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Performance - Country Cases

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STRUCTURAL REFORMS AND MACROECONOMIC PERFORMANCE: COUNTRY CASES

IMF staff regularly produces papers proposing new IMF policies, exploring options for reform, or reviewing existing IMF policies and operations. The following document(s) have been released and are included in this package:

- The **Staff Report** prepared by IMF staff and completed on October 13, 2015

The report prepared by IMF staff has benefited from comments and suggestions by Executive Directors following the informal session on October 28, 2015. Such informal sessions are used to brief Executive Directors on policy issues and to receive feedback from them in preparation for a formal consideration at a future date. No decisions are taken at these informal sessions. The views expressed in this paper are those of the IMF staff and do not necessarily represent the views of the IMF's Executive Board.

The documents listed below have been or will be separately released.

- Structural Reforms and Macroeconomic Performance: Initial Considerations for the Fund.

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STRUCTURAL REFORMS AND MACROECONOMIC PERFORMANCE: COUNTRY CASES

EXECUTIVE SUMMARY

As a companion piece to the Board paper on [*Structural Reforms and Macroeconomic Performance: Initial Considerations for the Fund*](#), this paper presents a selection of case studies on the structural reform experiences of member countries. These papers update the Board on work since the Triennial Surveillance Review toward strengthening the Fund's capacity to analyze and, where relevant, offer policy advice on macro-relevant structural issues. The paper builds on the already considerable analytical work underway across the Fund, setting out considerations to support a more strategic approach going forward.

Countries' reform experiences offer invaluable insights to help inform a more well-rounded approach to enhancing the Fund's work on structural reform. In this context, the Fund is working to better leverage its country-based analysis and to share knowledge of cross-country reform experiences. For this paper, we examine six country cases: Armenia, Australia, Malaysia, Peru, Tanzania and Turkey. The cases cover a range of reform issues and experiences, with some focusing on longer-term reform efforts as part of a broader structural transformation and others focus on more concentrated reform episodes.

The experiences of these countries tend resonate with historical reform patterns and the analysis in the main paper, suggesting that sustained reforms typically coincide with periods of improved productivity and macroeconomic performance more generally. Moreover, these experiences hint at potential lessons for designing and implementing effective reforms, including the importance of strong ownership, the ability to sustain reforms, and the need for complementary macroeconomic and structural policies.

Approved By
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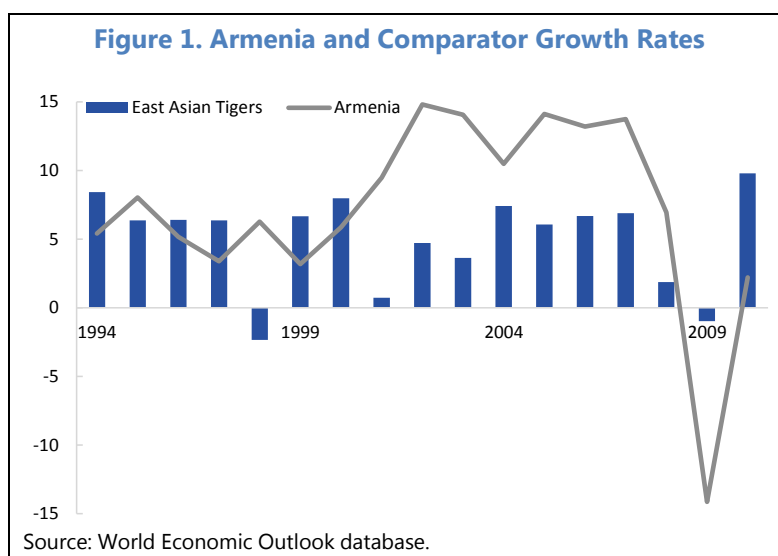
List of Abbreviations

AMs	Advanced Market economies
AML/CFT	Anti-Money Laundering/Combating the Financing of Terrorism
DSGE	Dynamic stochastic general equilibrium
EMs	Emerging Market economies
EMDCs	Emerging Market and Developing Countries
GPA	Global Policy Agenda
ILO	International Labor Organization
IMF	International Monetary Fund
LICs	Low-Income Countries
LIDCs	Low-Income Developing Countries
OECD	Organization for Economic Cooperation and Development
NPL	Non-Performing Loans
QE	Quantitative Easing
R&D	Research and Development
REER	Real Effective Exchange Rate
REO	Regional Economic Outlook
TFP	Total Factor Productivity
TSR	Triennial Surveillance Review
ULC	Unit Labor Cost
UMP	Unconventional Monetary Policy
WEO	World Economic Outlook
ZLB	Zero Lower Bound

