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INTRODUCTION

During the so-called “lost decade” of the 1980s, Latin American governments gradually began adopting market-oriented policy packages in order to improve overall economic performances. In some countries, large-scale turnabouts were necessary, while others needed to merely change a few key measures. An example of the latter is provided by Chile, which had deregulated and privatized much of its economy during the late 1970s and early 1980s, but failed to introduce a flexible exchange rate regime until the mid-1980’s (Edwards, 1994). In contrast, Venezuela attempted to adopt badly needed policy changes over a wide range of public sector activities in 1989 (Hausmann, 1990).

Prior to the debt crisis, most Latin American economic development strategies followed some facsimile of the inward-looking “infant industry” import substitution argument pioneered by Raul Prebisch at the United Nations. Unlike what was originally prescribed under the original strategy, the “incubation periods” in much of the region became permanent (Cardoso and Helwege, 1992). The latter development was due in large measure to rent-seeking behavior on the parts of labor unions and business groups seeking protection from import competition (Krueger, 1987). While global trade was rapidly expanding during the 1950s and 1960s, these practices were feasible. Petroleum importing nations in Latin America began experiencing difficulties during the mid-1970s. They were joined by oil exporters such as Ecuador, Mexico, and Venezuela by the early 1980s.

Problems which surfaced in the 1980s included business cycle downturns, high levels of unemployment, balance of payment deficits, and unstable prices. The vast majority of these disequilibria can be traced to self-inflicted government policy mistakes. With the exception of Colombia, virtually all of the economies in the region allowed their exchange rates to become severely overvalued. The latter were frequently accompanied by large consolidated public sector fiscal deficits that eventually became monetized, forcing inflation rates to accelerate (Fullerton, 1993a). Retail price controls and government interest rate subsidies encouraged investments to flow to sectors of the economies that generally did not hold any true comparative advantages. These decisions, plus sharply higher global interest rates following the second OPEC crisis, made it increasingly difficult for Latin American governments to finance infrastructure projects, further eroding growth potential on a region-wide basis (Cuddington, 1987).

The chronic nature of these debilitating problems, combined with reduced access to international capital markets, finally convinced regional policymakers to begin implementing austerity measures and adjustment packages. Selecting the Bolivian anti-inflationary experiment (Sachs, 1986) as the starting point for this trend, an approximate ten-year track record exists in which sufficient evidence is available to analyze whether the efforts have proven worthwhile. This article provides a broad outline of the major results that have accrued under the structural reform period in this important region of the world.

PREVIOUSLY EXISTING ECONOMIC CONDITIONS

By the time Mexico defaulted on its international debt payments in 1982, Latin American economies were already experiencing serious problems in the aftermath of 37 years of government intervention beyond the traditional public sector roles in health, education, infrastructure, and institutions such as the judiciary. In 1982, for instance, consumer price increases averaged 68.2 percent among the nine largest economies in the region. Business cycle downturns occurred in all of these countries (Argentina, Brazil, Chile, Colombia, Ecuador, Mexico, Peru, Uruguay, and Venezuela), causing real per capita gross domestic product (GDP) measured in dollars to fall by 3.4 percent. The recessions were not short-term in nature. Measured in 1980 constant dollars, real per capita GDP declined for three consecutive years before increasing by only slightly more than $30 to $2065 in 1985 (Garlow, 1988).

A common difficulty faced throughout Latin America in 1982 was the burden imposed by regional indebtedness. Higher global interest rates, especially the six-month London Interbank Offer Rate or LIBOR, low nonpetroleum commodity export prices, and surging imports all contributed to widespread increases in external obligations. Between 1978 and 1982, total international debt owed by the nine largest economies more than doubled in nominal terms from approximately $140 billion to just over $300 billion (World Bank, 1987). Debt service ratios (DSR) of 50 percent or lower are generally considered manageable for developing countries. In 1982, the average DSR for the nine major Latin American debtors reached nearly 140 percent. Not surprisingly, the international creditworthiness of these and other neighboring countries was virtually nonexistent during the mid-1980s (Swan, 1992).

