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The Role of Fiscal Policy in Sustainable Stabilization: Evidence from Latin America

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Abstract

This paper reviews the role of fiscal policy in a number of stabilization programs in Latin America since the early 1980s. The paper highlights the importance of sustainable fiscal adjustment in stabilization efforts, and discusses the main issues that arise in this context. By reviewing the Latin American experience, it is argued that responsibility for failed stabilization attempts can be traced to four main factors: inconsistent policy mixes; excessive reliance on temporary factors of improvement in the fiscal accounts; failure to implement fundamental fiscal reforms; and lack of complementary structural reforms.

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Summary

This paper reviews the role of fiscal policy in a number of stabilization programs in Latin America since the early 1980s. The paper highlights the importance of sustainable fiscal adjustment in successful stabilization efforts, and discusses the main issues that arise in ensuring such adjustment—namely, measuring the degree of the existing fiscal disequilibrium; determining the size of the adjustment needed to arrive at a fiscal balance consistent with the macroeconomic objectives of a stabilization program; selecting high-quality and lasting fiscal measures; and correctly sequencing these measures. After reviewing the Latin American experience, it is argued that failed stabilization attempts can be traced to four main factors. First, the adoption of inconsistent policy mixes, such as excessive reliance on heterodox elements, or the use of a nominal exchange rate anchor unsupported by adequate monetary and fiscal restraint, or an imbalance in the fiscal/monetary mix. Second, the excessive reliance on endogenous and temporary factors, for example, fiscal improvements that occur even in the absence of explicit policy measures, but are short lived. Third, the failure to implement fundamental fiscal reforms, and the reliance on quick-fix measures that frequently have adverse allocative implications. And, fourth, a lack of complementary structural reforms, such as privatization, foreign trade liberalization, or a redesign of the system of intergovernmental fiscal relations. The success of some recent stabilization programs in Latin America can be attributed to the fact that progress has been made in all or most of these areas. Electorates in several Latin American countries in recent years have rewarded governments that have introduced durable stabilization plans and have not shied away from the necessary fiscal reforms.

I. Introduction

During the last ten or so years, Latin American countries have carried out a variety of economic programs aimed at stabilizing their economies. Several of these programs have been extensively analyzed in the literature, with focus on the policy mix adopted in the programs, in particular the balance between "orthodox" instruments (in particular monetary and fiscal policies) and "heterodox" ones (i.e., direct government intervention in the wage and price formation processes). So far, relatively less attention has been paid to the specific content of the fiscal component of stabilization programs in Latin America. To be sure, a number of studies have emphasized the importance of credibility and sustainability of the fiscal measures adopted in these programs. There have been, however, few attempts at analyzing the impact that the nature and quality of fiscal adjustment have had on the success or failure of the programs.

This paper attempts a more systematic review of the role of fiscal policy in a broad range of stabilization programs in Latin America since the early 1980s. In section II, the theoretical rationale is set out for the view that not only the degree of fiscal adjustment, but also its nature and composition are important for lasting success of the stabilization effort. In section III, experiences of a number of Latin American countries are used to illustrate the theoretical agreement.

II. Why do Nature and Quality of Fiscal Adjustment Matter?

There exists a broad consensus in the literature—and, increasingly also among economic policy makers in Latin America—that effective macroeconomic stabilization cannot rely primarily on wage and price interventions, as was once claimed by proponents of an extreme version of the inertial theory of inflation. Undoubtedly, this consensus has been shaped by the experiences of numerous failed stabilization attempts that were implemented in Latin America during the 1980s, and that relied predominantly on "deindexing" the economy through temporary wage and price freezes. It is now generally recognized that effective stabilization requires a core of "orthodox" policies, aimed at reducing domestic demand to levels consistent with available supply, and that heterodox policy elements (such as deindexing wages and contracts) can best play a supporting role to orthodox policies, mainly in countries with a persistent record of high inflation.

Views differ on whether stabilization programs should use as a nominal anchor the exchange rate or a monetary target. The answer to this question depends, inter alia, on the availability of foreign exchange reserves (or foreign financing) to back a fixed exchange rate, on the stability (or lack thereof) of the demand for money, and on the history of past stabilization efforts that may influence the credibility of one or the other approach.

It is generally acknowledged that fiscal adjustment plays a key role in both exchange rate-based and money-based disinflation efforts. Proponents of what Montiel (1989) called the "fiscal view of inflation," see large and prolonged fiscal deficits, that lead to excessive

monetary expansion, as the root cause of high inflation. In this framework, clearly, a substantial reduction of the size of the fiscal deficit is a *sine qua non* for successful disinflation. However, even under an alternative analytical framework (which Montiel called the "balance of payments view of inflation," and which views inflation as being driven mainly by balance of payments disequilibria leading to exchange rate depreciation) reducing fiscal imbalances can be viewed as necessary to reduce inflation. By reducing domestic demand, a fiscal contraction improves the current account of the balance of payments; moreover, by strengthening confidence in government economic policies, it may also help arrest or reverse capital outflows.

While the need for fiscal adjustment in stabilization and disinflation programs can thus be considered part of "received wisdom," it is somewhat surprising that the literature generally does not dwell on the desirable characteristics of such an adjustment. Notable exceptions in this respect are papers by Tanzi (1990), and, more recently, Perry and Herrera (1994), and Edwards (1996). As noted by Tanzi (1990), four main issues need to be addressed in designing the fiscal component of a stabilization program: (i) measuring the extent of the existing fiscal disequilibrium; (ii) determining the size of the fiscal adjustment needed; (iii) selecting appropriate high-quality fiscal adjustment measures; and, finally, (iv) sequencing correctly the implementation of the selected measures. Each of these tasks is fraught, of course, with considerable difficulties.

Measuring the degree of an existing fiscal disequilibrium is often made difficult by shortcomings in the quality and comprehensiveness of available fiscal data, due to incomplete coverage (e.g., of the operations of decentralized agencies, extrabudgetary funds, or the subnational governments), long delays in reporting by spending units, lack of information on spending commitments and arrears, or the existence of extensive quasi-fiscal operations. Also, in measuring the fiscal deficit under conditions of high inflation, there arise additional conceptual and practical issues.[2]

Determining the size of the fiscal adjustment needed to arrive at a fiscal balance that is consistent with the macroeconomic objectives of a stabilization program would require, in principle, the use of a full-fledged econometric model. At a minimum, it requires informed judgments on certain key macroeconomic variables, such as the demand for money consistent with the inflation and output targets.

A major difficulty in assessing the size of the required fiscal adjustment is to distinguish exogenous from endogenous factors, and temporary from lasting changes in the fiscal balance. It is a well-known fact that stabilization programs—even programs that are primarily or solely based on heterodox policies and do not have an explicit fiscal adjustment component—may, initially, have important positive effects on the fiscal balance. These so-called **endogenous fiscal effects** are summarized in Table 1.

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[2]See, for example, Blejer and Cheasty (1988).

Table 1. Endogenous Fiscal Responses in Stabilization Programs and Main Variables That Determine Their Size 1/

Type of Endogenous Fiscal Response	Variables that Determine the Size of the Endogenous Fiscal Response
Endogenous responses that improve the overall fiscal balance	
• *Reverse Tanzi effect:* a decline in inflation tends to affect positively the ratio of tax revenue to GDP.	The reverse Tanzi effect will be larger the stronger the decline in inflation, the lower the frequency of tax collections, and the greater the share of taxes that are less frequently collected or have long collection lags.
• *A devaluation of the nominal exchange rate* at the outset of a stabilization program increases revenue from taxes on foreign trade. This effect is reversed if the real exchange rate appreciates as stabilization proceeds. In addition, the devaluation would increase the domestic currency value of foreign currency-denominated credits of the public sector vis-à-vis the private sector. It would also increase the domestic currency value of the return on foreign exchange reserves of the central bank, and therefore the transfer of profits of the latter to the budget.	The first effect will be stronger the larger the devaluation of the nominal exchange rate, and the higher the share of foreign trade taxes in total revenue. The strength of the others will reflect the size of foreign currency credits of the public sector and of the foreign exchange reserves.
• In the initial phase of an exchange-rate based stabilization, the decline in inflation may lead to a *consumption boom,* through the real wealth effect and, in some cases, through a shift in the income distribution in favor of groups with a higher marginal propensity to consume. To the extent that revenue depends on consumption-based taxes, the tax revenue to GDP ratio will increase during the boom period.	The effect will be stronger the faster the growth of consumption relative to the growth of GDP, and the larger the share of consumption taxes in total revenue.
• An *appreciation of the real exchange rate* in stabilization programs (particularly in programs based on a fixed nominal exchange rate) reduces the real domestic currency value of *interest payments on foreign currency-denominated debt.*	The effect will be stronger the larger the foreign currency denominated debt, and the greater the real appreciation.
• A reduction in inflation leads to lower nominal domestic interest rates and, hence, *interest payments* on the stock of domestic currency-denominated debt outstanding. This, in turn, reduces the overall (but not the operational) fiscal deficit.	The effect will be stronger the larger the stock of domestic currency debt outstanding, and the greater the decline in inflation.
Endogenous responses that worsen the overall fiscal balance	
• *A devaluation of the nominal exchange rate* at the outset of a stabilization program increases the local currency equivalent of *external public debt service* payments and other expenditure denominated in foreign currencies. The effect is reversed if the real exchange rate appreciates as stabilization proceeds.	This effect is stronger the larger the foreign currency-denominated public debt and other foreign currency expenditures, and the greater the devaluation.
• The maintenance of a *backward-looking indexation* of wages, salaries, and social benefits, as inflation rates decline under a stabilization program, increases real government expenditures (and the expenditure to GDP ratio). Of course, the reverse is true for forward-looking indexation.	This effect depends on the extent to which wages, salaries, and social benefits continue to be indexed; the weight of indexed expenditures in the budget; and the extent of the decline in inflation.
• An *appreciation of the real exchange rate* during the course of an exchange-rate-based stabilization program reduces the real domestic currency value of revenue from foreign trade taxes.	This effect is stronger the larger the size of the real depreciation, and the larger the share of foreign trade taxes in total revenue.
Endogenous responses with ambiguous effects on overall fiscal balance	
• Changes in *inflation tax revenue*	Inflation tax revenue is maximized where money demand is unit elastic. Usually, inflation tax revenue increases up to relatively high levels of inflation, but eventually collapses when a country moves into hyperinflation (or becomes effectively "dollarized"). Hence, a stabilization program may or may not reduce inflation tax revenue depending on when during the inflationary process a stabilization is carried out, and the extent of stabilization.

1/ "Ceteris paribus" assumptions are considered to hold. Some effects may differ when these assumptions are relaxed, for example, when the trade balance changes significantly in response to exchange rate adjustments.