ARMENIA¹

This case study covers Armenia's structural reform experience over the two decades following its independence from the Soviet Union and highlights its transformation from a centralized-based economy, into a thriving market-based model. This period has been underpinned by wide-ranging structural and policy reforms and macroeconomic stabilization, particularly since the late-1990s.²

1. Armenia was often referred to as the Caucasian Tiger in the 2000s given its stellar growth record since the 1990s. Real GDP per capita has risen by an annual average growth rate of almost 9 percent in 1995–2010, reminiscent of the East Asian Tiger economies and well above the levels of other transition economies (Figure 1). This strong growth partly reflects exceptionally high foreign flows (in the form of official development assistance and remittances from its large diaspora). However, it is also a testament to Armenia's steady pursuit of structural reforms, complemented by its sound macroeconomic stance that transformed the formerly centralized-based economy, into a thriving market-based model.



Transition Years

2. The first years of Armenia's independence were not easy. Between 1988 and 1994, Armenia was severely affected by an earthquake, the collapse of the Soviet Union and a conflict with Azerbaijan (the Nagorno-Karabakh conflict), which led to an estimated 50 percent decline in GDP in 1990–93. By 1994, annual inflation escalated to 5,300 percent—the result of massive fiscal imbalances financed by money creation (fiscal and external account deficits rose to 17 percent and 36 percent of GDP, respectively). Mounting internal and external payments' arrears, factory closures, little reliable electricity supply, heavy emigration and corruption concerns were prevalent. Some four-fifths of Armenians survived on humanitarian aid at the time.

¹ Prepared by Evridiki Tsounta (SPR), in consultation with Middle East and Central Asia Department.

² Sources include: *Republic of Armenia: Public Financial Management Reform Priorities*, World Bank (2010), and *Public Expenditure Review of Armenia*, World Bank (2003).

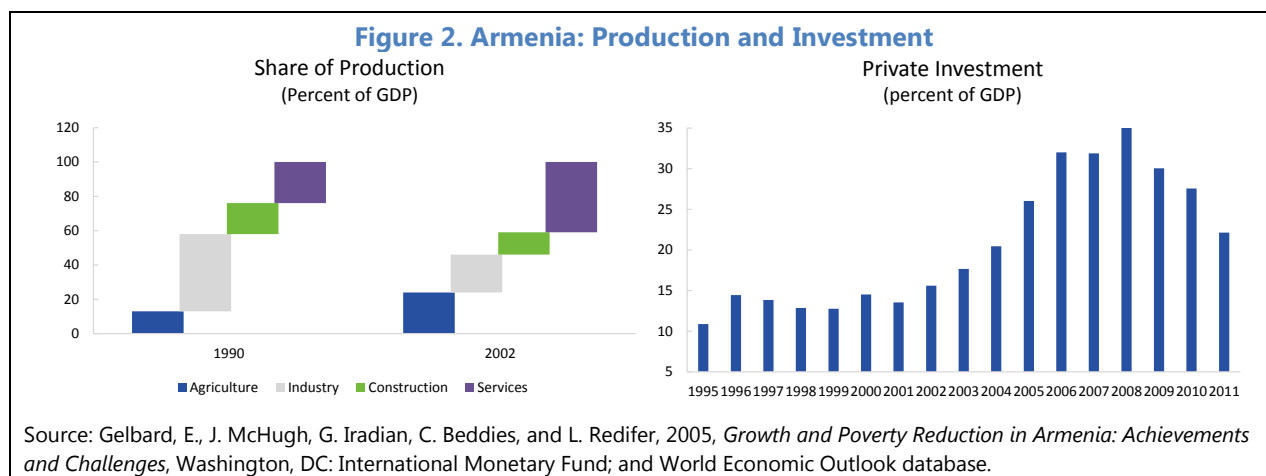
1994–1998

3. The 1994 cease-fire with Azerbaijan allowed the authorities to focus on their economic agenda. The authorities pursued strong monetary and fiscal policies, reflecting structural reforms in the conduct of macroeconomic policies.

