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Summing Up:
A Contemporary Policy Agenda for Latin America

The preceding chapters have reviewed the economic situation of Latin America and developed a set of policy proposals attuned to the present state of the region. The aim of this chapter is to summarize these proposals and place them in the context of past and competing ideas, as well as relating them to other major areas of social concern.

The book started by examining where Latin America has come over the past decade, since market-oriented reforms became widespread. The record is a mixed one. The per capita growth that was so conspicuously absent in the 1980s did return in the 1990s, but at not much over half the rate recorded during Latin America's Golden Age, between 1950 and 1980[1]. Income distribution may have stopped getting worse, at least in the region as a whole, but there was no widespread improvement despite the fact that distribution is more inegalitarian than anywhere else in the world[2]. Social indicators have continued to improve, but that was true even during the debt crisis. The region has witnessed major crises in all of its seven larger economies except Chile, and in Ecuador, with two of the three largest economies facing acute difficulties as this is written. This was far from the dramatic improvement in the region's performance that reformers had expected to result from widespread adoption of the liberalizing reforms that they advocated. What went wrong?

One hypothesis is that the whole strategy of what critics label "neoliberal reform" was mistaken. If that hypothesis were correct, then presumably one would expect to see the countries that had most resolutely resisted "neoliberalism", like Cuba and Venezuela, enjoying the biggest advance in living standards, whereas those that had embraced it first and most decisively, like Chile, would be lagging behind. Statistics do not provide much support for this hypothesis: setting per capita income as 100 in 1990, in Cuba it had fallen to 79 and in Venezuela to 97 in 2000, whereas in Chile it had risen to 147[3].

A second hypothesis is the exact opposite of this: that the reforms were not pushed far enough. Fernandez-Arias and Montiel (1997) estimated econometrically (on the basis of data from all developing countries) that the reforms had accelerated growth

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[1] Per capita growth was [5.5 minus the rate of population growth] between 1950 and 1980, -1.0 percent per annum in the 1980s, and 1.4 percent per annum from 1990-99, according to the March 2001 issue of *ECLAC Notes*.

[2] The unweighted average of the Gini coefficient for the 26 countries reported in the 2001 *Human Development Report* is 50.4 percent, as against an average for the rest of the world of 36.9 percent. Only in southern Africa is income distribution comparably skewed. The poorest 10 percent of the population gets an unweighted average of 1.5 percent of total income (varying from a maximum of 2.9 percent in Jamaica to a minimum of 0.4 percent in Honduras), while the richest 10 percent gets an unweighted average of 40.2 percent (varying from a minimum of 28.9 percent in Jamaica to a maximum of 48.8 percent in Nicaragua).

[3] According to the March 2001issue of *ECLAC Notes*..

by about 2 percent, although this was partly offset by a deterioration in the international environment. They estimated that more vigorous reform along the same lines, to match the performance of the East Asian countries, could have produced a further acceleration of about 2.5 percent per year. It is also widely accepted that liberal reforms[4] need to be complemented by institutional reforms (often called "second-generation reforms") in order to be fully effective.

A third hypothesis is that it takes time to benefit from market-oriented reforms. After all, it took well over a decade from the time in 1974 when Chile first started implementing such reforms until many people were prepared to call it an economic success story, and it became a model that other countries might find it attractive to emulate. But then of course one is led to ask why it took so long. China did not have to wait for 15 years after it initiated market reforms in 1978 to benefit, nor did India have to wait 15 years after 1991: both started to benefit within a couple of years. What did they do right that Latin America did wrong?

The answer may be in part that they had less to lose, since the majority of their labor forces were still in peasant agriculture. But perhaps the far more pragmatic approach to policy making also helped. There is absolutely no question about the direction in which their policies moved, toward exploiting rather than repressing market forces, but both of them were cautious in the way they went about it rather than following an ideological blueprint. China tended to reform one or two sectors at a time, sectors where there was a pretty clear presumption that reform would bring benefits even if the remainder of the economy remained unreformed. India maintained balanced macro policies while it began a cautious opening of markets, and set up a series of high-powered committees (particularly on the financial sector) that deliberated on how to move forward before it acted. I personally believe that India should have moved a lot faster on many issues than it did, but it is arguable that the benefits from not acting precipitately on capital account liberalization (thus avoiding contagion from the East Asian crisis) outweighed the costs of not acting faster on, say, liberalizing trade and factor markets.