The strength of these endogenous effects on the government's budget will of course vary from country to country, depending on the characteristics of the latter, and on the types of stabilization policies implemented. While some combinations of the two are likely to result in strong endogenous effects (such as a large exchange rate devaluation in a country that relies heavily on taxes on foreign trade), it is very difficult to know *ex ante* the duration and strength of such endogenous fiscal effects. For example, while an increase in tax revenue due to the reverse Tanzi effect may be considered permanent (as long as inflation stays down), it is more difficult to predict accurately when a consumption boom will end, or when a real exchange rate appreciation will be halted or reversed. Uncertainties about the duration and strength of fiscal improvements resulting from such endogenous factors are, in turn, likely to affect adversely the credibility of a disinflation program, and may contribute to the emergence of self-fulfilling expectations of their reversal. These adverse credibility effects are likely to be stronger the more heavily a disinflation program relies on endogenous policy elements.

There is now growing consensus in the literature that successful stabilization requires **high-quality fiscal adjustment**, meaning that not only the extent but also the nature and composition of fiscal adjustment matter. There are at least two broad sets of reasons for this.

First, a reduction of the fiscal deficit can have different effects on aggregate demand and supply, depending on the nature of the specific adjustment measures taken. Clearly, increases in different taxes and/or reductions in different categories of public expenditures affect differently the various components of aggregate demand, the incentives to work, save and invest, and thereby, over time, the growth potential of an economy.

Second, fiscal policy packages of the same magnitude can differ profoundly in their sustainability, and in the perception thereof by economic agents, and can therefore have different effects on expectations and market behavior. Specifically, fiscal measures that are—and are viewed by economic agents, both within and outside the country—as politically feasible, socially balanced, and of a lasting nature, are likely to carry greater credibility—and to affect appropriately market behavior—than measures which, because of their temporary character or their lack of political viability, can be expected to be reversed soon.

There is, of course, a good deal of variability from country to country in what makes a fiscal policy package to be of high quality and sustainable. An assessment of the political and social viability, as well as of the administrative feasibility, of specific fiscal measures needs to take into account the circumstances of each individual country at a particular point in time. For example, even a sound and well-balanced package of structural fiscal adjustment measures may not be feasible or credible if it is introduced during the last months of the expected tenure of a government, unless it is endorsed by the likely successor government.

Nevertheless, some broad generalizations on high quality fiscal measures can be drawn from a range of country experiences. As concerns **tax policies**, it is widely recognized that sustainable and high quality reforms are those that aim at simplifying the tax system by

eliminating relatively low-yielding taxes; broadening the tax base, while streamlining the rate structure and reducing high marginal tax rates; and at establishing a level playing field, by curtailing special treatments and incentives, and thereby reducing the scope for tax planning and avoidance. In the area of **tax administration**, reform efforts need to focus on promoting taxpayer compliance through strengthened procedures for monitoring, detecting and reacting to noncompliance, including the establishment of tough but credible penalties. These broad tenets of policy and administration have been reflected to some extent in tax reforms worldwide—which have included the introduction of the VAT in a large number of countries and reductions in the top marginal rates of most income taxes—and in ongoing efforts to strengthen and modernize tax administrations. Often, however, resistance by organized interest groups and a misplaced confidence in the effectiveness of tax incentives, have constrained progress.

On **public expenditure policy reform**, there is also a consensus, at least in theory, that it is desirable to eliminate or phase out unproductive expenditures (such as "white elephant" investment projects or excessive military expenditures); make adequate provision for operation and maintenance expenditures; replace generalized price subsidies with targeted income support to the poorest and most vulnerable segments of the population; give priority, in the allocation of scarce resources for health and education, to basic/preventive health services and primary education; and reduce the overstaffing of civil services, while promoting their productivity and professionalism. Unfortunately, this consensus does not always translate into concrete policy actions, also because of resistance by powerful interest groups that would be adversely affected by these reforms.

Frequently, achieving high quality and sustainable fiscal adjustment requires wide-ranging **institutional and structural reforms**. Although they are unlikely to yield short-term budgetary savings, such stabilization-enhancing structural reforms are of crucial importance to improve the longer-term outlook for public finances, and may include, inter alia:

• privatizing state enterprises and certain services traditionally provided by the government;

• reforming the social security systems, including health care and pensions, in order to improve their long-term viability;

• overhauling public expenditure management systems in order to improve the choice of expenditure priorities, the control and supervision of expenditure execution, and the ex-post evaluation of the cost-effectiveness of spending programs; and

• strengthening the system of intergovernmental fiscal relations, which, especially in federal countries, is important to ensure that ongoing decentralization efforts do not weaken macroeconomic management or worsen distributional equity;

• implementing banking sector reforms, including through a strengthening of bank supervision, also to reduce the fiscal costs associated with rescue operations for private and public financial institutions.

In general, stabilization programs that do not undertake to address these problems are likely to carry limited credibility. Still, many stabilization programs, including those implemented in Latin America, have tended to rely more on "quick fixes" (i.e., measures that are easily implementable and relatively less costly politically, albeit frequently nondurable and distortive), than on the high-quality measures discussed above. A nonexhaustive list of such quick-fix fiscal policy measures would include (Tanzi, 1990):

• emergency tax measures, including the introduction of temporary surcharges (e.g., on import duties, consumption taxes, or income taxes) or distortionary taxes (e.g., taxes on exports, or on financial transactions);

• incentives to prepay future tax liabilities, which tend to boost current revenues at the expense of future ones;

• tax amnesties, which weaken incentives for future tax compliance, particularly if used repeatedly;

• forced savings schemes and/or forced conversions of public debt instruments;

• across-the-board cuts in non-entitlement spending programs;

• suspensions of investment projects underway, and reductions in operation and maintenance expenditures on completed investments;

• delays in civil service wage adjustments, to compress real wages of civil servants;

• forced unpaid "administrative" leave for government employees;

• accumulation of payment arrears, including to suppliers, civil service salaries, or social security contributions;

• postponement of interest payments on public debt through financial engineering operations;

• reliance on quasi-fiscal operations of the central bank or of state-owned financial institutions, in order to "park" the fiscal deficit outside the government's budget;

• use of nonfinancial public enterprises for quasi-fiscal purposes (e.g., by levying extraordinary taxes on their profits, allowing their decapitalization, or preventing them from adjusting their workforce as needed).

Frequently, stabilization requires policymakers to confront complex issues of **sequencing fiscal adjustment measures**. Short-term macroeconomic and financial considerations often argue for giving priority, in timing and effort, to measures that can be expected to yield budgetary savings quickly. Political considerations, often related to preserving the limited political capital and goodwill enjoyed by elected governments in representative democracies, also often argue in the same direction. As a result, structural reform measures, that are frequently politically controversial and often have less immediate (albeit more lasting) economic effects, are often postponed, and, when finally implemented, may not begin to produce benefits until it is too late for them to sustain an ongoing stabilization effort.

III. SELECTED EXPERIENCES IN LATIN AMERICAN STABILIZATION PROGRAMS

A comprehensive and detailed review of the fiscal adjustment components in the many stabilization efforts undertaken by Latin American countries in the 1980s and early 1990s is beyond the scope of this paper. Nevertheless, an analysis of salient successful and failed stabilization attempts in Latin America during that period may help illustrate the considerations put forward in section II above.

A first observation that can be made on the basis of a broad-brush review of stabilization efforts throughout Latin America, is that the quality and sustainability of stabilization programs seems to have improved in recent years. Lasting success in stabilization and disinflation during the 1980s was, by and large, more the exception than the rule. Chile in the 1980s, Bolivia (with the *New Economic Policy Program* of 1985), and Mexico (with the *Solidarity Pact* of 1987) constituted the main examples of successful stabilization. By contrast, the histories of Argentina, Brazil, Peru and, to a lesser extent, Uruguay and Venezuela during the 1980s, show a succession—in some instances at an accelerating pace—of attempts at stabilizing their economies, with shorter and shorter success records. In Argentina alone one can identify at least 15 such stabilization programs between mid–1985 and the end of 1990. In Brazil, there were at least 9 major and minor stabilization attempts between the beginning of 1986 (the *Cruzado Plan*) and 1991 (the *Collor II Plan*). In the more recent past, however, these countries have implemented more comprehensive and sustainable stabilization programs.

While the short-lived stabilization efforts of the 1980s obviously differed in a number of specific characteristics, they also exhibited certain common traits. Their foremost common characteristic is perhaps the fact that they all failed to signal convincingly a fundamental change of the economic policy regime, and therefore lacked credibility. This lack of credibility can, in turn, be viewed as a reflection of a number of factors:

• **inconsistent policy mixes**, like excessive reliance on heterodox policies, especially repeated and increasingly ineffective price and wage freezes; or the use of a fixed nominal exchange rate anchor unsupported by adequate monetary and fiscal restraint; or an imbalance in the

fiscal/monetary mix, resulting in very high levels of real interest rates, speculative capital inflows, and excessive real appreciations of the exchange rate;

• excessive **reliance on endogenous factors**, which failed to provide a lasting improvement of the fiscal balance;

• **failure to implement fundamental fiscal reforms**, and sole or main reliance on revenue and expenditure measures of a quick-fix type;

• **lack of needed complementary structural reforms**.

Each of these points can be illustrated with a few country examples. More or less **inconsistent policy mixes** plagued many stabilization programs in Latin America during the eighties. The extent and the timing of the consequences of such imbalances for the stabilization performance has varied depending on the severity of the imbalance. Stabilization attempts like Brazil's *Cruzado Plan* or Peru's *Inti Plan*, both in the mid–1980s, which did not support heterodox policies with financial and fiscal restraint, had only a short-lived success. By contrast, programs like Mexico's *Solidarity Pact*, Argentina's *Convertibility Law*, or Brazil's *Real Plan*, which combined incomes policies with fiscal and monetary tightening, succeeded in securing more lasting disinflation.

Based on the hypothesis that inflation was largely inertial, many of the earlier Latin American stabilization programs experimented with temporary prize/wage freezes that were thought to break inflationary expectations. Indeed, some stabilization programs boiled down to little more than a temporary freeze.[3] While the effectiveness of freezes in stabilizing prices in the short run explains their recurrent use, they became increasingly ineffective, and, particularly in countries with a history of repeated freezes such as Brazil or Argentina, the very hint or expectation of a new freeze encouraged private sector firms to increase prices preemptively. In addition, once the freeze went into effect, popular expectations that it would soon have to be lifted, and a new bout of inflation would follow, resulted in further delays of tax payments.

