The Political Challenges of Economic Reforms in Latin America

Notes

1 Inter-American Development Bank, *Economic and Social Progress in Latin America, 1996 Report* (Washington, D.C.: 1996), p. 70.

2 An econometric analysis of the electoral performance of the incumbent administrations in Latin America during 1982—95 concluded that "fiscal and monetary orthodoxy and market reforms have led to much better electoral results for the incumbent administrations than heterodoxy and statism." See the dissertation by Carlos Gervasoni, "Economic Policy and Electoral Performance in Latin America, 1982—95," Center for Latin American Studies, Stanford University, September 1995.

3 Inter-American Development Bank, "Employment in Latin America: What is the Problem and How to Address It?" Papers for Seminar at the IDB Annual Meeting, Cartagena, Colombia, March 15, 1998.

4 For a discussion of the stages of reform in the region, see Moisés Naím, "Latin America: The Second Stage of Reform," *Journal of Democracy*, vol. 5, no. 4 (October 1994).

5 Regarding the political impact of economic volatility, Ricardo Hausmann, Chief Economist at the Inter-American Development Bank, writes: "The many benefits of globalization will not compensate for the costs of volatile capitalism quickly enough to build, much less sustain, a strong social consensus around the policies that facilitate global integration. If volatility remains unchecked, a backlash will build against the market-oriented, democratic reforms that are essential to consolidating the remarkable political and economic progress of the last decade." See Ricardo Hausmann, "Will Volatility Kill Market Democracy?" *Foreign Policy* (Summer 1997).

6 An outline of policies required to reduce the impacts of international capital market volatility can be found in Ricardo Hausmann, op. cit., and Inter-American Development Bank, *Latin America After a Decade of Reform: Economic and Social Progress Report, 1997* (Washington, D.C.: 1997), pp. 63—70.

7 On the lack of progress in labor market reforms, see Shahid Javed Burki and Guillermo Perry, *The Long March: A Reform Agenda for Latin American and the Caribbean in the Next Decade* (Washington, D.C.: The World Bank, 1997), pp. 37—44; and the IDB, *Latin America after a Decade of Reform*, op. cit., pp. 46—47.

8 On the importance of civil service reform and other improvements in governance capacity, see Shahid Javed Burki and Guillermo Perry, *Beyond the Washington Consensus: Institutions Matter* (Washington, D.C.: The World Bank, forthcoming).

9 For an excellent review of these issues, see Liliana Rojas-Suarez, ed., *Safe and Sound Financial Systems: What Works for Latin America* (Washington, D.C.: Inter-American Development Bank, 1997). For a broad assessment of banking system issues, see International Monetary Fund, *Toward a Framework for Financial Stability* (Washington, D.C.: IMF, 1998).

10 For a discussion of the benefits of and issues surrounding foreign participation in Latin American banking systems, see Michael Gavin and Ricardo Hausmann, "Make or Buy? Approaches to Financial Market Integration," in Rojas-Suarez, *Safe and Sound Financial Systems*, op. cit., pp. 133—162.

11 Reformers may be able to counter such nationalist sentiments by arguing that the banking sector is crucially important to the growth of the whole economy, and that this sector needs to import bank management skills.

12 Regulatory forbearance means that the superintendent hesitates to intervene in a bank that is technically insolvent—perhaps in the (usually false) hope that the bank will be able to recover, or perhaps due to political pressure. On the importance of both political independence and technical capacity of the superintendent, see Stephan Haggard, Chung H. Lee, and Sylvia Maxfield, eds., *The Politics of Finance in Developing Countries* (Ithaca: Cornell University Press, 1993).

13 These measures are well reflected in the recent legislation in Panama.

14 In the short run, it may be useful to develop arbitration procedures to which debtors and creditors can resort without awaiting resolution through the judicial system.

15 Such mechanisms should also cover the rules and processes for mergers and acquisitions, which are often the best approach for dealing with a bankrupt firm or insolvent bank.

16 Argentina made important and rapid progress in this area during the Tequila crisis in 1995.

17 Some argue that excessive risk-taking by bank managers and owners cannot be avoided as long as the government stands ready and able to be a lender of last resort. This argues in favor of a currency board arrangement, as in Argentina and Estonia, in which that government's capacity to lend to the banking system is severely restricted.

18 On this point, Aristobulo de Juan writes: "Bank crises are great. We all need a good banking crisis in order to ignite the engine and to undertake serious banking reforms. This may sound like black humor, but, in fact, it is only when a country has a serious crisis that its governments reacts thoroughly and addresses key areas as bank restructuring and crises resolution." From his article, "Clearing the Decks: Experiences in Banking Crisis Resolution," presented to the Fourth Annual Bank Conference on

Development in Latin America and the Caribbean, *Banks and Capital Markets: Sound Financial Systems for the 21st Century*, San Salvador, June 28—30, 1998.

19 For an excellent diagnosis of problems of education in the region and a review of proposed reforms, see "Education: The Dynamics of a Public Monopoly," Chapter 4 in the IDB, *Economic and Social Progress Report 1996*, op. cit.

20 A recent survey indicates that employers in Latin America find it more difficult to get skilled workers than employers in Asian countries and that "the employers feel that the deficiencies in the labor supply are rooted in the educational system. In their view, education is unable to meet the needs of a competitive economy." See IDB, "Employment in Latin America," op. cit., 1998, pp. 4—5.

21 During the coming decades, following a period of declining birth rates in many countries, both the ratio of students to workers and the average number of children per working parent will fall in Latin America. This demographic change will provide an opportunity for the region to increase its public and private expenditures on education. Even a stable share of income per worker devoted to education would mean an increasing expenditure per student.

22 On the broad issues involved, see E. Mark Hanson, *Educational Decentralization: Issues and Challenges*, Program to Promote Education Reform in Latin American and the Caribbean (PREAL), Occasional Paper Series No. 9 (Washington, D.C.: Inter-American Dialogue, November 1997). On the political obstacles, see especially Edward B. Fiske, *Decentralization of Education: Politics and Consensus* (Washington, D.C.: The World Bank, 1996). It notes that political leaders in the central government should be willing to reduce their control of the educational system for the sake of gaining political legitimacy as a result of better educational services. In a broader context, Rudolf Hommes makes a similar argument in "Conflicts and Dilemmas of Decentralization," in the Michael Bruno and Boris Pleskovic, eds., *Annual World Bank Conference on Development Economics 1995* (Washington, D.C.: The World Bank, 1995).

23 This is also a key recommendation in *The Future at Stake: Report of the Task Force on Education, Equity, and Economic Competitiveness in Latin American and the Caribbean*, Program to Promote Education Reform in Latin American and the Caribbean (PREAL) (Washington, D.C.: Inter-American Dialogue, April 1998).

24 On this point and on the role of the teachers' union in Colombia, as well as other excellent lessons of that country's reform effort, see Armando Montenegro, *An Incomplete Educational Reform: The Case of Colombia*, HCO Working Paper, no. 60 (Washington, D.C.: The World Bank, August 1995).