After first adopting a wait-and-see attitude in the vain hope that international economic conditions would begin to resemble those of a decade earlier, governments throughout the region began considering alternative policy responses to the economic debacle in which Latin America became ensnared. In several cases, this slow acceptance of reality came in recognition of earlier policy mistakes such as Chile's adoption of a fixed nominal exchange rate during the late 1970s. In other instances, such as the panic observed during Bolivia's hyperinflationary episode, market-oriented adjustments were introduced out of sheer desperation. The demonstration effect of the Chilean and Bolivian success stories played an important role in convincing other leaders to reexamine many previously sacrosanct administrative decisions. No case serves to better illustrate this than when Mexico began dismantling import barriers in 1985, thus reversing six-and-a-half decades of post-revolutionary foreign policy (Arellano-Cadena, 1993).

Other examples abound. Colombia, macroeconomically the most stable country in the region over the past 30 years, began introducing microeconomic reform measures under the Barco administration with the 1986 income tax code revisions (Hommes and Correa, 1990). Efforts such as the latter often entailed hard-fought battles that pitted executive branches against legislative branches in the new democracies that emerged during the crisis period. These political slugfests generally made it difficult to introduce comprehensive orthodox remedies, and mixtures of old interventionest and new deregulation packages were common. Frequently, serious policy disagreements resulted between debtors and creditors. Over time, however, adjustment packages began to rely increasingly on market-oriented measures that included the elimination of fiscal deficits (Lora and Talvi, 1996). As a consequence of these efforts, Latin America began emerging from the recurring bouts of heterodox policy and business cycle dowturns that characterized the 1980s.

As an inducement to enacting the 180-degree turnabouts required to improve economic and social performance in Latin America, the Brady Initiative offered a combination of partial debt write-offs and partial U.S. Treasury Department official repayment guarantees. Widely scorned after its introduction, it was characterized by flexibility and a basic "hands-off" approach in allowing debtors and creditors hammer out their own individual agreements in market-style sessions of give-and-take negotiations. Mexico was the first country to obtain a Brady Agreement, although similar negotiations had already occurred with Bolivia and Chile (Edwards, 1995). Regional moves in favor of market reforms also received a boost from the rapid deregulation which occurred in Eastern Europe during the late-1980s and early-1990s. Latin American leaders during this period essentially became concerned that they would miss out on global capital flows shifting in favor of eastern bloc economies that initiated transitions to western-style markets with radically smaller degrees of government planning.

CURRENT ECONOMIC CONDITIONS

Though roundly criticized from multiple quarters when finally introduced, the "shock therapy" of the Brady-style adjustment packages has materially contributed to vastly improved regional economic performance in Latin America. As noted above, the Bolivian stabilization effort of the mid-1980s was one of the first endeavors of this nature. Most notably, it ended one of the worst hyperinflations of the post-war period. Chile's adoption of a flexible exchange rate system in concert with other market-oriented policy steps ushered in a remarkable era of sustained income growth. The latter was accompanied by moderate inflation and external payments equilibria, a combination which had eluded previous adjustment attempts under the Pinochet regime (Edwards, 1985).

However, several countries have lagged in the adoption of adjustment packages. For example, Ecuador adopted a brand of heterodoxy widely known as “gradualism” under the Borja administration from 1988 through 1992. Fraught with niggardly rates of investment and growth, Ecuadorian gradualism simultaneously permitted historically high rates of inflation to persist over the entire four-year period (Fullerton, 1995). Separately, Venezuela’s Congress was lulled into a false sense of security by temporarily higher oil prices during the Gulf War. Voters in that country later succumbed to seductive promises of populist political rhetoric until “regulatory fatigue” once again resurfaced in a manner analogous to what occurred in late-1988. Negotiations with the multilateral agencies are currently under way to re-introduce another Brady-style structural reform program, retracing steps Venezuela had earlier taken when it obtained debt relief under the same initiative in 1989 (Lora and Talvi, 1996).