The importance of supporting a nominal anchor, like a fixed exchange rate, with adequate monetary and fiscal restraint, in order to achieve a consistent policy mix, can be illustrated, for example, by contrasting Argentina's failed attempts at fixing the rate in some of its stabilization programs during the 1980s with the success to date of the *Convertibility Law*. A nominal exchange rate anchor can generally be maintained for a short period, particularly when prices and wages are frozen. However, Argentina's experience in the 1980s shows that a nominal anchor unsupported by appropriate financial policies tends to quickly lose

[3]For example, in the words of Rodriguez (1988), Argentina's *Austral Plan* "was (i) a price, wage, and exchange rate freeze; (ii) a promise of no issuing of money to finance the treasury; and (iii) a promise of fiscal restraint. Of those three points only the freeze was fulfilled, although partially."

credibility, thereby jeopardizing the sustainability of stabilization. In contrast to earlier stabilization attempts, the *Convertibility Law* was backed by substantial financial, fiscal, and structural reforms. Also, the Argentine government demonstrated that it was prepared, in the wake of speculative attacks on the currency, to take prompt fiscal measures—as it did in March 1995, shortly before the presidential elections. These policies were essential for ensuring the success to date of the nominal exchange rate anchor, the key element of the *Convertibility Law*.

Still, there are numerous examples of imbalances in the fiscal/monetary policy mix, even in programs with a relatively long record of success. Brazil's recent experience under the *Real Plan* falls in this category, as an initial improvement in the fiscal position in 1994 was reversed in 1995 through excessive wage increases of civil servants and overspending by state and local governments. Even today, after three years of successful stabilization, further fiscal adjustment and the early implementation of structural fiscal reforms would help strengthen the credibility of the *Real Plan* and secure its durability over the longer term.

Excessive reliance on endogenous factors has been another problem that has beset stabilization programs in a number of Latin American countries. In many cases, fiscal balances showed marked improvements in the early phases of stabilization programs, largely reflecting endogenous factors (see Table 2), like the reverse Tanzi effect or disinflation-induced consumption booms. Usually, these improvements were short lived. The reverse Tanzi effect, for example, played a substantial role in stabilization programs in, among others, Argentina, Bolivia, and Chile, as well as in the initial phase of the Brazil's *Cruzado Plan*. Disinflation-induced consumption booms boosted revenues in the early stages of stabilization programs in Brazil (the *Cruzado Plan* and also the *Real Plan*), Mexico, and Uruguay. In the case of the latter, it is estimated that, during 1991–93, the cyclically adjusted budget deficit exceeded the actual deficit by a cumulative 9 percentage points of GDP[4] (Talvi, 1995). The reversal of these temporary factors (as the economies moved into recessions or the exchange rate weakened) exposed the fragility of the fiscal improvement.

Another shortcoming of many Latin American stabilization programs has been a **failure to implement fundamental fiscal reforms** and their reliance on revenue and expenditure measures of a quick-fix type. For example, Argentina during most of the 1980s, Chile during 1984–87, and Colombia during 1985–88 all made extensive use of foreign trade taxes, despite their well known allocative shortcomings. In some cases, reliance on the quick fixes was in stark contrast to the declared general policy objectives. For example, Argentina's 1985 *Austral Plan* raised export taxes, notwithstanding the declared policy objective of fostering export-led growth. Some countries used multiple exchange rates as an implicit form of export taxation. Such distortive policies, once in effect, are difficult to change: for example, in 1989,

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[4]This includes also the positive impact on the budget balance of the real appreciation of the currency during that period.

export taxes still amounted to over 1.5 percent of GDP in Argentina, before being eliminated in the context of the *Convertibility Law* plan.

Another popular quick-fix stabilization measure has been the use of taxes on financial and exchange transactions, which tend to increase financial disintermediation. For example, especially during the 1980s, Argentina and Brazil, repeatedly resorted to taxes on financial transactions, because of their relative ease of collection and also made significant use of forced savings schemes, forced conversions of public debt instruments, and outright freezes of financial assets. To some extent, the cost of such schemes in terms of public confidence still manifests itself today in the relatively high real rates of interest demanded by financial asset holders, especially in Brazil.

Similarly, public sector price adjustments were frequently viewed as a quick-fix remedy in stabilization programs. Frequently, governments had failed to adjust some public sector prices (for example, public transportation or household energy tariffs) in line with inflation or cost developments. Many stabilization programs relied heavily on adjusting public sector prices to reduce enterprise subsidies or to halt full decapitalization of these enterprises. Bringing public sector prices closer in line with cost often required rather large adjustments. Instead of implementing systematic adjustments of public sector prices to costs, these adjustments were, in many instances, implemented haphazardly in large steps, after which prices were kept constant and left again to erode in real terms. In some stabilization programs, particularly in the 1980s, public sector price adjustments were decreed along with, or immediately prior to, a general price freeze. However, these adjustments fed into prices of other sectors, thereby increasing cost pressures on prices and contributing to the demise of the price freeze. Public sector price adjustments were often implemented in a way that magnified their adverse impact on inflationary expectations, wage claims, and, in some cases (for example, Venezuela in 1989), even led to social unrest.

Up to very recently, the tax system of many Latin American countries resembled Heymann's (1991) description of the Argentine tax system of the late 1980s: "the general picture is that of a system without clear design, with complicated legislation that is not enforced, which cannot collect broad-based taxes and has to rely on a diversity of rather primitive taxes." Some of the more successful stabilization programs made remarkable progress precisely in reforming tax policies and strengthening tax administration. The Bolivian program of 1985, for example, replaced a complicated and ineffective system of over 450 different taxes, levied mainly on income, with a streamlined system of nine taxes, levied mainly on consumption and wealth. Substantial tax reforms were also part of the Mexico program of 1987 and of the more recent stabilization programs in Argentina (1991) and Peru (1990). The Mexico program included reductions in tax rates (especially import tariffs and income taxes), together with steps to broaden the tax base and to strengthen enforcement. In the context of Argentina's *Convertibility Law* of 1991, about 20 distortionary taxes were abolished, including some taxes on exports and on financial assets, and many exemptions and incentive schemes were curtailed; at the same time, a substantial effort was launched to strengthen tax administration. Peru's *Fujimori Plan* of 1990 included major reforms both in tax policy (with

Table 2. Estimated Size of Some Endogenous Fiscal Effects in Various Stabilization Programs

Country and Period	Reference	Endogenous Responses Considered	Major Results
Uruguay following the December 1990 stabilization program	Talvi (1995)	Cyclically adjusted overall budget balance, i.e., the balance without the temporary effects generated by the stabilization program.	Cyclically adjusted overall budget balance during 1991–93 was, respectively, 1.2, 3.7, and 4.1 percent of GDP worse than the unadjusted balance. In 1991, for example, the unadjusted overall budget deficit was 0.9 percent of GDP, whereas the cyclically adjusted overall budget balance was estimated at a deficit of 2.1 percent of GDP.
Argentina during 1978–85 before the Austral I stabilization plan	Kiguel and Neumeyer (1989)	Inflation tax revenue	Empirical evidence suggests that inflation tax revenue is maximized at a monthly inflation rate of about 20 percent and falls unambiguously if monthly inflation rates exceed 22 percent. At its maximum level, inflation tax revenue amounts to about 7.5 percent of GDP. Any serious stabilization effort requires an alternative source of revenue to replace such a large inflation tax revenue.
Argentina and Brazil in the early-mid 1980s	Dornbusch and Simonsen (1987)	Tanzi effect and other elements that cause budget deficit to be high because of inflation	Stabilization automatically reduced budget deficits. The Tanzi effect alone accounted for 1–2 percent of GDP in revenue lost; this revenue was regained automatically during stabilization.
Argentina during 1985–87 under the Austral plan	Machinea and Fanelli (1988)	Tanzi effect	Before the Austral plan, revenue losses on account of the Tanzi effect amounted to about 2.5 percent of GDP. When the Austral plan was in effect, these losses dropped to 0.5 percent of GDP.
Argentina under the Austral plan during June 1985–March 1996	Canavese and Di Tella (1988)	Reverse Tanzi effect	Revenue increased from 23 to 28 percent of GDP; almost 4 percentage points of this increase was due to the fact that real taxes were no longer eroded by inflation.
Argentina under the Austral plan	Kiguel (1991)	Transitory versus permanent effects	The budget deficit was cut from 11.7 percent of GDP in the first quarter of 1985 to 2.3 percent of GDP in the third quarter, largely due to changes in tax revenue. This increase in tax revenue was due to four main elements, increases in trade taxes, higher public sector prices, the introduction of a forced savings scheme, and improvements in tax collections resulting from the reduction in inflation (reverse Tanzi effect). The latter two effects were transitory.
Bolivia during 1983–85 before introducing the stabilization plan	Kiguel and Liviatan (1995)	Tanzi effect and inflation tax revenue	Government revenue fell from around 85 percent of expenditure in 1980 to around 50 percent during 1983–85, and coincided with the rise in inflation, which suggests the presence of an extreme form of the Tanzi effect. While inflation tax revenue increased up to 1984, when it reached a level of over 15 percent of GDP, it dropped during the hyperinflation of 1985, and continued to drop further during the ensuing stabilization program.
Argentina, Brazil, and Peru during 1989–90	Kiguel and Liviatan (1995)	Inflation tax revenue	In Argentina and Brazil, inflation tax revenue increased (rather than fall) in response to the onset of hyperinflation; hence, an extreme form of the Tanzi effect was not present. In Peru, the hyperinflation outburst of 1990 was preceded by a large increase in inflation tax revenue; however during much of the period leading up the hyperinflation, which was characterized by high but relatively stable inflation, inflation tax revenue was decreasing.
Nicaragua in the second half of the 1980s	Saborio (1990)	Tanzi effect	Tax revenues plummeted by about 18 percent of GDP during the second half of the 1980s, largely as a result of the Tanzi effect.
Chile during 1950–82	Larraín and Meller (1991)	Tanzi effect	Tanzi effect helps to explain the low level of tax revenue during 1970–83; in particular, regression estimates for 1950–82 suggest that a 10 percent rise in inflation increased the overall fiscal deficit by 1.2 percentage points of GDP.

a drastic simplification of the tax system and reductions of exemptions, as well as the introduction of some emergency taxes), and in tax administration. A significant beginning in needed tax reforms has also been made recently in Brazil, with a streamlining of personal and corporate income taxes, and with proposals to replace the narrowly-based federal level VAT (the IPI) with one levied on the same broad base as the state-level VAT (the ICMS).

The public expenditure systems of many Latin American countries were also plagued by severe shortcomings. Again, Heymann's (1991) description of Argentina in the late 1980s can serve as a good illustration of a fairly generalized problem throughout the region: "expenditure allocations depended more on the amount of pressure that various groups could exert than on considerations of economic performance or overall equity," and since the budget "was always approved late in the year, it validated actions that had already been taken." Also, expenditure management systems were frequently weak, and, as a result, expenditure controls remained fairly ineffective.