The example of Chile reinforces this diagnosis. There was a false dawn in the late 1970s when it looked as though Chile might be a success story in the making, but then dogmatic macro policies – a fixed exchange rate to reduce inflation regardless of the loss of competitiveness this entailed, combined with relative freedom for capital inflows, and financial deregulation without effective supervision – led to the disaster of the 1982 collapse. In the following years, Chilean policy became far more pragmatic. The authorities aimed to achieve and maintain a competitive real exchange rate, and they were content with a very gradual approach to disinflation. Supervision of the financial system became a priority. After the restoration of democracy in 1991, they adopted the *encaje* to

[4] Note that I drop the "neo" prefix, which is simply inaccurate as a description of the reforms undertaken in most Latin American countries (let alone as a description of the reforms favored by the authors of this report). According to Mario Henrqique Simonsen (1994, p.280), who was the only person I know who took the trouble to define the concept, neoliberalism is the economics of Reagan and Thatcher, Hayek and Friedman. Prominent among the doctrines they espoused were supply-side economics and monetarism, neither of which has featured in the reforms adopted in Latin America. The reforms we are talking about are those bits of Reagan-Thatcher doctrine that have been retained by successors like Tony Blair.

limit capital inflows and they pursued an anti-cyclical (dare one say Keynesian?) macro policy. In conjunction with the market-oriented micro policies that were then securely in place, the result was the impressive Chilean progress of the 1990s.

A fourth hypothesis is that the region was hit by a series of exogenous shocks that repeatedly disrupted the progress that was beginning to be achieved. The tequila crisis in Mexico in 1994-95, the falloff in capital inflows and the decline in commodity prices after the East Asian crisis in 1997 and the Russian crisis in 1998, and the Brazilian crisis in 1999, reverberated around the region, as the Argentine and terrorism crises are as this is written. But then one has to ask whether these shocks were truly exogenous to the policies being pursued in the region, to which one would presumably answer that the East Asian and Russian crises were, and the terrorism crisis is, but the others were not. That then suggests major elements of the needed agenda for the next stage of economic reform: to seek policies that are less prone to induce crises, and ones that will make the region more resistant to crises that originate elsewhere.

The authors of this book essentially subscribe to a combination of the second, third, and fourth hypotheses. We believe that while the reforms of the 1990s were fundamentally in the right direction, they were sometimes applied in an over-ideological way, or without the needed accompanying institutional reforms, that delayed or vitiated their benefits. Privatizations were sometimes carried out without the necessary care to ensure that the privatized firm was selling in a competitive market or, where that was impractical, was properly regulated. Trade was liberalized without the necessary complementary concern to make sure that the exchange rate was sufficiently competitive to induce vigorous export growth. Perhaps because they are largely in the public sector, education and training did not receive the priority necessary to nurture the growth of a modern knowledge-based economy. And so our agenda in the chapters that followed was to tease out the modifications and additions to the original "Washington consensus" policies of macroeconomic discipline, liberalization, privatization, and opening the economy that are needed to secure the full benefits of those policies. These include policies to crisis-proof economies. In many cases it turns out that the types of reforms needed are rather mundane "second-generation" (institutional) reforms.

<u>The New Agenda</u>

The first topic addressed was the role of the state. Much of the focus was on cutting back the bloated role that the state had assumed in most Latin American countries during the decades that culminated in the debt crisis. Fiscal deficits got far too large; the government set itself up as producer of many goods and services that can be provided more efficiently by the private sector; government regulation of economic activity was oppressive; and government was far too centralized. But a desire to prune back government in those areas is not the same as a desire for minimalist government. In the recent words of one of the pillars of Washington orthodoxy[5], the World Bank (2001, p.26): "A strong and capable state is necessary to support markets, and an arbitrary and corrupt state can impede their development." One of the reasons for wanting to prune the state of those activities it does

[5] Whether its president is comfortable thinking of the Bank that way or not!

not do well is to allow it to concentrate on the key functions that it alone can fulfill: providing security, the institutional infrastructure of a market economy, and public goods; internalizing externalities; and looking after those members of society least able to care for themselves. The agenda of "second-stage reforms" (Naim 1994, Burki and Perry 1998) is devoted to building the institutions that will allow the state to perform those core functions efficiently. The need to restore a sense of physical security, by combating the crime wave that has swept through the region, is one of the crucial elements of that agenda on which Pedro Pablo Kuczynski dwells in chapter 2.