Although many countries in Latin America have made important progress, it will be years before all of them reap the benefits of the structural adjustment efforts implemented over the course of the past 15 years. Table 1 compares inflation adjusted per capita GDP in 1985 US dollars for the major economies in the region. While these data suffer from the pitfalls associated with exchange rate conversions (Summers and Heston, 1984), an interesting fact emerges from the table. The only two economies in Latin America to enjoy consistent annual improvements are Chile and Colombia. These countries have longer traditions of relatively market-oriented macroeconomic management practices than do the others. Chile, where the most rapid income growth is evidenced, further adopted market-oriented microeconomic management policies many years before Colombia, possibly contributing to its superior performance.

Table 2 contains consumer price inflation rates over the same ten-year period. In 1990, Argentina, Brazil, and Peru observed inflation rates in excess of 2000 percent. In response, all three eventually adopted more conservative monetary policies and currently enjoy significantly more stable price conditions. Argentina employs a strict “monetary board” that controls liquidity in the banking system, but leaves it vulnerable to capital outflows such as those occurring in 1995 in the aftermath of Mexico’s so-called “tequila effect” devaluation. Brazil has yet to resolve the risks posed by a fractured fiscal system that allows regional governments to run deficits that must be shouldered via monetization by the central bank.

Colombia has fallen short of the disinflationary goals set during the Gaviria administration, but has lowered price trends to a range more in line with historically observed rates (Fullerton, 1993b). Chile may have made the transition from a “high inflation” regime to one more commonly identified with industrial economies (Dornbusch, Sturzenegger, and Wolf, 1990). It joined Argentina as the only other major Latin American country to enjoy a single-digit inflation rate in 1995, but did so on the basis of an independent monetary policy apparatus. Ecuador also employed traditional monetary decision-making to substantially lower consumer price inflation from 1994 forward (Banco del Pacifico, 1996).

In nominal dollar terms, Latin America became more indebted during the ten-year period from 1986 through 1995 (Berges, 1995). Total international obligations owed by the nine largest regional economies increased from \$361 billion in 1986 to \$507.5 billion in 1995. This higher collective debt burden, however, is more manageable than it was prior to the introduction of the Brady Initiative. As shown in Table 3, external interest payments as a percentage of merchandise export volumes have fallen substantially from their decade-ago averages in all nine major debtors. That development is a welcome change from the early 1980s when vulnerability to interest rate hikes contributed to the debt crisis (Brannon and Schauer, 1983). The improvement resulted primarily from more market-oriented trade policies, including more competitively valued currencies.

Of course, exports are the payment exacted upon countries for the privilege of purchasing imports from abroad. One of the initial responses to the debt problems of the 1980s was to severely restrict merchandise imports. This type of policy can directly hamper growth performance by making it difficult to obtain badly needed capital goods and intermediate inputs. It can also have significant indirect negative impacts by limiting access to new goods and services that are not locally produced (Romer, 1994). Recent empirical research has confirmed the presence of the latter effects in an international sample of developing economies (Dollar, 1992). Import trends thus have important implications for economic development in Latin America.

Table 4 examines regional per capita import trends. With the exception of Venezuela, per capita imports have grown significantly in both real and nominal terms. This probably reflects the emergence of a virtuous circle effect wherein better income performance and lower trade barriers associated with structural reform encourage purchases from abroad. Innovative goods and services from elsewhere, in turn, serve as catalysts to growth and productivity, thus raising imports via income effects. The major exception to this pattern is Venezuela, where a series of disastrous populist intervention policies were adopted in the chaotic aftermath that followed the toppling of the Perez administration (Berges, 1995). A new adjustment plan was belatedly introduced by the Caldera government in 1996, but it is too early to tell whether it will actually be implemented since the executive branch cannot count on the support of wither of the major parties that dominate the legislative branch in Caracas.