Within this context, it is not surprising that many of the earlier stabilization programs in the 1980s either did not pay much attention to expenditure reform or relied on rather crude policy measures that amounted to little more than "cuts without adjustment." Hausmann's (1990) description of expenditure policy reforms in Venezuela in the mid–1980s seems applicable to many Latin American stabilization programs of the time: "no strategic criteria were established to redirect spending: cuts were made in those areas where they were easy to achieve." Usually, the initial brunt of expenditure cuts fell on public investments, and on operation and maintenance spending, as expenditures on wages and entitlement programs (such as social security payments and transfers to subnational levels of government) were relatively inflexible in the short run. However, in several cases, when fiscal adjustment needs were especially large, governments resorted to more drastic but equally short lived measures, such as freezes in civil servants wages and in public sector hiring. In a few instances, they even ran up payment arrears for wages, pensions, or interest on the public debt. For example, the issuing of recognition bonds (Bocones) in Argentina, which, during 1991–95 totaled Arg$20.5 billion (or 8 about percent of the country's 1993 GDP),[5] was a legacy of an era when running up payment arrears to pensioners and suppliers was used extensively as a fiscal policy tool.

Expenditure management during stabilization often took the form of cash rationing, based on revenue availability. Use of cash limit characterized also some of the more successful stabilization programs, such as the Bolivian plan of 1985 and the more recent programs in Argentina and Peru. Cash limits can be an effective instrument of spending control when they are part of a realistic government financial plan, including the planning and timely monitoring of spending commitments. Over the last several years, a number of Latin American countries have made substantial progress in strengthening financial control over expenditures, particularly of the central government. For example, already in 1986, Brazil implemented a

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[5]See Teijeiro (1996). The Bocones were issued with 15 years maturity, 6 years grace period and at the LIBOR interest rate.

major reform and modernization of the central government financial management information system. Similar systems have been, or are being, set up in a number of other Latin American countries in recent years. Most of these systems, however, so far do not cover adequately the operations of decentralized agencies, and especially of the subnational levels of government. Moreover, these systems are primarily geared toward financial control. More limited progress has been made to date in strengthening other aspects of public expenditure management, including budgeting techniques and ex-post evaluation of the quality and cost-effectiveness of public expenditures (value-for-money analysis).

The evidence on the distributional impact of successful stabilization programs in Latin America to date is mixed. A number of studies have suggested that the distributional impact of expenditure policies adopted in the context of stabilization programs has often been negative.[6] However, it is also clear that the lower income groups tend to be the ones most adversely affected by high inflation (Amadeo, 1995): backward looking indexation does little to protect their wages when inflation is rising; they frequently do not hold indexed financial assets; high real interest rates imply a major redistribution of wealth from the government to its creditors (who tend to be in the middle to higher income brackets). On the other hand, it is also true that the impact of budgetary cuts, necessitated by stabilization efforts, has often fallen sharply on social spending. Pressures from powerful interest groups and the lack of political clout of the poor have often prevented expenditure reforms that would be more likely to benefit the poor, such as redirecting health and education expenditures toward basic/preventive health care and primary education, and improving the targeting of social safety nets.

These expenditure allocation problems continue to beset stabilization programs, and more generally expenditure policies. For example, in the context of Mexico's recent *PARAUSEE* stabilization program, an important initial priority was to provide significant budgetary support to bank debtors (mostly for mortgage and credit card debt), also to prevent large-scale debtor defaults from adding to the severity of the banking crisis. Only in a second step the Mexican government started to reform its social safety nets, for example by transforming generalized transfers to all households into transfers targeted to the poor. Securing substantial improvements in the income distribution without endangering macroeconomic stability remains a major challenge throughout Latin America in the years ahead.

Finally, some of the early stabilization programs in Latin America were characterized by a **lack of complementary structural reforms**. For example, while privatization was often talked about in the 1980s, it usually remained nothing but a promise; none of the unsuccessful Argentine stabilization attempts of the 1980s even envisaged privatizing state enterprises to the extent that it was carried out in the context of the *Convertibility Law* a few years later. By contrast, in the last several years, a number of Latin American countries have made substantial progress in structural reform. Argentina, Bolivia, Chile, Mexico, and Peru have made major strides in restructuring and privatizing state enterprises, thus reducing their drain on the

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[6]See, for example, Altimir (1994); Cardoso and Helwege (1991), and Morley (1992).

budget and improving the overall efficiency of the economy. Similarly, major social security reforms have been already implemented in Chile and Argentina, and are currently underway in other Latin American countries. These reforms entail substantial short term cost to the budget but will have major beneficial effects in the longer run. Available evidence already suggests that, in general, those Latin American countries that implemented deeper structural reforms experienced greater reductions in macroeconomic volatility than did countries in which reforms were less pronounced (Gavin, 1997 and Lora, 1997).[7]

Still, it seems fair to say that the structural reform agenda in areas related to the public finances remains large for most Latin American countries. Major items in this agenda are: (i) continuing progress in restructuring and privatizing public enterprises, including public banks; (ii) continuing the reform of social security systems, to ensure their financial viability over the long term with moderate payroll tax rates; (iii) advancing with civil service reform to improve government efficiency; and (iv) undertaking, especially in federal states, major reforms of the system of intergovernmental fiscal relations. While these reforms are unlikely to lead to quick improvements in the fiscal balance—indeed some, like the restructuring of state enterprises and banks, civil service reforms, or pension reforms are usually costly, also because they bring into the open hidden liabilities—failure to carry them out would likely undermine, over the longer term, hard-won gains in fiscal adjustment.

Political economy considerations suggest that conditions for wide-ranging structural reforms are probably better today than during the 1980s. First, Latin America's fledgling democracies of ten years ago have gained strength and credibility. Second, despite setbacks in the wake of the Mexico crisis, most countries in Latin America have experienced some years of significant economic growth, and, helped by lower international interest rates, have substantially reduced their external debt burden. Most importantly, after prolonged high inflation, a political and social constituency has emerged for low inflation and financial stability. Electorates in several major Latin American countries have rewarded governments that introduced durable stabilization plans and did not shy away from the fiscal reforms necessary to make stabilization policies stick. Finally, Latin America, through trade and financial sector reforms, is becoming more and more closely integrated in the global economy. Its economic policymakers, and its citizens are becoming increasingly aware that structural reforms— although inevitably involving losses for various, often powerful, interest groups—are necessary to enable their countries to fully exploit the potential gains from globalization.

All these considerations give cause for cautious optimism that the progress made in recent years by most Latin American countries in stabilization will not be lost, that the maintenance of low rates of inflation will go hand in hand with strong and balanced economic growth, and that governments will persevere with, and expand the scope of, reforms of the public finances.

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[7]Still, at least in the short run, there may not necessarily exist a causal link between structural reform and volatility, as more progress on structural reforms may just indicate a government's greater ability and resolve to carry out its overall reform agenda.

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Appendix Table 1. Overview on Policy Components of Selected Stabilization Plans in Latin America

Country Name of plan Date launched	Fiscal policy content	Structural policy content	Income policy, exchange rate policy, monetary policy, and others
Argentina Austral I June 1985	Promised fiscal restraint and to use only "genuine resources" to finance the budget deficit rather than issuing money. Improvements in the fiscal accounts were to result from revenue measures; no significant changes in government expenditure were planned. The four main revenue elements were increases in trade taxes (which increased the prevailing anti-export bias); higher public sector prices; improvements in tax collection resulting from the reduction in inflation (reverse Tanzi effect); and a temporary forced savings scheme (essentially a disguised tax). In this context, US$ deposits were announced to be frozen (initially for 120 days), and companies and individuals who paid taxes on profits, capital, and inheritances, had to deposit with the treasury in advance the equivalent of 30-40 percent of their 1984 net worth and income tax payments in return for interest bearing forced savings certificates. There were various measures to control spending, but the government was unable to sustain these measures. Contrary to the initial announcement to keep US$ deposits frozen for 120 days, the first relaxation came in August 1995, when deposits under US$1,500 were freed; in September 1995, deposits of up to US$8,500 were released.	Implemented a public sector recruitment freeze, and a freeze on filling vacancies; no attempt was made to overhaul the tax structure and to strengthen the tax collection system. As a late addition to the plan, in November 1996, it was proposed to overhaul the central administration. This included plans to reduce central government staffing levels by 20 percent over 3 years (mostly through voluntary retirement), proposals for a unified salary structure across different ministries, and a minimum requirement for government workers to be present at their workplace 35 hours per week.	Introduced a new currency (the Austral) fixed to the US$ at, initially, A1=US$0.80, and announced a freeing of the exchange market; the fixed exchange rate had to be devalued when it could no longer be sustained. Prices were frozen at the levels prevailing on June 13; private-sector wages were frozen as well. A realignment of public sector prices had been carried out prior to the plan but was reinforced on June 14 when public sector prices were increased by 23.6 percent. On April 4, 1996, the government announced the "flexibilization" stage of the program, which consisted of a devaluation of the exchange rate accompanied by the introduction of a crawling peg system, and a lifting of the price freeze by replacing it with a system of government supervised prices.
Argentina August plan August 1986	Contained no new measures to address fiscal imbalances; the government argued that the fiscal stance was fundamentally sound.		Formalized the flexibilization of the Austral plan by establishing ceilings for monthly price increases (3 percent) and wage increases. Announced a tightening of monetary policies.
Argentina February Plan (Austral IV) February 25, 1987	Reintroduced a forced savings scheme, whereby individuals and companies contributed, respectively, 30 and 40 percent of their 1984 net worth and income tax payments in return for interest bearing forced savings certificates. Attempted to introduce new levies and to crack down on tax evasion, but without much force. To increase revenue, public sector tariffs were increased by 2 percent before being frozen; cigarette prices were raised by 15 percent and then fixed.	Announced plans for privatization but no specific actions; announced plans to move of the federal capital; announced plans to crack down on tax evasion. To foster the liberalization of trade, import tariffs on capital goods not produced or not available in Argentina were eliminated.	Imposed a new price freeze for an indefinite period, but many agricultural and livestock prices were exempt (which made the plan to be perceived as having a proagricultural bias). Fruit and vegetable prices were subject to an intermediate form of control based on "suggested prices." A wage increase was announced for end-March (in the form of a top-up to make up the difference between the January wage settlements and actual inflation in January-February). Following the March increases, wages were to remain frozen in the second quarter; on July 1 a system of limited collective bargaining with established wage bands was to come into operation Announced a devaluation of the Austral by 6.1 percent to A1,535=US$1, which was to remain at that level until end-April and, from June onward, be devalued 2 percent each month.
Argentina October package October 14, 1987	Announced a set of revenue raising measures; some of the measures required congressional approval which was delayed until January 1988. In October, the government increased the import surcharge and the price of cigarettes. The package that was finally approved included an increase in the tax on checking transactions and a prohibition of multiple endorsements of checks; the introduction of a special tax on gasoline, natural gas, other petroleum products, and telephone services, all of which were earmarked to improve social security finances; an increase in the import surcharge from 10 to 15 percent; an increase in excise taxes on tobacco products; and various changes to the income tax law. The government also announced a new compulsory saving scheme for 1988 and 1989. Also announced were increases penalties and interest charges for overdue tax payments, a broadening of the definition of taxes subject to withholding at source, and provisions to allow government purchasing agents to withhold VAT from payments to state suppliers and make corresponding transfers directly to the treasury.	Announced plans to deregulate/privatize state enterprises, and carry out far-reaching financial reforms. The government reiterated its commitment to proceed with structural reforms (deregulation/privatizations) that would strengthen the finances of state enterprises, and to modify the system of revenue sharing between the federal government and the provinces.	Announced the introduction of a free exchange market for various service and capital transactions in which the exchange rate was allowed to fluctuate freely. Announced a renewed freeze of wages and prices.

