Atlanta Fed Conference on Fiscal Policy in Latin America

ROBERT EISENBEIS

Eisenbeis is senior vice president and director of the Atlanta Fed's research department.

FISCAL POLICY IS AT THE VERY CORE OF THE PROFOUND ECONOMIC TRANSFORMATION UNDER WAY IN LATIN AMERICA. WHILE PRICE STABILIZATION AND LIBERALIZING REFORMS HAVE PLACED REGIONAL ECONOMIES IN A MUCH MORE COMPETITIVE POSITION OVER THE PAST TWO DECADES, THE NEED FOR ADDITIONAL REFORM EFFORTS—SO-CALLED SECOND-generation reforms like those for fiscal policy—is increasingly apparent.

Because sound fiscal policy is key to viable monetary policy and sustainable economic growth, few issues are as critical to the region's economic future. This encompassing relevance is the reason the Federal Reserve Bank of Atlanta chose to sponsor a conference on sustainable public sector finance in Latin America, which took place in Atlanta on November 1 and 2, 1999. While the Federal Reserve's job is the supervision of the U.S. financial sector and the formulation of domestic monetary policy, the reality is that it is no longer possible to think of economic policy—be it monetary policy or supervisory policy—in purely domestic terms. The Federal Reserve's mandate is indeed domestic, but the setting in which that mandate is carried out is increasingly global.

In order to address these broad policy implications, participants in the conference "Sustainable Public Sector Finance in Latin America" were asked to explore the issue from various angles, employing different disciplinary approaches. The multidisciplinary approach allowed participants to examine the wide-ranging nature of fiscal policy. The following overview of the papers and presentations from the conference provides insight into some of these perspectives on several important issues.

The basic policy elements of sustainable public sector finance were explored in a paper by Elizabeth McQuerry, Michael Chriszt, and Stephen Kay of the Atlanta Fed's Research Department. Economic fundamentals and the notion of policy credibility were presented through a review of existing research on fiscal policy and an overview of how Latin American governments have performed in achieving their fiscal policy objectives. The review highlighted a newfound appreciation of the role that institutions play in producing policy outcomes alongside the long-standing consensus about the deleterious impact of prolonged fiscal imbalances. The authors stressed that sustainable public sector finance is neither a purely financial nor institutional/political problem. Rather, the two dimensions of the problem are inextricably intertwined.

The paper by Larry Graham (University of Texas at Austin) presented a framework for thinking about fiscal-reform policies through a comprehensive, historical survey of the different developmental paths found in Argentina, Brazil, Mexico, and

Venezuela. Dr. Graham's analysis argued that an examination of these four distinct political trends, which to varying degrees have been manifested throughout the region, provides critical knowledge not only about the past but about how historical politics and economics in the region influence the path of reform today.

Ben Ross Schneider (Northwestern University) explored why administrative reform has been so problematic in the region. Varying types of administrative reform tend to stimulate different dynamics in terms of the policy process as well as the particular collection of reformers and allies behind the reform. Drawing insight from institutional economics to examine the specific political dynamics of the life cycle of reform—from elections to final implementation—Schneider's analysis has important policy implications for efforts to reform bureaucracies and public services as well as for other types of economic and political reforms.

While price stabilization and liberalizing reforms have placed regional economies in a much more competitive position over the past two decades, the need for so-called second-generation reforms like those for fiscal policy is increasingly apparent.

Juan Carlos Echeverry and Verónica Navas (Colombian National Planning Department) evaluated fiscal policy in Colombia, analyzing public sector net worth using both flow and stock approaches. The authors argued that the feasibility of a particular fiscal package depends on not only a sound economic approach but also the establishment of a new political and judicial approach to the decision-making process that would avoid the type of institutional conflicts that have occurred in some countries. Echeverry and Navas also argued that policy should be directed toward the pursuit of a dynamic equilibrium related to public sector net worth as opposed to explicit debt and deficit targets.

Deficit finance was the subject of a panel featuring remarks by two experienced practitioners of debt management in Latin America. Carlos Boloña, who served as Minister of Economy and Finance in Peru from 1991 to 1993, shared insight from his experiences reining in government expenditure during a very difficult period in the country's economic and political history. His tenure was also the period when Peru effectively came to terms with many public finance concerns.

The discussion by Fábio de Oliveira Barbosa, the Secretary of the Treasury in Brazil, mapped out the debt strategy being pursued by his government. His presentation demonstrated many of the choices facing countries seeking to establish and maintain access to international credit lines as they build domestic credit markets. The Brazilian experience also illustrates how fiscal policy and global economic conditions sometimes work at cross-purposes, presenting policymakers with even larger budgetary challenges.

The final panel featured a discussion of international lending and capital flows by Francisco Gil-Díaz, formerly the vice governor of the Banco de México, and Graham Stock, a vice president with Chase Securities. In his review of capital flows to developing countries, Gil-Díaz asserted that all foreign debt in emerging market economies—whether held by the government or in private hands—is, in essence, a sovereign liability, providing a sobering reminder that the rapid increase in capital flows and international markets has wide-ranging implications.

Graham Stock traced the evolution of international lending in the 1990s from the perspective of both the borrower and the lender, providing insight into capital flows, credit fundamentals, and commercial bank lending. Stock noted that beyond the many changes in capital flows and markets lies a fundamental certainty: credit analysis of emerging market economies is essentially the same as other credit analysis, and countries that meet these criteria will find ready access to international capital markets while those that fail to meet them must resort to much more onerous terms.

The conference also featured two individual speakers. Ann Helwege (Tufts University) shared her research on how Latin American governments have fared with poverty alleviation efforts and outlined the prospects for future efforts in an environment of resource constraints. Helwege noted several improvements in social policies in the region but also warned that privatization and decentralization have thus far done little to improve the region's inequalities. Cláudia Costin provided the keynote address from her first-hand experience with state reform as Brazil's secretary of state for administration and government property. The Brazilian example illustrates many of the multifaceted challenges facing reformers.

The conference also benefited from a knowledgeable and engaged group of participants—encompassing viewpoints from academia, banking, government, and the private sector—who shared their perspectives and first-hand experiences in designing fiscal policy. This depth allowed participants to discuss public sector finance along a broad spectrum during the two-day conference.

At the end of the proceedings, participants were asked to identify the primary areas on which further research on fiscal policy would most fruitfully be focused. Three areas figured prominently in this discussion: (1) the need for greater understanding of the role of institutions in fiscal policy reform, especially in regard to constitutional reform, Congress, and transparency of the policy process; (2) the need for further study and specification of several issues, such as tax reform, income distribution, foreign direct investment, hidden public debt, and pension liabilities, to determine the significance of their role in fiscal policy reform; and (3) the need for a greater understanding of the relationship between fiscal policy and dollarization.