CONCLUSION

Latin American economic performance has improved substantially over the course of the past decade. While this is welcome news, it does not mean that opinions regarding market-oriented structural adjustment packages are necessarily favorable. In fact, there remains much political opposition to the type of policy innovations introduced following the outbreak of the debt crisis in the early 1980s (**The Economist**, 1996). Furthermore, additional reforms are still lacking in a number of important sectors such as regional labor markets (Pages-Serra, 1996). Given the political risk of potential backtracking, the next few years will be critical in determining whether much of the region will continue to stabilize and grow more rapidly.

Table 1
Real Per Capita GDP - 1985 US Dollars

Country	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
Argentina	3127	3164	3061	2831	2794	3001	3216	3362	3562	3439
Brazil	1678	1704	1672	1694	1594	1573	1537	1578	1645	1698
Chile	1430	1503	1588	1720	1749	1847	2020	2114	2168	2301
Colombia	1230	1272	1300	1320	1352	1356	1388	1434	1490	1540
Ecuador	1763	1618	1745	1709	1720	1766	1788	1784	1816	1821
Mexico	2359	2357	2341	2374	2432	2472	2494	2462	2503	2281
Peru	989	1059	956	832	776	783	763	791	877	923
Uruguay	1695	1824	1812	1823	1827	1880	2009	2053	2149	2109
Venezuela	3766	3804	3927	3506	3604	3905	4048	3969	3766	3630

Source: The WEFA Group Latin America Service

Table 2
Consumer Prices - Annual Percentage Changes

Country	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
Argentina	90	131	343	3080	2314	172	25	11	4	3
Brazil	131	222	586	1201	2901	411	965	1920	2503	77
Chile	20	20	15	17	26	22	15	13	11	8
Colombia	19	23	28	26	29	30	27	23	22	21
Ecuador	23	30	58	76	49	49	55	45	27	23
Mexico	86	132	114	20	27	23	16	10	7	35
Peru	78	86	668	3523	7483	410	73	49	24	11
Uruguay	76	64	62	80	113	101	68	54	45	65
Venezuela	12	28	29	85	41	34	31	38	61	60

Source: The WEFA Group Latin America Service

Table 3
Interest Payments to Merchandise Exports - Annual Percentages

Country	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
Argentina	62.6	65.2	51.2	62.9	45.4	43.4	34.4	27.5	28.1	24.2
Brazil	45.1	35.5	31.3	31.8	34.6	30.0	23.1	24.2	18.7	22.5
Chile	46.3	31.3	25.5	22.0	21.9	18.3	14.0	13.0	11.4	10.4
Colombia	24.7	24.7	26.1	26.3	23.2	19.9	18.4	16.0	17.6	13.7
Ecuador	35.7	40.1	42.3	46.3	40.8	35.7	28.1	26.3	23.5	18.8
Mexico	51.6	39.5	42.0	40.6	34.4	34.0	34.9	36.4	34.5	35.5
Peru	38.5	33.9	36.6	28.8	36.0	33.5	28.4	31.0	27.8	35.5
Uruguay	34.1	32.5	29.9	34.5	34.2	29.1	24.2	26.9	24.9	27.1
Venezuela	38.1	28.3	31.8	28.8	18.3	16.9	20.3	19.4	16.7	19.1

Source: The WEFA Group Latin America Service

Table 4
Per Capita Imports - Nominal US Dollars

Country	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
Argentina	146	174	153	129	116	232	414	441	582	548
Brazil	101	106	101	124	143	143	138	167	215	323
Chile	255	324	379	498	546	561	695	754	794	984
Colombia	112	122	143	141	158	138	181	267	315	383
Ecuador	170	204	155	161	167	210	194	225	292	323
Mexico	213	269	242	294	385	461	571	569	672	481
Peru	128	157	135	102	138	163	187	183	251	342
Uruguay	269	355	363	369	409	496	617	672	818	869
Venezuela	477	568	640	368	352	512	628	411	363	320

Source: International Monetary Fund and authors' calculations

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