Appendix Table 1. Overview on Policy Components of Selected Stabilization Plans in Latin America (continued)

Country Name of plan Date launched	Fiscal policy content	Structural policy content	Income policy, exchange rate policy, monetary policy, and others
Argentina Primavera August 1988	Announced a series of measures to cut the fiscal deficit. Public utility rates were increased by an average of 34 percent to reduce state enterprise losses; it was also announced that no further tariff increases would be made until early October when a rise of 4 percent was to be implemented. Announced that the treasury will no longer supply funds to state enterprises to cover operating losses, but only provide resources for foreign debt payments. The VAT rate was reduced from 18 to 15 percent in exchange for a promise of price restraint by producers; the government reserved the right to increase the VAT rate back to 18 percent after 60 days if VAT receipts should fall significantly. Losses from quasi-fiscal operations were reduced by cutting rediscount lines of the National Mortgage Bank with the Central Bank. Announced plans to terminate spending on a nuclear reactor project and on the Buenos Aires-La Plata motorway from 1989 onward, and to terminate treasury funds for the Yacyreta hydroelectric scheme with Paraguay. Reduced import duties for several products (pharmaceuticals, x-ray plates, lubricants, some animal products). Announced that foreign capital goods could be imported for a flat import duty of 5 percent. Some measures lacked credibility because they were only to go into effect in 1989.	Changed the industrial promotion regime. Announced a voluntary retirement program for 30,000 civil servants. Created a committee for administrative reform. Emphasized the need for import liberalization by removing 3,000 goods from the list of imports that require prior authorization.	Announced a devaluation and reorganization of the multi-tier exchange rate system. The two main official exchange tiers (the commercial and financial rates) were maintained, but plans were announced to unify them by April 1989. The commercial rate was devalued by 11.4 percent and then fixed to the US$ at A12=US$1. The financial rate was maintained in a dirty float. The gap between the commercial and financial rates was to be kept at no less than 20 percent. The plan included an agreement with major producers on a six-month price restraint: companies agreed to freeze their prices in the first half of August, to keep increases to 1.5 percent in the second half of August, to 3.5 percent in September, and to negotiate at a later date restraints that were to prevail thereafter. A commission was set up to monitor the agreement. Announced a 25 percent increase in public sector wages to soften the impact of the increase in utility rates. The exchange rate mechanism and the policies built around it had to be abandoned in early February 1989.
Argentina Transition I May 19, 1989	Plan was introduced 5 days after the elections that was won by the opposition, but with the old economic team still in office; promised action against tax evaders; announced that the fiscal deficit would be reduced by public tariff adjustments (of up to 40 percent) and by abolishing export rebates (for industrial exports). The export tax was increased by 10 percentage points to 30 percent.		Announced another price freeze that was largely ignored by markets as the government was powerless to enforce the freeze.
Argentina Transition II May 28, 1989	Introduced 14 days after the elections, with a new Finance Minister and at the onset of a wave of food riots, the plan emphasized the need to cut the fiscal deficit. Announced plans to abolish export rebates (as in Transition I); retained export duties (30 percent for agricultural exports; 20 percent for industrial exports); introduced a new tax on the first sale of agricultural land (4 percent); announced a suspension of all state-funded public works, and further increases in public utility rates. The revenue increasing measures were swiftly approved by Congress.	Promised a drastic clampdown on tax evaders. In early June, the government rushed in a new emergency unemployment benefit scheme, designed to cover the 640,000 people listed as unemployed in official statistics; the benefit level would be equal to the national minimum wage (an earlier emergency unemployment benefits scheme that had been introduced in 1985 lasted for 1 year).	Formally continued price freeze (same as Transition I Plan), which was ineffective since mostly ignored. The exchange rate was fixed against the US$ at Australes175=US$1.
Argentina Bunge & Born Plan July 1989	Introduced a draft Economic Emergency Law that was sent to Congress for approval. The plan included the following fiscal measures aimed at reducing the deficit: a series of massive increases in public sector prices (gasoline, gasoil, gas, electricity, telephones, and public transport) ranging from 200 percent to 640 percent; a suspension for 6 months of all state subsidies and regional industrial promotion schemes (the suspension of regional industrial promotion schemes failed to get congressional approval); the retaining of export duties at levels of 30 percent for agricultural goods and 20 percent for industrial goods, combined with a promises to carry out a series of staged reductions of these duties in the future. It was announced that the Economic Emergency Law was to be supplemented by a tax reform, with heavy penalties for evasion; the VAT rate was to be lowered and its base broadened. The government committed itself not to increase public sector prices again for at least another year.	The following actions were envisaged to supplement the emergency measures: a large-scale privatization program that would only exclude companies of importance for national security; measures to place foreign and domestic investment on an equal footing; creation of a deposit insurance scheme to replace the automatic state guarantee of all banking system deposits.	The Austral was devalued 53.3 percent and then frozen against the US$; the government committed itself not to devalue again until March 1990. Announced maximum price guidelines for a group of commodities making up the basic basket of goods and services; all other prices were to be rolled back to their July 3 levels and frozen; the freeze was expected to be in effect "for a reasonable period of time." The announced price freeze was largely ignored, and had to be replaced by a negotiated agreement with 300 "price forming" companies to hold prices constant for 90 days at their July 14 levels (not their July 3 level, as the government initially requested). The increase in public sector prices was differentiated to cushion the blow on low income sectors: for example, industrial gas prices increased by 640 percent; prices for medium and low volume users were raised by 280 and 200 percent, respectively. The poorest consumers, who buy gas cylinders, faced a price increase of only 50 percent. Also, the government announced an advance payment of July salaries, and a one-off bonus in July to cushion the impact of the public sector price increases; otherwise, wage levels were to be determined by collective bargaining. To supplement the measures of the economic emergency law, it was envisaged to carry out a rescheduling of domestic debt obligations.

Appendix Table 1. Overview on Policy Components of Selected Stabilization Plans in Latin America (continued)

Country Name of plan Date launched	Fiscal policy content	Structural policy content	Income policy, exchange rate policy, monetary policy, and others
Argentina November Package November 1989	Announced a new set of emergency fiscal measures aimed at improving the fiscal position ahead of tax measures that were to come into effect in January 1990. The announced measures included: an emergency tax on windfall profits banks that were caused by hyperinflation and the appreciation of government bonds, a tax on cars, and a tax on state companies.	Announced the sale of 60,000 "unnecessary" state properties, the elimination of government departments that were duplicating services, and a commitment to reorganize the State Railways, the largest single loss maker in the public sector, so as to eliminate its deficit over a two-year period.	
Argentina December Package December 1989	Package was announced amid new pressures on the currency. Measures included: an increase of export tariffs by 11 percentage points and a reduction in import tariffs by 10 percentage points; increases in public sector prices, including regular gasoline (61 percent), higher grade gasoline (59 percent), bus fares (86 percent), electricity tariffs (69 percent), telephone tariffs (60 percent), postage (40 percent), and water (20 percent). With US$650 million (out of US$7,000 million) of domestic debt due to mature in March 1990, the government announced plans to require bond holders to exchange the maturing papers for new interest bearing *Bonex* (government bonds linked to the US$).		Price controls on the private sector were relaxed by removing price ceilings and authorizing price increases for basic foods (oil, rice, pasta, flour, bread) of 25-175 percent. To compensate for price increases, the government announced lump-sum pay increases for public and private sector workers.
Argentina Erman I December 1989	Government rescinded the proposed increase in export tariffs and reduction in import tariffs; the government also partially withdrew from the plan to reschedule internal debt and stated it would strive to redeem maturing bonds in cash; if this could not be done, redeeming them with *Bonex* would remain an option.	Reiterated the longer-term policy goal of privatization, restructuring of the state, and tax reform.	Announced an additional lump-sum wage increase for all workers on top of the one announced previously. Announced a deregulation and liberalization strategy consisting of unifying the exchange rate and introducing a single floating rate, removing restrictions on the purchase/sale of foreign currencies, and abolishing all remaining price controls (except for public sector prices which would continue to be regulated). Pledged not to print new money unless there were "real" resources to back their issue. Pledged not to impose restrictions on the availability to depositors of their funds held in the banking system.
Argentina Bonex Plan (Erman II) January 1990	Reversed the December policy statement on government bonds. The main thrust of the package was to force down the price of the US$ by restricting the supply of Australes; there were no additional fiscal measures, even though the "asset freeze" that was implemented acted as an implicit tax.	To rebuild confidence (amid fears of capital flight), the government promised to accelerate the privatization program. The enabling legislation (known as the Economic Emergency Law), which also restricted government subsidies, was announced to be renewed for another six months. President signed a decree for privatizing the telephone company (Entel), and announced plans to privatize several petrochemical companies and a ship repair facility. Restructuring of State Railways was started by making 1,500 middle managers redundant and transferring another 1,500 to the tax authorities to be trained to become tax collectors; also announced plans to give early retirement to 5,300 railways employees, and to close selective routes. Announced reorganization of the state energy companies. Also, government announced that it would not bail out banks in difficulties.	While the Government stopped printing money in excess of the minimum required to pay wages and pensions, the plan's main policy tool was a partial "asset freeze." Under the asset freeze, the amount of fix-term deposits that depositors could withdraw from Banks was limited (to the equivalent of about US$500); savings above this amount would be paid in 10-year US$-denominated bonds (Bonex89). The minimum term for fix-term deposits, which, in the form of 7-day deposits, had become the preferred hedge against inflation, was increased to 90 days. To increase acceptability of Bonex 89, it was announced that interest will be paid monthly (instead of every 6 months), and that the Bonex 89 could be used to pay taxes.
Argentina Erman III February 1990	New series of measures that entailed minor changes to reduce the public sector deficit. Announced that federal treasury would no longer subsidize either state enterprises (with exception of the railways) or the provincial administrations. Announced that efforts would be made to balance the social security budget and make provincial administrations pay their debts to state enterprises. Announced plans to rein in special pensions to government officials. Announced plans to prolong by one year (to March 1991) the suspension of 50 percent of federal subsidies and tax breaks for industry. Tariffs on food imports were cut to 10 percent (from levels as high as 25 percent), and restrictions on pharmaceutical imports were relaxed. Public sector prices had been raised sharply at the beginning of February (prior to the plan's announcement), and further increases were implemented in March (following the plan's announcement).		Made an attempt to manage prices by requiring 330 top companies to report their prices to the government. President announced he would reduce his salary by 20 percent, and the president's new salary was then announced to represent the ceiling for government pay.