The function of looking after those members of society least able to care for themselves is one where the historical legacy of Iberian colonialism has meant that Latin American states have traditionally performed particularly poorly. The result is that the region suffers the most inegalitarian income distributions in the world. In seeking to remedy this, present day thought holds out less hope from massive redistribution of income through the tax system than from measures to empower the poor to exploit the potentialities of a market economy. That is not to say that one should not strive to make both the system of taxation and the pattern of public expenditure progressive, but it is to recognize that one of the things that money is quite good at buying is the ability to minimize tax obligations. Even with careful attention to tax design and enforcement, this seems to mean that a roughly proportionate tax system is the best that can be achieved without serious damage to incentives. Fortunately the fiscal system as a whole can still have a progressive impact if the pattern of public expenditure is biased toward the poor, by focusing heavily on the universal provision of basic public services like education and health. These are perhaps the most potent instruments available to empower the poor, although they can usefully be supplemented by access to microcredit and legal recognition of de facto property rights in the informal sector (Hernando de Soto, 2001).[6] These are the three major instruments that have been identified as ways of empowering the poor to take advantage of a market economy, and their deployment should be high on the policy agenda.

Revamping the fiscal system so as to reverse its traditional tendency in Latin America to aggravate income inequalities is merely one of the challenges to fiscal policy discussed in chapter 3. Now that the region has made good progress in overcoming the problem of secular fiscal deficits that was so troubling in the 1980s, attention needs to turn to another of the traditional roles of public finance that was ill-served in Latin America in the past: that of stabilizing the macro-economy over the business cycle. Ricardo Lopez Murphy and his colleagues explain the pro-cyclicality of fiscal policy in political economy terms as an equilibrium between political pressures to increase spending during the boom and the response of an executive branch concerned with

[6] That is not to argue that any attempt to grab property rights should be subsequently ratified by the state: that would make a mockery of the very concept of property rights. And public property (e.g. forests) may need to be defended from illegal encroachment or some extremely important public goods will be threatened. The fact is that there remain large extra-legal settlements in most Latin American countries where the former owners have long ago abandoned any attempt to exercise property rights but the current de facto owners are denied the advantages that come with legalization. Similarly, there are cases in which, in the name of conservation, indigenous peoples have been expelled from national parks that they seemed unlikely to harm.

deficits and distortions that gets leverage only in the bad times. Their prescription is more transparency regarding hidden debts and tax expenditures plus rules analogous to the EU's Maastricht criteria – though both more stringent and more sophisticated -- to govern the reaction of expenditure and debt policies to exogenous shocks. The greater sophistication is required because any attempt to curb the region's volatility has to start by restraining the temptation to splurge in the good times[7].

Another area needing attention in a number of countries is reconciling the new and welcome measures of fiscal decentralization with maintenance of overall national fiscal discipline. This again needs the design and acceptance of rules, in this case designed to confront sub-national governments with hard budget constraints without depriving them of the autonomy that will allow them to act on the basis of local preferences.

While fiscal deficits are not the drag on national savings that they used to be, the change has not been sufficiently pronounced to make the budget a big contributor to savings. That makes it all the more essential to have a financial system that is capable of mobilizing private savings and intermediating them to where they will be invested productively. That is not the case at present. Firms declare that by far the most important obstacle to their development is a lack of finance, which is manifest in the very low gearing ratio of Latin American firms, 35 percent on average (less than half that in South East Asia and a third that in most developed countries) (IDB 2001). Banking systems continue to have a high ratio of non-performing loans, limited coverage, too many inefficient state banks, and little medium-term lending. Bond markets have improved but remain weak, while mortgage markets are virtually non-existent outside Chile. After briefly flourishing in the first half of the 1990s, equity markets have once again gone to ground. The most hopeful financial development of the last decade is the growth of private pension funds, which were pioneered by Chile and have since been copied in a number of countries. The challenge now is to implement a range of "second-generation reforms" needed to enable the capital markets and the banks to fill the void that will be left if capital inflows never revive, as they may not given that the international banks are still feeling burned, the FDI surge associated with privatization has largely run its course, and the shine has gone off emerging markets among international investors. Pedro Pablo Kuczynski suggests in chapter 4 that these rather unglamorous but very necessary reforms include upgrading credit disclosure standards, introducing mortgage guarantee schemes analogous to that provided by Fannie Mae in the United States, strengthening the rights of minority investors, privatizing state banks, and liberalizing restrictions on the assets that insurance companies and pension funds are allowed to buy.

