fresh start" in the form of debt reduction through the Brady Plan. Together, these developments held out the promise that Latin America could overcome a history of default and embark on a high-growth path of the type seen in East Asia.

Although the specifics of the stabilization and reform programs differed importantly across countries, there were many important common elements. The programs were generally aimed at establishing macroeconomic discipline and centered on ending the inflationary financing of government deficits. To promote transparency and credibility, monetary policy was typically constrained by a commitment to a fixed exchange rate. Complementing stabilization policies were structural reforms that generally focused on increasing the role of market forces through privatization and deregulation, while economic openness was promoted through removal of currency restrictions and liberalization of trade and capital flows, including for foreign direct investment. Extensive restrictions on domestic financial systems were eased, and market access to foreign institutions was increased.

The region's economic performance in the first half of the 1990s appeared to validate many of the high initial expectations. Inflation came down dramatically. With the debt overhang resolved and reforms under way, private capital inflows resumed. In conjunction with more liberalized domestic financial markets, domestic spending rose and per capita output growth accelerated to an average of almost 2½ percent per year during 1990–95, after contracting through the 1980s. Social indicators, such as life expectancy, infant mortality, and poverty, registered visible improvements.

Signs of fragilities became evident, however, with Mexico's "tequila" crisis in 1994–95 and contagion to the other major economies in the region. Subsequently, during the latter part of the 1990s, in the wake of the Asian and Russian crises, investor appetite for global risk declined; and the consequent sudden reversals of capital inflows accentuated inherent vulnerabilities in many Latin American economies. Economic and financial crises recurred in Brazil and Ecuador (1999), Argentina (2001), and Brazil and Uruguay (2002); and other countries in the region also came under pressure. Real per capita GDP contracted by more than 1 percent, on average, during 1997–2002; and the improvement in social indicators came to a halt in many countries, although, encouragingly, Chile and Mexico were generally able to resist these pressures and maintain positive growth.

In view of these setbacks, important questions have been raised about why the reform programs in Latin America did not yield larger and more lasting benefits. This study assesses the experience with economic reform programs in Latin America since the early 1990s and draws lessons for future policy priorities. In particular, the paper identifies the achievements and disappointments of the period; seeks to better understand the explanatory roles of both external factors and domestic policies (especially macroeconomic policies); points to the responses of the region to the experience of the 1990s; and assesses key future challenges, including those for the IMF and the international community. It emphasizes the experiences of the larger emerging market countries, such as Argentina, Brazil, Chile, and Mexico, given their economic importance inside and outside the region, while also drawing on the experiences of a wider range of countries. It surveys the literature, reviews the empirical evidence, and aims to

[1]The reform policies included fiscal discipline, reordering public expenditure toward basic health and education, tax reform, market-determined interest rates, a competitive exchange rate, trade liberalization, openness to foreign direct investment, privatization, deregulation, and improved property rights. See Williamson (1990).

bring together the results of other studies undertaken inside the IMF.

There was substantial and prolonged IMF and other international financial institution involvement in the region during this period, including through financial arrangements and surveillance. This relationship, however, is not a main aim of this study, enabling it to remain focused on the policy outcomes, explanatory factors, and lessons for setting future priorities. Separate assessments of the IMF's relationship with countries in the region are being made by the IMF's Independent Evaluation Office (IEO) and researchers outside the IMF.[2] Such an assessment requires a different methodology from that followed in this paper to, for example, analyze to what extent policies followed were influenced by IMF involvement, and to compare actual outcomes with those under a counterfactual scenario assuming no relationship with the IMF.

This study finds that stabilization and structural reforms did boost growth, although the effects were smaller and less long-lived than originally hoped. One frequent weakness of reform plans was that the initiatives were not coordinated in a mutually reinforcing way—for instance, by strengthening financial supervision while liberalizing financial regulations or enhancing regulatory oversight while privatizing public enterprises. Another was that reforms were sometimes unbalanced, in that initiatives in some key areas, such as increasing flexibility in labor markets, were limited compared with those that were easier to implement, such as privatization and deregulation. On the macroeconomic side, exchange rate-based anchors were not supported by fiscal prudence. As a result, the initial benefits that resulted from stabilization and structural reform policies were eroded later in the decade by financial instability. In retrospect, it is clear that macroeconomic policies did not sufficiently crisis-proof these economies in the face of challenging internal and external environments.

This study begins by taking stock of the main outcomes of the stabilization and reform programs and reviews the explanatory factors. Subsequent chapters seek to understand these mixed results from a macroeconomic perspective, to identify lessons from this experience, and to assess the region's responses to these lessons and future challenges. Although a broad range of economic, political, social, and institutional influences have had an impact, this study concentrates on the key policy areas that lay at the heart of stabilization and reform programs—notably, fiscal, monetary, financial, and trade policies. The final section draws broad lessons and points to future challenges, including those for the IMF and the other international financial institutions.

[2]There is a growing literature published, both within and outside the IMF, that analyzes the economic impact of IMF programs. Prominent examples of this literature with particular relevance to the Latin American experience include Hutchison and Noy (2004); IMF, Independent Evaluation Office (2002, 2003, 2004); IMF (2003); and Mussa (2002).

References

Hutchison, M., and I. Noy, 2004, "Macroeconomic Effects of IMF-Sponsored Programs in Latin America: Output Costs, Program Recidivism and the Vicious Cycle of Failed Stabilizations," forthcoming in the *Journal of International Money and Finance.*

International Monetary Fund, Independent Evaluation Office, 2002, *Evaluation of Prolonged Use of IMF Resources* (Washington: International Monetary Fund). Also available on the Web at *http://www.imf.org/external/np/ieo/2002/pu/#intro*.

———, 2003, *The IMF and Recent Capital Account Crises: Indonesia, Korea, and Brazil* (Washington: International Monetary Fund).

———, 2004, *Report on the Evaluation of the Role of the IMF in Argentina, 1991–2001* (Washington: International Monetary Fund).

Mussa, Michael, 2002, *Argentina and the Fund: From Triumph to Tragedy* (Washington: Institute for International Economics).

Williamson, John, 1990, "What Does Washington Mean by Policy Reform?" in *Latin American Adjustment: How Much Has Happened?* ed. by John Williamson (Washington: Institute for International Economics).