Appendix Table 1. Overview on Policy Components of Selected Stabilization Plans in Latin America (continued)

Country Name of plan Date launched	Fiscal policy content	Structural policy content	Income policy, exchange rate policy, monetary policy, and others
Argentina Erman IV March 1990	Announced a new set of measures to attack the fiscal deficit. Accordingly, state enterprises were to postpone payments to their suppliers for 60 days and all promotions and new hirings in the public sector were to be frozen. Also, public sector employees with up to two years of service left before retirement were to be required to leave work (although they would continue to get paid) and employees beyond the retirement age were to be retired. Announced plans to eliminate 56 secretary of state (rank just below cabinet minister) positions, and to reduce the number of sub-secretary positions from 112 to 32. Announced plans to eliminate overtime pay for civil servants. Revenue measures included raising the net assets tax to 2.76 percent and export taxes by 5.5 percent. Announced that central bank financing of the public sector deficit would be stopped and that the government would call in loans given to commercial banks. Announced plans to close the National Mortgage Bank, and took over the management of the Development Bank. However, government backtracked on earlier plans to close railway lines and backed down on a planned 400 percent increase in telephone charges.	Announced plans to improve tax administration and further public sector reform; announced plans to reduce civil service employment.	
Argentina Erman V September 1990	Plan was announced as an "omnibus" package of 122 decrees with the main aim to cut public expenditure. A main tool was to convert about US$8 billion of public sector debts to private suppliers into 10-year bonds (with interest rates set 8 percentage points above the wholesale price index). Servicing of this debt had been frozen earlier in 1990. Announced tight cash limits on public spending, and held top officials personally responsible for abiding to these limits; various top officials were dismissed for failing to abide to limits and usually replaced by managers hired from the private sector. Allowed state enterprises to cut off services to customers who failed to pay--gas and electricity companies were the first to cut off supplies to other state enterprises. A special committee to monitor progress was established.	Established committee to carry out personnel reductions in all areas (except the armed forces, the police, state intelligence, the prison system, and the health and education ministries, which are to prepare their own proposals for cutting back. Required state enterprises to cut payments to staff on temporary contracts by 15 percent and terminate all such contracts by year-end, unless they obtain special permission. The severance pay system was modified, increasing payments to workers with short tenure and lowering payments to workers with longer tenure.	Plan included measures to strengthen the Central Bank and tighten monetary policy. The Central Bank is to demand payment of all outstanding debt owed to it by commercial institutions; commercial institutions in noncompliance on December 1 would be declared bankrupt. Commercial banks were disallowed to dip into pension funds to meet short term cash flow problems. State banks were told they could no longer automatically rely on the Central Bank to cover their bad debts, without making attempts to recover these bad debts. Minimum reserve requirements for commercial banks were increased.
Argentina Convertibility Law March 1991	Abolished distortionary taxes (21 taxes and levies abolished), particularly foreign trade taxes, earmarked levies of regulatory agencies, and financial transaction taxes; improved measures to enforce tax payment discipline. Expenditure policy measures included increases in public tariffs.	Proposed concrete steps to implement social security reform and carry out privatization on a large scale; announced plans to make various major improvements in tax administration and expenditure management. Began to address the problem of controlling provincial finances by negotiating two fiscal pacts with the provinces that affected revenue sharing arrangements and expenditure assignments, but that did not offer a permanent solution.	The exchange rate was fixed to the US$ (at 1:1) and the currency was made fully convertible with the monetary base required to be backed 100 percent by international reserves. Imposed an explicit requirement that prohibited indexation clauses in wages and financial contracts, and pursued an implicit incomes policy where the government tried to keep down price increases though negotiations and persuasion.

Appendix Table 1. Overview on Policy Components of Selected Stabilization Plans in Latin America (continued)

Country Name of plan Date launched	Fiscal policy content	Structural policy content	Income policy, exchange rate policy, monetary policy, and others
Bolivia New Economic Policy August 1985	Public sector accounts were balanced daily on a cash flow basis; public investment was frozen for one year. Strict controls of state enterprises were implemented by requiring that all their revenue be deposited in the Central Bank and all their spending be authorized by the Ministry of Finance. Public sector employment was cut by 10 percent. Tax reform aimed at moving away from income-related taxes and toward consumption-related taxes. Overall, about 450 taxes (mostly earmarked taxes) were abolished; in 1986 a VAT was introduced and quickly became the centerpiece of the new tax system. Public-sector tariffs and gasoline prices were increased (to international levels), a special gasoline tax was introduced. Following the proposed investment freeze, capital spending rose substantially, mainly as a result of new international resources. Government subsidies (bread, foodstuffs) were eliminated.	Put in place the preconditions for enterprise reform by establishing central control over state enterprises finances and eliminating illegal bonuses to state enterprise employees (in kind or in cash).	Nominal wage freeze in the public sector (generated a 60 percent real wage reduction in a single month) also to induce voluntary reductions in public sector employment. Devalued the official exchange rate by 93 percent to unify official and parallel exchange rates, which was followed by a dirty float. Prices were fully liberalized.

Appendix Table 1. Overview on Policy Components of Selected Stabilization Plans in Latin America (continued)

Country Name of plan Date launched	Fiscal policy content	Structural policy content	Income policy, exchange rate policy, monetary policy, and others
Brazil Cruzado I February 1986	Announced some cutbacks in subsidies, but major fiscal policy measures were not part of the plan, as they were considered unpopular and the government did not wish to risk its chances to be reelected in the upcoming elections. Also, it was argued that inflation was largely inertial, and, hence, stabilization would primarily require measures to address these inertial components.		Decree law 2283 (of February 28, 1986, modified by another decree law on March 10, 1986) introduced a new currency (the Cruzado) to replace the Cruzeiro. The plan relied almost exclusively on incomes policies. Main instruments were a reform of indexation arrangements; a price freeze; a reform of wage setting mechanisms; a conversion scheme for rents and mortgages; and the creation of an unemployment insurance scheme. Indexation for all financial contracts with a maturity of less than one year was abolished (except for passbook savings and compulsory savings). A new government bond (OTN) that had a fixed value for one year replaced the indexed ORTN. The OTN was to be fully adjusted after 12 months (in March 1987) for inflation in the preceding 12 months, and financial contracts maturing after end-February 1987 were permitted to be indexed to the OTN. Nonindexed financial contracts were converted into Cruzados using a conversion factor that sought to discount the expected rates of inflation incorporated in those contracts. Retail prices were frozen at their February 27, 1986 level for an indefinite period, but in some cases the level was renegotiated. A government list of maximum prices covered over 400 items. Government wages were converted into cruzados at their average real value during the previous six months plus an increase of 8 percent; the minimum wage was increased by 16 percent in real terms. Annual wage negotiations were reestablished with a mandatory but partial (60 percent) cost-of-living adjustment during the first negotiation and the remaining 40 percent subject to negotiation. A mandatory full cost-of-living adjustment was to take place each time when accumulated inflation since the last negotiation reached 20 percent; adjustments granted on this basis were to be considered as a salary advance in the next wage negotiation. Residential rents were converted at their average real level prevailing since their last adjustment. Mortgages were converted at their average level during the previous six months. Rents and mortgages were to remain frozen until end-February 1987. An unemployment insurance scheme was established that provided for payment of at least 70 percent of the minimum wage.
Brazil Cruzadinho July 1986	The plan was a product of the need to control a consumption boom underway, remove distortions in relative prices, generate funds for the treasury (also in light of elections), and increase investment levels. Two compulsory loans were implemented. One was a temporary 28 percent levy on the purchase of fuels that was to be repaid/credited to each car owner as if his/her vehicle consumed the national average of 2,000 liters per year; the other was a levy on the purchase of new or used cars, equal to 30 percent of the purchase price, that was to be repaid with National Development Fund shares and to be issued after 1989. Taxes on short-term financial operations were changed: the tax (IDF) on paper maturing in less than 60 days was increased from 45 to 65 percent, while tax on longer-term paper was reduced from 35 to 20 percent. A 25 percent tax on purchases of air tickets to foreign destinations was introduced; and it was announced that purchases of hard currency to travel abroad would be taxed.	As part of a four-year plan of goals (*plano de metas*) that was announced at about the same time, the government pledged to guarantee children under the age of six one liter of milk per day, expand the national housing program to provide more low-cost units, and to settle more families under the national land reform program. The *plano de metas* was to be funded from both compulsory loans and a variety of resources accruing to the National Development Fund (FND). It was planned to require government pension funds to invest some 30 percent of their assets in FND paper. Additional resources were planned to come from sale of stock in state enterprises. The FND was perceived as little more than a source of financing for state enterprises--a few days before the Cruzadinho plan was announced, the government had announced a bail-out plan for the debt-stricken state steel company Siderbras. Government did not publish plans to streamline the overblown federal administration, as had been expected.	Further measures designed to phase out indexation from the financial system included the creation of a new passbook savings account with floating interest rates. Increased penalties for banks failing to comply with the Central Bank's compulsory minimum reserve requirement. Announced plans to relax the rules that govern foreign investment in Brazilian stocks. The Cruzado remained fixed to the US$ at CZ13.85=US$1; this had to be changed in October 1996, when a crawling peg system with mini/midi devaluations was introduced.