Even if large-scale capital inflows do not revive, it would be a mistake to suppose that Latin America will in the future regain the insulation from the international capital market of the earlier postwar period. Barring strong and costly, perhaps prohibitively costly, policy actions to close the capital account, exchange rate policy will in the future have to be conducted on the assumption of capital mobility. In fact, the speculative crises

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[7] Note that this is what Chile did in the early 1990s (in part by imposing the *encaje*). It was rewarded by being the only Latin American country to avoid a major macro crisis during the decade that followed.

spawned by capital mobility have already led to a big change in the exchange rate policies employed in the region, away from the varieties of crawling band that were widely employed in the past toward the "two-corner solution". One of the corners is a fixed exchange rate backed up by institutional measures to create confidence that its fixity will be sustained, meaning either dollarization (as in Ecuador) or a currency board (as in Argentina). The other corner is a floating exchange rate, with the nominal anchor being provided by inflation targeting (as in Brazil, Chile, and Mexico). But questions still abound about whether this two-corner solution is going to provide a lasting resolution to the crises that have dogged the region in the past. Does Argentinean experience not demonstrate that the hard peg may impose costs at least as great as those of classic currency crises? Are the countries that claim to be floating allowing their exchange rates to move freely, or do their actions demonstrate a "fear of floating"? Is it true that no principles of exchange rate management can be devised that will improve on the behavior of a floating rate?

Liliana Rojas-Suarez argues in chapter 5 that the best answer for the larger countries (though not necessarily the small countries of Central America and the Caribbean) is likely to involve inflation targeting with a floating exchange rate qualified by clear and limited rules for foreign exchange intervention. But even this regime cannot be expected to work satisfactorily unless it is accompanied by a series of complementary institutional innovations. Banks must be required to internalize correctly the risks that they take in accepting foreign exchange exposure or lending in dollars to the nontradable sector, perhaps by requiring them to insure such risks. Shocks need to be countered, both by an ability to adjust the exchange rate and by building up and running down stabilization funds. The operation of such stabilization funds should be guided by public and transparent information on what is considered "normal", in much the same way that I have long argued that exchange rate policy should be conducted with reference to a publicly announced though movable-for-transparent-reasons band. With the latest examples of speculative attacks providing a warning that even well-managed bands can be problematic when the markets go on the rampage, I can see why she is not attracted to bands with hard edges, but that does not rule out attempts to guide markets by indicating what rate is believed consistent with the fundamentals or intervening in support.

Chapter 6, on trade, by Roberto Bouzas and Saul Keifman, describes both the process of trade liberalization in the region during the last decade and its consequences. One consequence they note is that import growth has vastly outpaced export growth, which on average accelerated very little in volume terms from the previous two decades. Two major reasons for this were the limited gains in market access to the OECD countries (except in Mexico and Central America) and widespread real appreciations in the 1990s. While some recovery from the depreciated rates of the crisis years was to be expected, in many cases real appreciation went further than was desirable, particularly in countries that used the exchange rate as a nominal anchor to reduce inflation, but even in those like Chile and Colombia that tried to resist appreciation by imposing an *encaje* on capital inflows. More competitive exchange rates are going to be imperative in the future if the region is to reap less unbalanced, and therefore greater, benefits from liberal trade. Given what was just said about the impossibility of administrative management of the

exchange rate in the brave new world of capital mobility, that implies that the fiscal-monetary mix will need to be chosen with a view to keeping the exchange rate competitive, which reinforces the earlier call for continuing fiscal discipline and a better framework to mobilize private savings.

Another consequence of trade liberalization noted by Bouzas and Keifman is that it did not have the effects on employment and real wages that had been predicted. These expectations were based on a simple two-factor model where developing countries are all assumed to be labor-abundant so that free trade will raise the demand for labor and therefore the wage rate. It turns out that the abundant factor in many Latin American countries is natural resources rather than labor, so that the impact on wages and income distribution is ambiguous. This is something that should have been appreciated sooner. It implies that it would be mistaken to treat further trade liberalization as a reliable weapon for overcoming the region's inherited inequality[8]. It is perfectly reasonable to seek further trade liberalization on efficiency grounds; the point is that this one stone cannot be relied on to kill two birds. The big issue is what strategy should be adopted in order to liberalize trade: unilateral, multilateral through the WTO, multiple bilateral (i.e., signing as many bilateral free trade agreements as possible), through an FTAA, or all of the foregoing?