- *Monetary policy.* The newly independent Central Bank adopted a strategy to curb inflation and minimize the accumulation of bank credit to the government. A flexible exchange rate gave the authorities the necessary control over the money supply in an environment of free capital mobility. As a result, inflation dropped from over 5,000 percent in 1994 to single digits in 1998.
- *Fiscal policy.* A stabilization program adopted in 1995/96—with support from the IMF, World Bank and other donors—included enacting the Budget System Law (1997), which improved budget preparation/execution and set a 5 percent ceiling for the annual budget deficit. The deficit fell to 8.2 percent of GDP in 1996 and the government repaid most of the arrears built up during 1993–94. However, the underlying fiscal position remained weak, reflecting the declining tax base (largely stemming from poor tax administration and archaic tax legislation). In response, successful VAT and custom duties reforms were pursued (e.g., collection at the border), the profit tax was simplified, and tax administration was strengthened (e.g., taxpayer identification numbers were introduced).

4. At the same time, Armenia also pursued trade and foreign investment liberalization. Policies included removing quantitative restrictions on imports, adopting a simple import tariff and a liberal foreign direct investment regime, and full current account convertibility.

5. Other broad-based structural reforms aimed at deregulating markets. Wage and price controls were eliminated for most goods and services by 1995, setting the stage for a period of market-driven capital formation (Figure 2). Most land was also privatized in the early 1990s, stimulating agricultural production. A wave of privatization initially focused on small enterprises and banks were gradually privatized by 2001. Energy sector reforms started in 1997, with the setting up of the basic regulatory framework and increases in tariffs toward cost-recovery levels.



6. Since the mid-1990s Armenia introduced a series of education reforms, including: per capita financing and establishment of a textbook fund which became a model for other countries. Armenia's skilled workforce and low labor costs resulted in an expanding services sector (Figure 2).

7. The legal framework was also strengthened. Basic laws on the central bank, commercial banking, and insolvency were introduced in 1996. Bank regulations were aligned with the Basel Core Principles in 1997 and international accounting standards were adopted in 1998.

8. With broad-based and complementary structural reforms under way and macroeconomic stability restored, Armenia recorded an impressive growth performance. Also, total factor productivity (TFP) rose by over 8 percent per year during 1994–97.

1998–2008

9. The Russian financial crisis of 1998 and Armenian political assassinations in 1999 led to a period of political uncertainty and the reform effort slowed.³ Exports, transfers, and remittances fell, the deficit rose again (including in the state-owned utilities sectors), and domestic and external payment arrears grew rapidly. The banking sector also entered a difficult period given the collapse of 10 (one-third of country's) commercial banks during 1999–2001 following liberal expansion of the sector with little regard to prudential requirements and supervision.⁴

10. To address these problems, Armenia renewed its stabilization and reform efforts (supported by the IMF's Poverty Reduction and Growth Facility) in the late 1990s and early 2000s. Fiscal consolidation underpinned by important fiscal reforms (e.g., introduction of a Medium Term Expenditure Framework in 2003) was the cornerstone of the stabilization policies. At the same time, Armenia strengthened infrastructure spending and social safety nets (education, health and social

³ A parliament shooting killed, among others, the two *de facto* political decision-makers—Prime Minister Vazgen Sargsyan and Parliament Speaker Karen Demirchyan—and slowed down further far-reaching reforms efforts.

⁴ Berglof and Bolton, 2002.

welfare) thus becoming the CIS leader in social safety net program reforms. Fiscal deficits declined, debt sustainability indicators improved, and all arrears were eliminated. To boost private activity, income taxes were reduced and a single profit tax rate was introduced (1999). At the same time, the Central Bank of Armenia formally introduced an inflation-targeting regime in 2006.