Appendix Table 1. Overview on Policy Components of Selected Stabilization Plans in Latin America (continued)

Country Name of plan Date launched	Fiscal policy content	Structural policy content	Income policy, exchange rate policy, monetary policy, and others
Brazil Bresser-A (New Cruzado) June 12, 1987	The "New Cruzado" plan (also dubbed Bresser Plan) included various measures to contain public expenditure. Subsidies on imported wheat were eliminated, and subsidies for alcohol fuel and milk were reduced. Significant cuts and postponements of state investment plans for 1987-89 were announced. Public sector prices were raised by between 8 and 45 percent. Required government loans to specific sectors to carry an interest rates that exceeds the government's cost to fund itself. Plans to abolish farming subsidies were announced on July 1.	The plan announced the Government's intention to establish an independent central bank. Also announced was the amalgamation of fiscal and monetary budgets to provide for a more coherent expenditure policy, and the creation of an expenditure regulatory commission to establish expenditure targets for 1987.	The currency was devalued by 9.5 percent. A 90-day freeze on prices and rents was announced; price controls were to be phased out thereafter. Price adjustments were to be dealt with on a case-by-case basis. Wages were increased by 20 percent and subsequently frozen until September, after which adjustments were to be made each quarter according to average inflation in the previous 3 months. The automatic wage-adjustment trigger of the Cruzado I plan was abolished. Credit instruments were partially reindexed.
Brazil Bresser-B July 21, 1987	Consisted of a macroeconomic policy package for 1987-91 to complement the New Cruzado Plan initiated in the previous month, and aimed at opening up the Brazilian economy and cutting the budget deficit, while redistributing income to low-income groups and taxing high-income groups. The plan set ambitious goals for fiscal deficit reduction. On the revenue side, the plan foresaw a broad range of measures, such as eliminating tax breaks, including export earnings into the calculation of profit income for tax purposes, improving the indexation of tax obligations, and levying the capital gains tax also on financial capital gains; the plan was later watered down in Congress. On the expenditure side, it was announced that public sector prices would be allowed to rise at comparable rates as private sector prices, and that there would be massive cuts in the expenditures of federal and state governments, and state enterprises. The plan also announced tight controls over spending that were to be accomplished by centralizing government accounts; the proposal was later watered down in Congress. A month earlier, however, the government had approved a bail-out package to stave off bankruptcies among small and medium-sized enterprises and various other measures that would entail additional fiscal costs.	Plan was complemented by announcements to eliminate 35,000 posts in the federal government and freeze new hirings.	Prices and wages continued to be temporarily frozen; the indexation mechanism was kept. There was a simultaneous squeeze in wages and a drop in employment, adding to the perceived downward spiral that had begun in late 1986. This increased pressures to allow wages to adjust significantly after the initial three-month freeze. The government agreed to increase wages for public sector employees by 41 percent, for central bank workers by 45 percent, and for the military by 52 percent.
Brazil April package April 1988	The plan proposed to increase taxes on the profit of banks and other financial institutions. It also announced a freeze on ministerial budgets.	Announced substantial incentives for public sector employees to accept voluntary early retirement or redundancy; a freeze on recruitment; and measures to discourage public employees from holding more than one job.	Announced a 60-day freeze on public-sector salaries; various government institutions and labor courts have been able to ignore wage freezes.
Brazil Verão January 1989	Attempted to tackle public sector deficit but lacked support in Congress. The new Constitution obliged the federal government to increase outlays on social welfare, and to raise the share of tax revenue transferred to the states and municipalities; as a result, in the first three months of 1989, tax revenue transfers to states and municipalities were 20 percent higher in real terms than they had been in 1988. Initially, the government tried to balance these higher transfers by postponing its own expenditure on grounds that the budget had not yet been passed. The plan announced that federal budget allocations for current spending in 1989 would be cut by 50 percent. However, given the large share in spending of subnational governments, the announced spending cut would amount only to a 15 percent reduction in total spending. Announced not to make use of debt financing of the budget (except for rolling over maturing debt). Delayed payment of public sector salaries by up to 18 days. Fines on outstanding tax payments were raised after it became clear that it was more profitable to invest overdue tax payments as overnight interest rates exceeded fines. Public sector prices, as well as prices for milk and bread, had been raised just prior to introducing the plan.	Announced plans to step up privatization, and reduce the size of the state by dismissing 60,000 civil servants and closing five ministries; these proposals ran into Congressional resistance.	After a 17 percent devaluation, the plan introduced a new currency (Cruzado Novo) to replace the Cruzado. Announced an indefinite retail price freeze on 180 basic products. A central plank of the plan was to abolish wage indexation; it declared an indefinite wage freeze, but allowed for one further adjustment based on the difference between actual inflation and the previously used index. The payment of the one-time correction was to be spread over a three-month period. Plan lacked a properly defined wage policy for the future. Abolished indexed certificates of deposit and monetary correction (except for savings accounts). Included a number of financial sector policies to control credit.

Appendix Table 1. Overview on Policy Components of Selected Stabilization Plans in Latin America (continued)

Country Name of plan Date launched	Fiscal policy content	Structural policy content	Income policy, exchange rate policy, monetary policy, and others
Brazil Verão followup package 1989	This followup package was part of a series of measures to make the Verão plan stick. It meant to address serious price distortions that had become apparent and had led to speculative buying.		The currency was devalued by 3.2 percent, and further min-devaluations were promised "as appropriate." Prices of 39 food and hygiene products were raised by about 8.2 percent, and then frozen again. Salaries were to be raised by 15.8 percent, quarterly. Introduced a new indexed government bond (BTN) to serve as the official indexing standard for contracts and financial instruments.
Brazil Collor I March 1990	The plan's attack on inflation was to a large extent carried out through a liquidity squeeze, not through fiscal measures. Apart from the liquidity freeze, the plan offered a mix of deregulation, privatization, forced loans, and some fiscal measures. Revenue measures consisted of increases of taxes on financial transactions and capital gains, and the removal of some tax incentives. Other tax measures included increases in the rates of the wealth tax and the agricultural tax. Expenditure measures focused at reducing ministerial perks, removing/reducing subsidies, and raising public sector prices. To reduce domestic debt servicing cost, old bonds were exchanged for new bonds.	Announced plans to reduce the number of government ministries and eliminate various government agencies. Announced plans to step up privatization and to deregulate the economy. Initiated a campaign against tax evasion.	Introduced a new currency (Cruzeiro) to replace the Cruzado Novo. The plan's central objective, to bring down inflation by reducing liquidity, was to be achieved through "asset freeze," which meant that for an indefinite period nobody would be able to take more than the equivalent about US$1,000 out of bank and savings deposits or to access more than 20 percent of their money tied up in overnight markets. This took the equivalent of some US$110 billion out of circulation overnight. Still, the market devised numerous strategies to unblock the frozen funds. One such strategy was to overpay back taxes in the old currency as to receive a refund in the new currency that was introduced. By early June liquidity (as measured by M4) had returned to 85 percent of its pre-plan level. Announced a temporary control of prices and wages not exceeding 90 days to implement a new salary policy; this was in contrast to the promise not to use freezes as a policy instrument. Introduced a new currency that floated. The government's attempt to overrule pay increases awarded by labor tribunals was undone by a Supreme Court ruling in June. However, the promise to remove price controls quickly was kept. With the exception of a few staple goods and public sector prices, all price controls had been lifted by end-July. However, a sample of 463 representative companies was forced to submit monthly reports on salary and production costs, profit margins, and prices charged to the supply and production departments of the economy ministry, and the government announced to take stern action against those charging "abusive" prices. By early September only 3 consumer products (flour, bread, cigarettes) had their prices determined by the government.
Brazil Collor II January 1991	The plan did not propose a major fiscal adjustment or additional structural measures; with its heavy reliance on incomes policy it was frequently compared to the failed Cruzado plan. However, contrary to the policies under the Cruzado plan, the government had been implementing various revenue and expenditure measures aimed at tackling the causes of inflation. This meant that the government was not using incomes policies as a substitute for serious reforms, but to deal with the problem of expectations to complement its otherwise orthodox policy intentions. Still, the initial public reaction to the Collor II plan was one of disappointment.	The government announced it was to proceed with reducing import tariffs from 40 percent in 1990 to about 20 percent in 1991, and to continue with deregulation, in order to increase competition and the efficiency of industry and services. Important steps in this regard were the deregulation of the state telephone monopoly (Embratel) and the deregulation of the shipping industry. Announced plans to discourage government employees from holding more than one job.	Contrary to its promises, the government implemented a price freeze, the fifth in recent years. Accordingly, prices were fixed at the January 30 level, and were to remain frozen for a short but otherwise undefined period; the lifting of the freeze was to be gradual. The freeze was difficult to maintain without a fundamental change in policies. Announced that February wages were to be adjusted on the basis of their average real level in the past 12 months. Abolished the Treasury Bond (BTN) that was used as a reference for indexation, and announced its replacement by a reference rate (TR) to be set by the central bank, the aim being to de-index financial markets. Eliminated the overnight rate and replaced it by an investment funds rate, in order to encourage longer-term deposits at lower interest rates, thereby reducing public-sector borrowing costs.

Appendix Table 1. Overview on Policy Components of Selected Stabilization Plans in Latin America (continued)

Country Name of plan Date launched	Fiscal policy content	Structural policy content	Income policy, exchange rate policy, monetary policy, and others
Brazil Real Plan December 1993 (stage 1) March 1994 (stage 2) July 1994 (stage 3)	A three-stage plan that consisted of measures to deal with the inertial component of inflation, to modify the exchange rate regime that had been focused on maintaining a real exchange rate target, and to tighten fiscal and credit policies. Stage 1 set the basis for improving public finances by establishing the Social Emergency Fund (FSE) for 1994-95 that exempted from earmarking 20 percent of almost all federal tax receipts and contributions to social programs (tax-sharing transfers to state and municipal governments were reduced by smaller amounts), thereby giving the federal government more flexibility to allocate expenditure. Also, stage 1 targeted a 0.7 percent of GDP increase in the 1994 primary surplus relative to 1993. In the period leading up to the December 1994 Mexico crisis, the government reduced tariffs on over 5,500 items, reduced taxes on mail-order imports, increased the interest rate equalization tax (to limit capital inflows), introduced a tax on foreign investment in the stock market, and increased taxes on bank credit. In the period following the December 1994 Mexico crisis, which contributed to large capital outflows, the government reversed some restrictions on capital inflows, raised, for the period of one year, duties for several import categories (including automobiles and consumer durables) from 20 to 70 percent, and, in June 1995, imposed quotas on automobile imports. At the same time, tariffs for some items (food and raw materials) were reduced on a temporary basis, and some other duties were eliminated. Since July 1995, the government again took measures to restrict capital inflows, and, among others, raised the interest rate equalization tax again. Fiscal policies weakened in 1995-96, also due to large wage increases that had been granted at subnational levels of government. To strengthen the financial situation of public enterprises, the government, in late September 1995, began to adjust public sector prices on a case-by-case basis and scale back implicit utility tariff subsidies to households.	Created a public debt amortization fund from privatization revenues, in order to buy back outstanding public debt; initiated discussions on administrative and social security reform.	Incomes and exchange rate policies dominated the stages 2 and 3 of the Real Plan. Stage 2 prepared the ground for deindexing the economy. In particular, it was to remove backward-looking indexation by introducing a new unit of account (the URV) that was to help synchronize price adjustments throughout the economy prior to introducing a new currency. The use of the URV (defined as approximately US$1) increased gradually, as more and more contracts became indexed to it. Stage 3 replaced the old currency and the URV with a new currency (the Real) that floats against the US$ (subject to a floor on its minimum value). Public and private wages, and the minimum wages had been fixed in terms of URV, and like all other URV-denominated contracts and prices, were converted into Reais at a rate of 1:1; all contracts and prices that had not switched to URV denomination were converted at the prevailing market rate of CR$2,750 per real. Public sector wages and the minimum wage were to be adjusted in January 1995 by the cumulative inflation in terms of URVs and reais during March-December 1994. Public sector prices were frozen indefinitely. In June 1995, the government announced new rules for wage contracts aimed at removing gradually backward indexation of wages. The new rules maintained annual wage negotiations, but prohibited indexation clauses. As a transitional measure for one year to end-June 1996, wage adjustments were stipulated to be at least equal to the previous annual adjustment.