If a country is lucky enough to have natural resources, then it would be silly not to take advantage of them. Nonetheless, if Latin Americans are to be more than hewers of wood and drawers of water, they will need to be able to command the tools of the knowledge economy. This means that they will need to overcome the longstanding weakness of the region in providing education to its children[9], and to move progressively toward the lifetime learning that is fast becoming the norm for a large proportion of the labor force in the more technologically advanced societies. Chapter 7, by Claudio de Moura Castro and Larry Wolff, surveys the present weaknesses in the region, but notes also the signs of recent progress. A variety of approaches will be necessary to extend these further. More money is an essential condition for further advances; good education does not come cheap. Of course, simply throwing more money into education is not enough. Other policies that they recommend include decentralization, increased testing, parental involvement, use of technology in teaching, and constant experimentation. There is also a need for redeploying public funding down from the universities toward the primary and increasingly the secondary level, which is as far as the bulk of the population get. That is not to call for curtailing university spending, which is going to be key to the technological upgrading that will allow the region to retain its place as the most advanced of the developing regions of the world. Rather, it calls for cost recovery, by expecting students to pay the bulk of the cost of their university education. By all means provide student loans practically on demand and scholarships to the truly needy, but middle-class students who riot against being charged for access to a lifetime of privilege are the true enemies of an assault on inequality, and they need to be told so.

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[8] It still seems even more implausible to imagine that trade restrictions can be used as a weapon for systematically improving income distribution.

[9] Fernandez-Arias and Montiel (1997, Table 3) attribute about 0.5 percent of the lag of Latin America's growth rate behind East Asia's to the education lag.

Chapter 8, by Andres Velasco and Patricio Navia, dealt with political economy. It is all very well to have an agenda for economic reform, but that is likely to remain an academic exercise without thought on how political support for reform can be mobilized. …[to be completed].

Supplementing the Agenda

No book of reasonable length can expect to contain a full treatment of every topic that is important to the future development of Latin America. Let me therefore try to compensate somewhat by a brief consideration of five crucial issues that were not treated in individual chapters: democracy, social progress, drugs, the environment, and the policies of the rest of the world.

Latin America, like Europe, is now almost universally democratic. Both regions now have only one regime that cannot claim democratic legitimacy with reasonable plausibility. It is true that much of the fervor that accompanied the revival or initiation of democracy has ebbed as democratic regimes have shown themselves just as vulnerable to corruption and just as capable of economic failure as those they replaced. Nevertheless, the whole mindset of what is a normal and acceptable form of government in Latin America, and what sort of actions would trigger hostile reactions by neighboring countries, has been transformed since the authoritarian epoch of the 1960s and 1970s. Democracy has ridden out the debt crisis and the adoption of market economics, despite the warnings of the jeremiahs that it would perish if subjected to such stresses. Today no one believes that only authoritarian regimes are capable of introducing market-oriented economic reforms or stabilizing inflation. Given a decade of decent economic progress comparable to that which Chile achieved in the 1990s, Latin America should emerge with democracy as securely entrenched as it is in North America or in Western Europe.

Perhaps surprisingly, given the facts about income distribution that have already been alluded to, Latin America on average seems to have somewhat better social indicators than would be expected given its level of per capita income. At least, more countries rank higher on the human development index than in terms of per capita income (18 countries higher, two the same, and 6 lower, according to Table 1 of the appendix to the 2001 UN *Human Development Report*). Comparing the figures for 1999 in the 2001 *Human Development Report* with those for 1990 in the 1991 report, one finds that life expectancy increased by just over 2 years to just under 70 years (as against 78 years in the high-income OECD countries), adult literacy increased from 84.0 percent to 87.4 percent, and, rather impressively, under-5 mortality almost halved, from 65 per thousand to 36 per thousand (though that is still a lot higher than the 6 per thousand in the high-income OCED countries)[10]. Latin America is still ahead of East Asia in terms of both longevity and literacy, although the gap is much smaller than that in terms of per capita income; but at least the region's poor income distribution does not completely nullify the advantage that one would expect it to gain from its higher income level. Further economic progress in the form of faster economic growth concentrated disproportionately on those lower down the income distribution, the objective of the policy agenda

[10] These figures are all unweighted country averages.

developed above, can be expected to improve the social indicators further. Progress could be further accelerated by an increased focus of public expenditure on the social sectors, although this should of course be accompanied by concern for the quality of expenditure (which may again need a second-generation reform program).