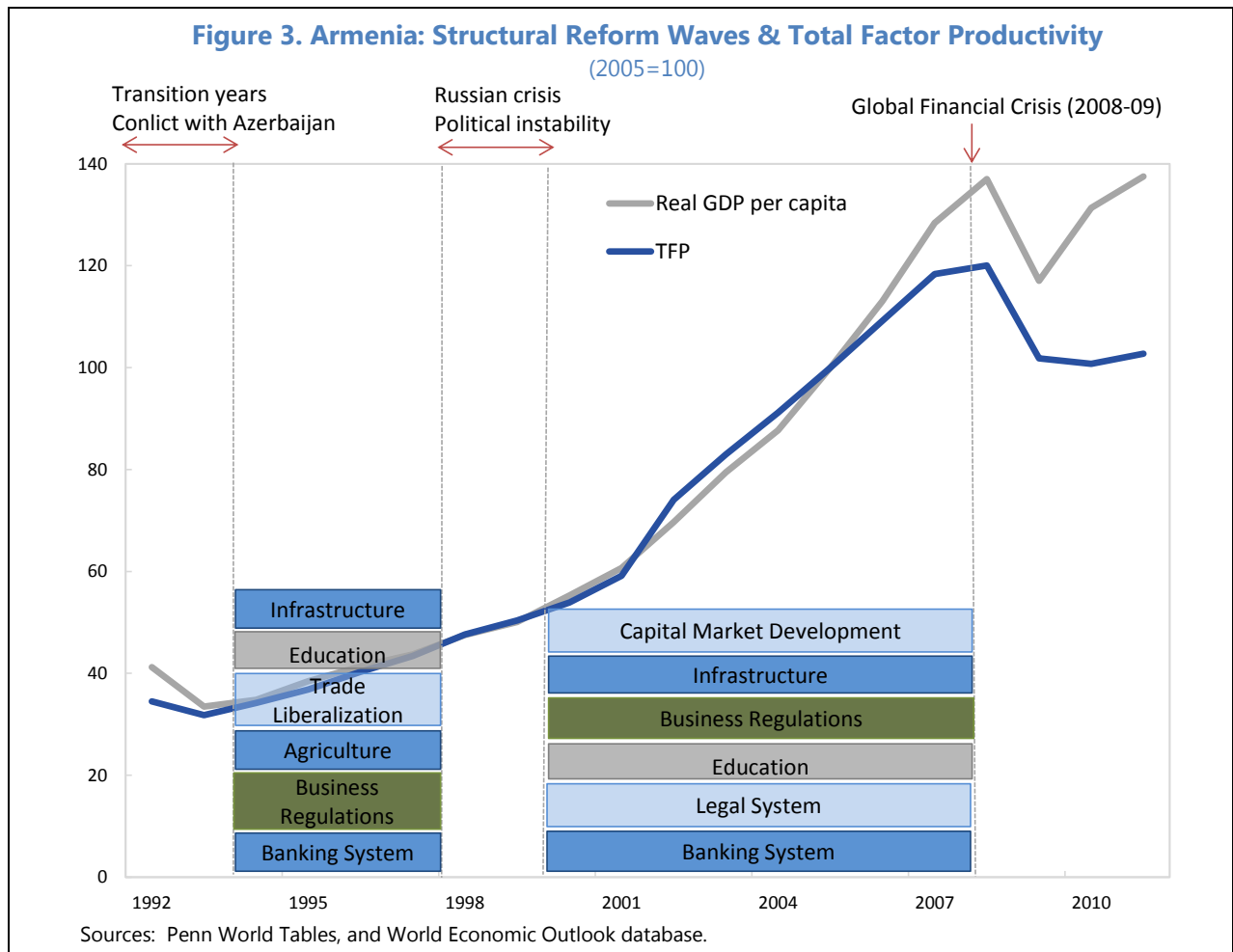
11. The structural reform agenda was geared to support stabilization efforts, reduce vulnerabilities, and sustain medium-term growth prospects. Second generation reforms were pursued including utility reform (energy and water sectors), and privatizing the remaining medium- and large scale state enterprises (including of public utilities), which resulted in significant efficiency gains and improvements in access and services. Reforms in tax and customs administration, and better expenditure management (e.g., financial audit standards in the public sector) were also pursued. In 2001 a civil service reform improved capacity, and better aligned salaries and skills. Following the earlier trade liberalization, Armenia joined the World Trade Organization in end-2002. During 2001–08, the government also focused on improving the business climate by simplifying licensing procedures, introducing a criminal code, new bankruptcy and competition laws and launching an anticorruption strategy (2003). These changes led to an improvement in the business environment and put Armenia ahead of most CIS countries in a variety of governance indicators.

12. During 2002–06 efforts also focused in restoring bank stability. In addition to bank restructuring, a deposit guarantee was established, and the minimum capital requirement was raised (in 2003 and 2005). In 2006 a single framework for risk-based financial regulation and supervision was introduced in compliance with international practice which led to significantly increased prudential standards for non-bank financial intermediaries and the revocation of several licenses. A new consumer credit law to increase market transparency and consumer protection was also introduced. These reforms restored confidence in the banking system and helped accelerate credit.

13. Capital market development was also pursued, though with less success. Information sharing of the activities of joint-stock companies improved and proper systems of financial accounting and auditing of their operations were implemented (2002). In 2008 tax breaks for publicly-traded companies were introduced. However, capital market development remains limited.

