Preface—Rethinking Structural Reform in Latin America

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This preface provides an overview of the conference "Rethinking Structural Reform in Latin America," held at the Atlanta Fed October 23–24, 2003, and cosponsored by the Federal Reserve Bank of Atlanta and the Inter-American Development Bank. Four of the papers from the conference appear in this issue of the Economic Review. *The remaining papers and presentations from the conference are available on the Atlanta Fed's Web site at www.frbatlanta.org under "News & Events," "Conferences," "2003."*

The process of structural reform in Latin America is in doubt amid economic crises and waning public support. Thus far the process of reform has been uneven, varying across sectors and countries alike. Discontent with reform arises in part from its distributional effect. To promote and highlight research exploring structural reform's impact on economic growth and income distribution in Latin America, the Federal Reserve Bank of Atlanta and the Inter-American Development Bank (IDB) cosponsored the conference "Rethinking Structural Reform in Latin America" in October 2003. The conference, held at the Atlanta Fed, drew over 100 participants, including policymakers, academicians, and financial sector professionals.

Conference papers investigated the effectiveness of reforms in a range of areas: trade and finance, where a great deal of progress has taken place; privatization and tax reform, which has had mixed results; and labor reform, where progress has been very modest. Four panels focused on issues of governance and institutional reform, second-generation reforms such as tax and labor reforms, financial sector reform, and the relationship between reform and macroeconomic stability.

Governance and Institutional Reform

In a panel on governance and institutional issues, panelists noted that public support for reform was declining in Latin America and that proceeding with reforms carries a political cost to policymakers. In their paper (page 1 in this issue of *Economic Review*), Eduardo Lora, Ugo Panizza, and Myriam Quispe-Agnoli describe the symptoms and causes of reform fatigue and explore the implications for the future of reform.

In their study of privatization, Alberto Chong and Florencio López-de-Silanes find that, overall, privatization led to increased profitability and productivity, firm restructuring, fiscal benefits, and output growth. They also find that most cases of failed privatization can be linked to poor contract design and opaque processes with heavy state involvement; these case generally lack reregulation and have a poor corporate governance framework. Panelist Mariano Tommasi argues that it is critical to improve the quality of policymaking processes, which requires thoughtful political analysis and a history-grounded understanding of the conditions in each country.

Labor Market Reform

The next panel's theme was labor reform, which has lagged other types of structural reform in the region such as trade and commercial reform. In her paper (page 67 in this issue), Carmen Pagés argues that the current regulatory system exacts substantial costs in terms of labor market performance, and such costs call for far-reaching labor reforms; however, demand is high for social protection, meaning that future reforms should aim at providing this protection at lower costs.

Rafael La Porta and his coauthors surveyed labor markets in eighty-five countries and found that richer countries regulate labor less than poor countries do although the former have more generous social security systems. Their paper seeks to explain this pattern; they find that the results are difficult to reconcile with efficiency and political power theories of institutional choice but are broadly consistent with legal theories according to which countries have pervasive regulatory styles inherited from transplanted legal systems.

Financial Sector Reform

In their paper on financial market reforms (page 29 in this issue), Arturo Galindo and Alejandro Micco argue that inadequate progress toward fostering credit protection is an important limiting factor in the region's financial development. In another paper, Geert Bekaert and his coauthors argue that, in their preliminary findings, overall financial liberalization has a very important economic effect—adding economic growth of 1 percent per year in developing countries that undertake financial sector liberalization. In his discussion of these papers, Sergio Schmukler commented on the reform agenda and how the results did not turn out as originally expected. His own paper (page 39 in this issue) suggests that so far only some countries, sectors, and firms have taken advantage of globalization. As financial systems turn global, governments lose policy instruments, so there is increasing scope for some form of international financial policy cooperation.

Reform and Macroeconomic Stability

In the paper by Arturo Galindo and his coauthors, microeconomic evidence suggests that Latin American firms tend to match the composition of their debt with the currency composition of their income stream. Both macro- and microlevel evidence suggests that liability dollarization can reduce or possibly reverse the typical Mundell-Fleming result of expansionary devaluations.

In the panel's second paper, Andrew Powell and his coauthors contend that foreign banks represent trade-offs for their developing country hosts. They present a portfolio model to show that a more diversified international bank may have lower overall risk and hence be less subject to funding or liquidity shocks; however, such institutions may react more to host country shocks that affect expected returns.

Discussing the Issues

The conference also featured a policymaker roundtable discussion among three eminent economists: Guillermo Calvo, chief economist at the IDB; Arnold Harberger, of the University of California, Los Angeles; and Carmen Reinhart, of the University of Maryland. Calvo noted that adjustments to recent downturns have been made and that future reforms should work to lessen Latin America's vulnerability to negative external shocks. Harberger cited the international support for the Mexican bailout as a great achievement, and he recommended that further reforms should include provisions to limit the wide fluctuations in inflows and outflows of capital from the region. Reinhart sounded a note of caution to policymakers to not oversell how fast economic reforms can deliver promised benefits and to follow through on the reforms themselves.

Two keynote addresses rounded out the proceedings. Miguel Ángel Rodríguez Echeverría, former Costa Rican president and the newly elected secretary general of the Organization of American States, discussed his personal account of how the reform process advanced and then stalled during his term as president, which ended in 2002. President Rodríguez was optimistic about the future of reform, noting that there is broad support for economic stability throughout Latin America. However, he made it clear that broad policy prescriptions have to be applied with particular care to the individual characteristics of each country. He called for caution in advancing economic reforms during times of wide global economic fluctuations such as those experienced over the last few years. And, in the case of privatization, special care must be made to ensure that the process is fair and open to avoid even the hint of corruption "so as not to transform public monopolies into private ones and to improve regulatory institutions."

In another keynote address, Harberger discussed reform in a historical context, which he provided with the perspective of someone who has spent a half-century working on this topic. His experience as a consultant to over a dozen Latin American governments and international organizations and his seminal writings on real exchange rate economics and cost-benefit analysis made his remarks uniquely apropos given the conference focus. He noted that policymakers increasingly act on the basis of sound economic principles and that countries have moved from unsustainable measures such as multiple exchange rates and high tariff barriers. Furthermore, he stated that governments now understand that value-added taxes produce fewer distortions than other taxes do and consequently have become more prominent in the region. He remarked that countries can continue to move forward by following sound economic principles.