One of the great unmentionable topics in discussions of economic policy in Latin America is the drug problem. It is time to recognize that this is in fact a critically important issue for a number of Latin American countries, particularly those whose geography gives them the climatic ability to produce marijuana and cocaine, meaning Bolivia, Ecuador, Peru, and above all Colombia. If these products were traded legally, their production would provide a modest income for a significant number of peasants and their commercialization would also generate a number of jobs, but there would be no large profits in the business because competition would keep prices close to the cost of production. But countries outside the producing region have decided to combat consumption through prohibition and have enlisted the producing countries in an effort to suppress production and trade. Since demand is highly inelastic, this attempted suppression results in high prices, and therefore tempts producers and traders into taking risks, for which they as individuals, but not the society of which they are a part, get amply rewarded. The war between those involved in the drug trade and the governments that try to suppress it results not just in the brutalization of society, but also in economic costs that surely outweigh the economic benefits of drug production. It is difficult to see how this will ever change except by some form of legalization in the drug consuming countries, which is a topic well beyond the scope of this study[11]. That leaves a large cloud hanging over a significant part of Latin America.

The source of the rich natural resource endowment of the region noted above is its unique natural environment, involving inter alia one of the two great mountain chains of the world, the world's largest tropical rain forest, its deepest topsoil, and its tallest and its most beautiful waterfalls. Biologists and all those with any aesthetic sense worry about the possible loss of this inheritance. The man in the street is perhaps even more concerned about local environmental ills, like the air and water pollution that are prevalent particularly in low-income urban areas. (And the region is now overwhelmingly urban: 74 percent of its people lived in urban areas in 1997, as against 78 percent in high-income countries, far higher than in other areas of the developing world.) These local problems have begun to receive attention, and some places, like Cubatao in Brazil, which was at one time reputed to be the most polluted place on earth, have already been transformed for the better. The slowdown in population growth, which is now down to 1.6 percent per year, as a result of declining fertility, which is forecast to reach replacement level within 20 years or so, also gives hope that local environmental problems may be on the road to solution.

The big outstanding questions concern global environmental issues. The region is a small player in terms of carbon emissions, but a major one in terms of biodiversity. Many of the logging companies continue to despoil the continent's forests, an action that

[11] But let us just note that, if demand is really inelastic, then the price fall resultant from legalization would not stimulate a large increase in demand. Or are we supposed to believe in a kinked demand curve?

in the future will surely win them the same revulsion that in our generation we feel toward the slave ship captains of old. If this were a case of making environmental issues take a back seat until living standards had risen, because of an environment-growth tradeoff, the toleration of the destruction of the forests would be sad, but at least understandable. However, the evidence suggests that allowing uncontrolled logging is a lose-lose policy from a social standpoint, with the logging companies (and any they may bribe to get access to the forests) as the only gainers.

This study has focused on what Latin America can do for itself. That does not mean that we believe that its future is independent of what happens in the rest of the world. While in the longer run a country's fate is primarily dependent on its own choices, in the short run the progress of any region is closely bound up with what happens in the outside world. Latin America clearly has an interest in the industrial countries avoiding recessions, and in their allowing access to their markets for the goods in which the region has a comparative advantage, especially agricultural products. Latin America would surely benefit if the industrial countries were to agree to a renegotiation of the intellectual property rights provisions in the WTO, to give more weight to the aim of achieving rapid and cheap diffusion of inventions and less to maximizing the rewards for inventing. The region would certainly benefit if the current phobia for emerging markets in industrial country capital markets were to be replaced by a more balanced view. Latin America would stand to benefit if international measures were taken to improve protection against such exogenous shocks as sudden falls in commodity prices, e.g. by strengthening the IMF's Compensatory Financing Facility. It could also hope to benefit if the international community were to decide that it was prepared to pay for global public goods like the preservation of biodiversity, and decided to raise real money to pay countries for safeguarding such treasures as tropical forests. And a few countries (mainly the poor ones, notably Bolivia, Haiti, Honduras and Nicaragua) would benefit if foreign aid programs were to be rebuilt. So there is a lot that the international community could do to help the region, only a small part of which could be described as charity. But, whether the rest of the world helps or not, Latin America needs to address the agenda laid out earlier.