14. Armenia's strong growth performance over the two decades following its independence was impressive (Figure 3). It also translated to significant improvements in Armenia's social indicators—the poverty rate has almost halved (from around 50 percent in the 1990s) and rising income levels saw Armenia graduate from PRGT eligibility in 2013. This unprecedented track record until the late 2009s also suggests the complementarities of macroeconomic stability and *strong* and *sustained* structural reforms in achieving strong TFP and real GDP growth.⁵ Armenia's most recent growth record reinforces the importance of sustaining structural reforms throughout the economic cycle.

⁵ TFP data should be interpreted with some caution since they are unobservable and largely depend on the assumptions made on the parameters in the growth accounting exercise. For example, Gelbard et al. (2005) find that increases in TFP explain more than three-fourths of the GDP growth during 1998–2005, while Annex I in IMF (2013) finds that the TFP contribution to GDP growth was much more muted during 2003–11.



AUSTRALIA⁶

This case study covers Australia's structural reform experience, including the relationship with broader macroeconomic reforms, focusing on the 1980s and 1990s.⁷

15. Australia is a high-income commodity exporting country that has been recession-free for 25 years. However, Australia's TFP growth performance had been poor relative to other OECD nations until the 1980s, reflecting high trade barriers, heavily regulated product and labor markets, and high-cost government-owned utility services. As a result, Australia saw its income rank slip continuously among OECD nations. This steady erosion in economic performance up to the 1980s provided the impetus for reforms.

16. While some reforms commenced in the 1970s, Australia's reform efforts accelerated sharply in the early-1980s. What followed was a comprehensive program of structural reforms that spanned nearly two decades. Reforms focused on opening up markets, promoting competition, and improving macro-fundamentals, which helped transform economic performance. Alongside these reforms, Australia experienced a steady rise in real per capita GDP from the early-mid 1980s, and a sustained period of high TFP growth in the 1990s and early 2000s.

17. Reforms initially focused on integrating the Australian economy into the global economy, starting with opening domestic markets to import competition and liberalizing the financial sector and capital flows. They later expanded to promoting competition more generally, including through efforts to improve the performance of state enterprises, industries, and labor markets. In this regard, much of the reform program was aimed at removing distortions that impeded economic efficiency.

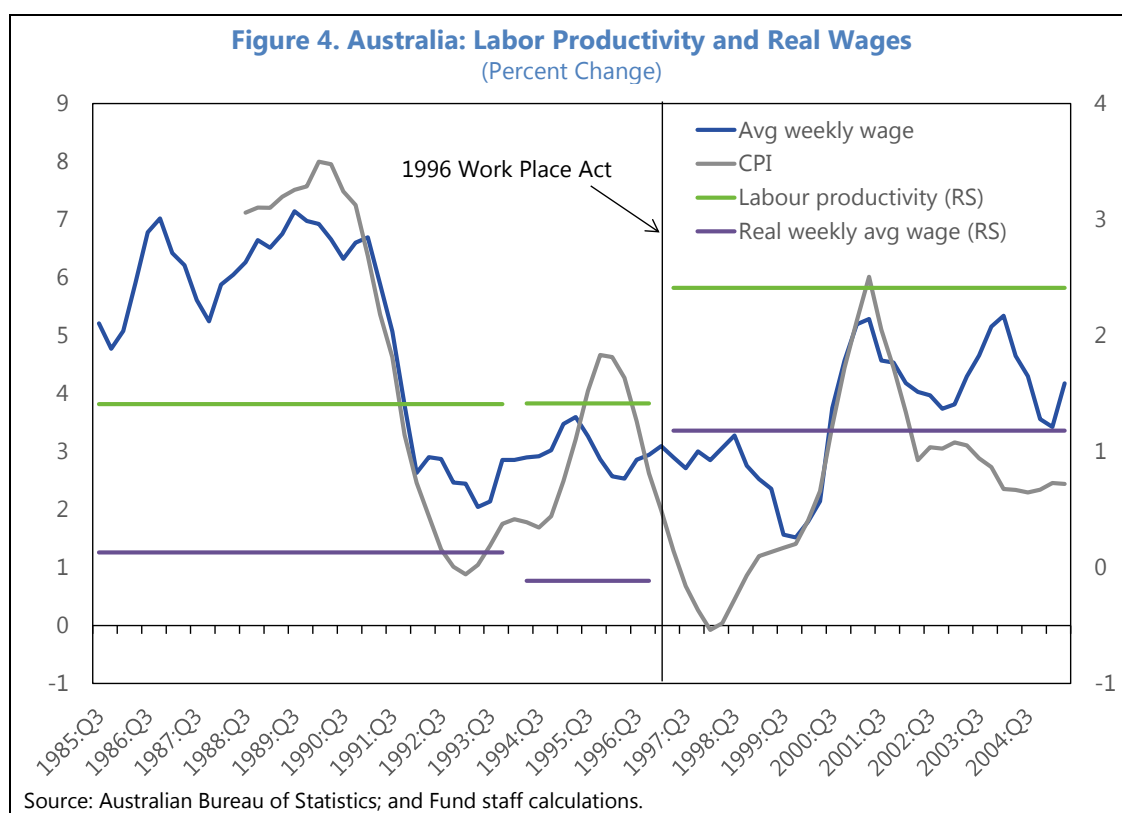
18. The government implemented comprehensive trade liberalization from late-1980s through 1990s, including phased reductions in tariffs across sectors, with virtually all tariffs falling to 5 percent or less by 2000. Extensive financial sector reforms in early- to mid-1980s saw interest rate controls and some bank lending restrictions removed, foreign banks allowed to enter the market, and processes for establishing new domestic banks eased to increase competition.