Appendix Table 1. Overview on Policy Components of Selected Stabilization Plans in Latin America (continued)

Country Name of plan Date launched	Fiscal policy content	Structural policy content	Income policy, exchange rate policy, monetary policy, and others
Mexico Solidarity Pact December 15, 1987	The Solidarity pact was a tripartite agreement between the government, workers, and entrepreneurs; the original pact was altered/renewed 5 times and formally remained in effect until end-1988, when, under a new administration, it was replaced by a new series of pacts (the economic pacts for stability and growth). The initial pact proposed to reduce government spending by 1.5 percent of GDP in 1988. In this context, the government announced substantial expenditure cuts, particularly on investment spending. A presidential decree provided for strict sanctions for government officials who would not observe expenditure targets. Energy tariffs were increased by 85 percent. Tax measures carried out in the broader context of the Solicdary pact were mostly aimed at extending tax bases and lowering tax rates. The maximum import tariff rate was reduced from 40 percent to 20 percent; the 5 percent import surcharge was abolished; this was done also to compensate for the devaluation of the currency. the 6-percent VAT on processed foods and medicines was eliminated (in September 1988) in exchange for price restraint; the income tax for those earning up to 4 times the minimum wage was cut by 30 percent. Later on, introduced some price increases for gasoline, fertilizers, electricity, and phone services, and provided for indexation of the tax base to inflation.	Replaced various quantitative trade restrictions with tariffs; initiated reforms in the area of tax administration.	The initial pact (Dec.15, 1987- Feb.29, 1988) carried out a devaluation of the free (36 percent) and controlled (22 percent) exchange rates The modified followup arrangement (Feb.29 - Mar.31, 1988) established a preannounced fixing of the free and the controlled exchange rates Announced a price freeze on a list of 75-80 basic consumer goods. During 1988, agricultural prices were to be kept at their end-1987 values in real terms. Provided for an initial 14 percent increase in minimum wages, plus a further 20 percent adjustment on January 1, 1988; starting in March 1988, a forward indexation was applied. This was done on the basis of monthly inflation forecasts that were agreed trilaterally using a basket composed of 76 basic goods.
Mexico AUSEE January 1995	The plan, drawn up in response to the December 1994 crisis, included fiscal tightening, with adjustments largely through expenditure cuts. Higher than expected world market prices for oil and the devaluation of the Mexican Peso in December 1994 had led to an increase in oil-related receipts, and therefore, total revenue. The plan put limits on increases in minimum wage and public sector salaries; announced increases in tariffs for some goods (shoes, garments, leather goods); increased fuel and electricity prices (by 10 percent); announced cuts in government spending in an effort to reign in domestic demand and increase aggregate saving, but no clear indication was given where cuts were to be made.	Emphasized need to make continued progress on privatization and to reform the social security system. Helped by higher oil receipts, and the swift international response to the December crisis, the government initiated various support and bailout operations for small debtors, commercial banks, and others who had been adversely affected by the crisis (such as highway concessionaires).	Continued the floating exchange rate regime that was put into place in December 1994, following the devaluation.
Mexico PARAUSEE March 1995	Package of measures to reinforce the 1995 economic program, introduced in response to adverse market conditions. The government announced to increase the VAT rate from 10 percent to 15 percent; eliminate some exemptions (at intermediate stages) for food and medicine while continuing to exempt final consumption (also, in border regions, the VAT rate would remain at 10 percent); reduce government expenditure (without further specification); and increase gasoline prices immediately by 35 percent and electricity prices to final consumers by 20 percent, with additional monthly increases in the remainder of the year.	Plan was followed by various measures to support/restructure the banking system, and to provide support to different debtor groups (mortgage debtors, small credit card debtors, etc.)	Announced that monetary policies would be tightened in the event of a further depreciation of the Mexican Peso. Established new legal reserve requirements, and limited the ability of banks to overdraft at the Central Bank. To address the lingering banking crisis, announced various measures to stabilize banks. Announced a 10 percent increase in the minimum wage, and a new personal income tax rebate for workers earning up to 4 minimum salaries. Announced that unemployed workers would be able to receive health benefits for a maximum of 6 months (previously 2 months). Announced the creation of a rural employment program. Announced that subsidy programs for basic staples would be continued while the government would seek to create improved targeting mechanisms.

Appendix Table 1. Overview on Policy Components of Selected Stabilization Plans in Latin America (continued)

Country Name of plan Date launched	Fiscal policy content	Structural policy content	Income policy, exchange rate policy, monetary policy, and others
Peru Inti Plan August 1985	Included a real wage increase to boost domestic demand. Revenue measures were largely confined to public sector price increases and reductions in military expenditure. Limited service of medium- and long-term public-sector foreign debt to 10 percent of earnings from exports of goods and nonfinancial services. Announced the establishment of a "cash committee" (similar to Bolivia) to force state enterprises to balance their budget. In October 1985 announced various measures to foster growth, among others by pumping credit into the economy. Abolished the wage tax (paid by workers), established public employment programs, increased import taxes on alcoholic beverages, and forced state enterprises to buy treasury bonds.	Announced a public sector hiring freeze, attempted to reduce top-level employment in state enterprises and Peruvian embassies, and banned official travel abroad; announced and ambitious program of structural reforms (labor market legislation and privatization including state-owned development banks).	The currency was devalued and fixed against the US$. After increasing wages and public sector prices, announced a 5-month freeze on wages and prices, road transport fares and rents. Foreign currency deposits were frozen. Banned various imports to encourage import substitution. Slowly introduced multi-tier exchange rate system. In 1987, announced the nationalization of most of the financial system (ultimately abandoned).
Peru Fujimori Plan August 1990	Fiscal adjustment was the centerpiece of the plan. It included a commitment to balance the budget, among others by establishing a cash committee--which led to some arrears, but, by and large, functioned well. Apart from eliminating subsidies, the plan initially relied largely on revenue measures which reflected the fact that expenditure levels were already low as the tax system had collapsed. Revenues were increased via emergency taxes (e.g., trade and real estate), elimination of tax exemptions, and drastically increasing public sector prices (gasoline was increased 20-fold). Quickly moved to reduce the number of taxes to five: an income tax, a corporation tax, a single 14 percent VAT, a capital gains tax, and a selective tax on consumer imports.	Totally overhauled the tax administration and bestowed special powers on tax collectors. Announced privatization plans, including privatization of the state-owned development banks.	Introduced a unified floating exchange rate. Incomes policies were not an important part of the plan.

Appendix Table 1. Overview on Policy Components of Selected Stabilization Plans in Latin America (continued)

Country Name of plan Date launched	Fiscal policy content	Structural policy content	Income policy, exchange rate policy, monetary policy, and others
Uruguay Stabilization plan December 1990	Fiscal measures, that mainly consisted of various tax increases, had been approved prior to the announcement of the stabilization plan. Under the stabilization plan, the behavior of public finances was largely driven by endogenous effects that overshadowed a deterioration in underlying fiscal balances. A private consumption boom led to an endogenous growth of tax revenue, and a real exchange rate appreciation reduced the real value of interest payments on foreign debt. At the same time, backward indexation of social security benefits (on a quarterly basis) and wages was an important source of endogenous growth in real government expenditure as inflation declined.	Initially, did not include major structural measures, but later initiated some privatization; proposals for comprehensive social security reform failed to get political support.	Imposed restrictions on public sector wage adjustments by using a target inflation rate to determine quarterly wage adjustments (forward looking indexation). Social unrest forced the government to compensate public sector workers for the reduction in real wages under the indexation mechanism. The government gradually disengaged from private sector wage bargaining. The exchange rate was maintained as a dirty float, with fluctuations against the US$ allowed within a 2.5 percent band (later 7 percent band).

Appendix Table 1. Overview on Policy Components of Selected Stabilization Plans in Latin America (concluded)

Country Name of plan Date launched	Fiscal policy content	Structural policy content	Income policy, exchange rate policy, monetary policy, and others
Venezuela Stabilization plan February 1989	Stabilization plan was based on a 4-pronged strategy promoting non-oil exports, increasing public sector savings, accelerating private investments, and targeting social policies to the neediest. Fiscal measures included increases in public sector prices (particularly gas and electricity), the elimination of tariff exemptions, and the introduction of a sales tax on non-essential products. Also, the government proposed measures to broaden the tax base and lower marginal tax rates for VAT and the income tax. No attempt was made to rein in expenditure. In fact, an increase in expenditure was planned from the outset. This increase was to be matched through explicit revenue measures, and higher oil export proceeds that would result from the devaluation of the domestic currency. While the government introduced various emergency social programs to protect vulnerable sectors of society, it also introduced a new subsidy to high-income mortgage borrowers that amounted to 2 percent of GDP in 1989. Overall, the stabilization program was implemented in a stop-and-go fashion.	Announced privatization plans for commercial banks, cement companies, sugar mills, hotels and other assets.	Unified the exchange rate and maintained a floating rate thereafter. Substantially reduced the extent of price controls and subsidies. The remaining basket of goods with controlled prices had a CPI weight of about 8 percent; these remaining controlled goods, for the most part, underwent substantial price increases. Wage increases the were initially granted to public and private sector employees were insufficient to maintain real wages. However, the government resisted pressures for further increases.
Venezuela Stabilization plan April 1996	Set a central government deficit target of 2 percent of GDP for 1996 and 1.2 percent of GDP for 1997. These targets were to be achieved by, among others, implementing stricter and more transparent controls on fiscal management; increasing gasoline prices (to about 85 percent of the export price) and public sector tariffs (e.g., electricity, telephone); and increasing the rate of luxury and wholesale tax from 12 to 16.5 percent and extending it to the retail level (thereby making it effectively a value-added tax). Announced a tax amnesty in exchange for paying outstanding back taxes. Abolished subsidized loans, including to the agricultural sector.	Announced plans to reduce government employment, revive the privatization program, and reform the banking law to pave the way for universal banks. Announced plans to reform the social security and severance pay systems.	Lifted exchange controls and implemented a crawling peg exchange rate regime that would be adjusted regularly on the basis of expected inflation. Announced the full liberalization of interest rates. Abolished the majority of the remaining price controls (including on food).

Sources: Economist Intelligence Unit (EIU Country Reports for various countries and years), de Faro (1991), Kiguel and Liviatan (1991), Meller (1992), Santaella and Vela (1996).