Concluding Remarks

Twelve years ago I summarized the "first-generation" policy reforms that were then being implemented in many Latin American countries in ten pithy points, which I termed the "Washington consensus". There is a lot of overlap between what most people in Washington believed to be relevant then, as communism was collapsing, and the agenda laid out above. Fiscal discipline is still not completely secure. Many countries still need tax reforms to broaden the base and cut marginal tax rates, and better tax administration to make tax yields more progressive. Public expenditure still needs to be redirected, away from indiscriminate subsidies toward productive social spending like health and education. Trade still needs to be further liberalized. It is as important now as it was then that exchange rates should be competitive. Privatization still needs to be pushed further, especially regarding state banks. There is still much to be done to register the property rights of those in the informal sector.

At the same time, the overlap is far from complete. Some of the reforms that then seemed important, like allowing FDI to enter or liberalizing interest rates, have essentially been accomplished. Other things have come onto the agenda, like the focus on empowering the poor to contribute to (and thus benefit from) economic growth, or the focus on crisis-proofing the economy. There are two quite distinct reasons for those changes that have occurred in the agenda. One is that time has progressed, and what was relevant then may not be so now: the Washington consensus did not claim to lay out ten fundamental truths that hold for all times and places. The other reason is that the original version of that consensus aimed to identify the ten principal policy reforms that "Washington" thought were key to economic progress in Latin America, whereas the agenda laid out above consists of the reforms that the signatories of this document believe to be needed.

To be specific, let me identify the five major ways in which our agenda diverges from the original version of the Washington consensus.

1. The concern with income distribution[12]. We have argued that this concern is best pursued by empowering the poor to contribute to growth. That means first and foremost focusing public expenditure on providing universal access to health and education. Providing access to microcredit and securing legal recognition of property rights in the informal sector are two other important policies that deserve to be adopted.

2. Increasing saving. A tight budget to yield a public sector surplus can help. So can a funded, defined contribution pension system, and a series of "second-generation" reforms to the financial system.

3. Crisis-proofing the economy: adopting fiscal rules to prevent spending of transitory income by the public sector, e.g. by building up stabilization funds in good times, and ensuring sufficient exchange rate flexibility to facilitate balance of payments adjustment when needed.

4. Inflation targeting. Instructing the central bank to make low inflation the primary but not the sole objective of monetary policy, and giving it operational independence in pursuing its targets.

5. Raising the standard of primary, secondary, and continuing education, and securing cost recovery from students at the university level. While we have emphasized the growth benefits of improving education and the equity benefits of achieving cost recovery from university students, the virtues of improved education are of course much broader than this: in nurturing democracy, civil society, self-realization.

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[12] Nancy Birdsall and Augusto de la Torre (2001) argue that the concern with equity is now widely accepted as a policy objective on a par with faster growth. They develop a 10-point agenda of policies that they argue could be expected to improve equity without sacrificing growth, analogous to the 10 points of the Washington consensus that were supposed to accelerate growth without sacrificing equity. There is significant overlap between their agenda and that laid out above.

It perhaps needs saying explicitly that this is the agenda that we commend given what we know in 2001, but it is not presented as any sort of ultimate truth. For example, we have not commended any form of industrial policy. This is not because of an ideological aversion to active government, but because we are not aware of any convincing evidence that the sort of governments that Latin America has are likely to be capable of improving on the outcome of market forces, while the risks of stimulating rent-seeking behavior are obvious. Evidence might alter our judgment on this issue and persuade us that it would be worthwhile for the government to try and provide the economy with a nervous system. But given what we know now, we believe that government would be more productively employed on seeking to improve the institutional infrastructure of a market economy, including the financial system, so as to help this to function as the nervous system of the economy, as happens in other market economies.

Finally, the agenda is a medium-term one rather than addressed to resolving the short-term crises that seem likely to be again preoccupying the region when it is published. This is deliberate. Latin America will never break out of the crisis syndrome unless it pays more attention to long-term issues, particularly but not exclusively when the good times eventually return.

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