19. Until 1980s Australia had a highly centralized wage fixing system that did not reflect productivity differences across enterprises—or even sectors—and also set the minimum wage standard. The opening of the economy to international competition led to efforts to reduce labor cost. Labor market reforms started with the shift from centralized wage fixing to enterprise- and productivity-based wage bargaining in the late-1980s and early-1990s. This shift was anchored in a series of *Prices and Incomes Accords*, which were effectively a social contract between the

⁶ Prepared by Adil Mohommed (APD) and Hajime Takizawa (SPR).

⁷ Sources: [Structural Reform Australian-Style: Lessons for Others?](#), Gary Banks, Australian Productivity Commission, May 2005; "Microeconomic Policies and Structural Change", Peter Forsyth, chapter in [The Australian Economy in the 1990s](#), Reserve Bank of Australia, 2000; *Australia: Benefiting from Economic Reform*, A. Singh, et al., IMF, 1998; [OECD Reviews of Regulatory Reform—Australia: Towards a Seamless National Economy](#), OECD, 2010.

Government and the Australian Council of Trade Unions. Reform accelerated in the mid 1990s with the introduction of individual employment contracts (1996 Work Place Act). These reforms helped constrain nominal wage and price increases and provided incentives for greater workplace labor productivity, in turn allowing real wages to grow more rapidly compared to the pre-reform period (chart). Aided in part by these reforms, the unemployment rate declined over time. After peaking in 1992 at over 11 percent, unemployment declined to around 6 percent over the next 10 years. Average unemployment during peak-to-peak periods halved from over 10 percent in 1992Q4-1995Q1 to just over 5 percent in 2001Q4-2009Q3. This decline in unemployment enabled the gains from rising prosperity to be more widely shared.



20. The reduction in import barriers from the mid-1980s and resulting increase in competition also prompted a focus on reforms in other sectors, such as infrastructure services (including public utilities), that bear on enterprise international competitiveness. Against this background, strands of the structural reform process were consolidated and extended in a coordinated National Competition Policy (NCP) in 1995, with a view to apply a more national approach to competition policy, expose previously sheltered activities to competition, and ultimately to promote the long term interests of consumer. The reforms were founded on the following key principles:

- no participant in the market should be able to engage in anti-competitive conduct against the public interest;

- universal and uniformly applied rules of market conduct should apply to all market participants regardless of the form of ownership;
- conduct with anti-competitive potential said to be in the public interest should be assessed by an appropriate transparent assessment process; and
- any changes in competition policy should be consistent with the general thrust of reforms: (i) to develop an open, integrated domestic market for goods and services; (ii) to reduce complexity and administrative duplication.

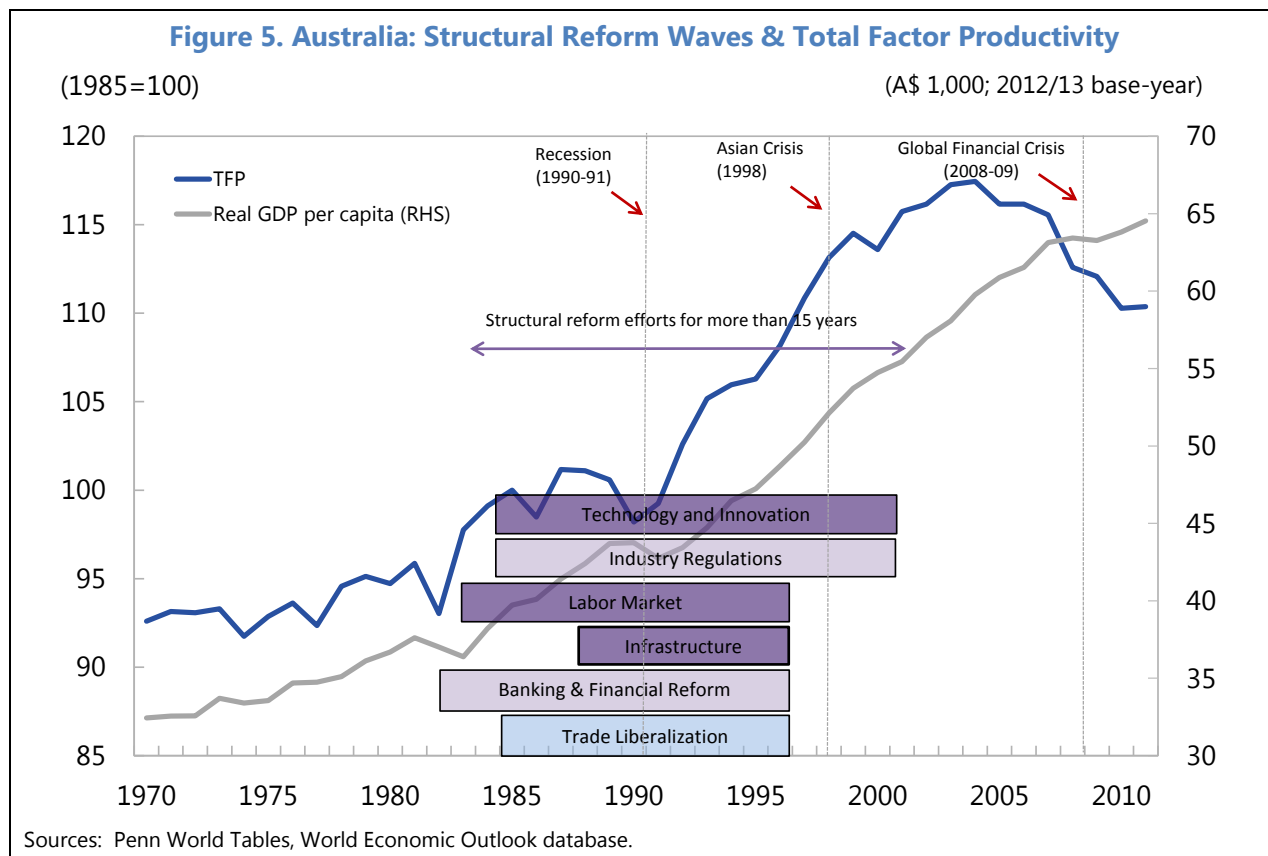
Elements of the NCP included reforming industry regulation to create a level playing field between the public and private sector, limiting monopoly pricing and anti-competitive behavior by firms, and reforming public monopolies to enhance competition, including through reducing barriers to entry.

21. Fiscal incentives have also played a role in boosting productivity. Australia has also seen a rise in the intensity of business R&D, with high rates of ICT uptake, in part aided by tax breaks on R&D expenditure that government provides to compensate for the “spillovers” that result from the R&D investment.

22. Australia’s structural reform efforts were part of a broader economic reform agenda including significant macroeconomic adjustment and reform of macroeconomic policies.

- The exchange rate was liberalized in 1983 against the backdrop of large and growing external current account deficit and the increase in capital flows under the fixed exchange rate regime. Floating the exchange rate also has provided a channel for the macroeconomic adjustment.
- To arrest the widening fiscal deficit that had grown in the aftermath of the recession in early-1980s, Australia began a sustained fiscal adjustment in the mid-1980s. This was underpinned by wide ranging fiscal structural reforms, including overhauling the budget framework as well as comprehensive tax and expenditure reforms. The fiscal consolidation effort was interrupted in early 1990s when Australia was hit by another recession, but was resumed and sustained in much of 1990s.
- The Reserve Bank of Australia effectively shifted to inflation targeting in 1993, stating price stability objective of inflation “held to an average of 2-3 per cent over a period of years.” This followed an average of 8 percent inflation for the 1980s.

23. The reform areas undertaken in Australia are well aligned with those identified as having highest productivity payoffs in AMs. However, trade liberalization—an area associated with high productivity payoffs for LIDCs—was also an important element of Australia’s reforms, reflecting the economy’s position as a remote commodity producer and its history of high tariff barriers until the 1980s. Though major economic reforms have already been implemented, Australia has continued to seek areas for additional reforms. It recently concluded the 2015 Competition Policy Review, setting out recommendations for reforms particularly in the services sector, including human services, transport, and retail.



MALAYSIA⁸

This case study covers Malaysia's structural reform experience as part of its broader economic transformation since the 1970s.

24. Malaysia is an upper-middle income economy whose income per capita has grown 20-fold over the past 40 years. Economic growth was inclusive, with the share of households living below the national poverty line falling from over 50 percent in the 1960s to less than 1 percent currently. This impressive transformation reflects, in part, sustained and wide ranging structural reforms throughout the last four decades. Long term political stability and sound macroeconomic policies have proved essential to successfully implementing structural reforms.

25. An initial period of structural reforms began in the 1970s, when Malaysia was predominately an undiversified agriculture-based economy. The government undertook substantial reforms to increase productivity and eradicate poverty in the agricultural and rural sector. This included a land settlement scheme to provide poor farmers with rights to the land, channeling sizable financial resources to support development of high-yielding agricultural products, improving irrigation and drainage systems, and providing training and other support services. As a result, agricultural productivity increased significantly, helping to reduce poverty and income disparities, while also unleashing ample surplus labor.

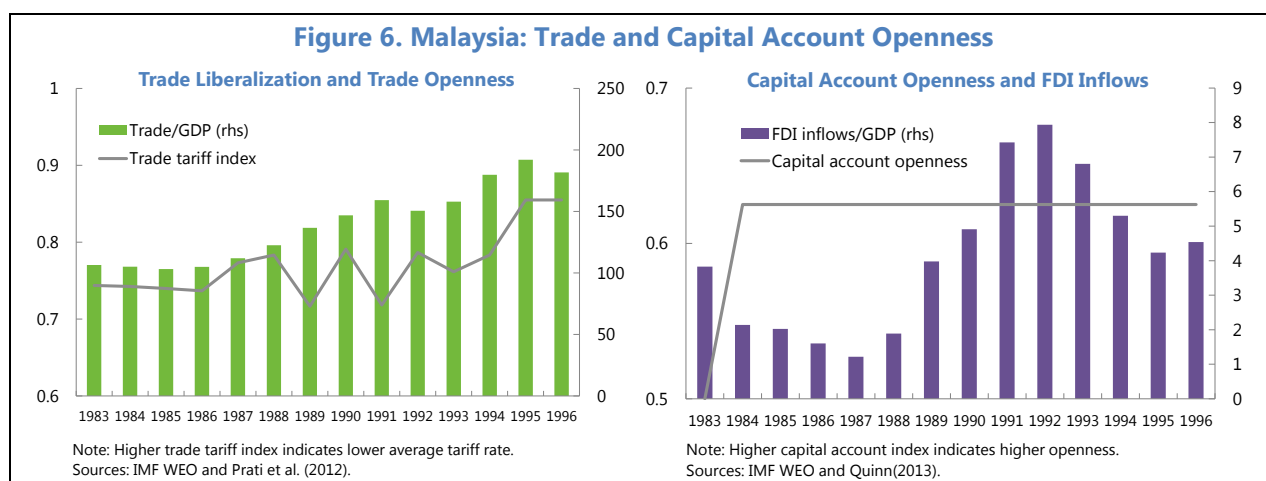
26. In parallel, Malaysia followed a public sector-led development strategy during the 1970s, by scaling-up public investment and strengthening the role of state owned enterprises (SOEs). Higher public outlays boosted annual growth to around 8 percent and reduced the incidence of poverty from about 50 percent in 1970 to 37 percent by 1980, but also led to double-digit fiscal deficits and record high public debt in the early 1980s. This coupled with a downturn in external demand and a fall in the prices of Malaysia's major primary export commodities, resulted in a sharp recession in 1985. The authorities responded by launching more more-based structural reform effort aimed at revitalizing the private sector and restoring macroeconomic stability.

First Generation Reforms

27. From mid-1980s to mid-1990s, undertook a wave of reforms focused on trade, financial liberalization and improving infrastructure. Trade liberalization policies accelerated as the country adopted an outward-oriented development strategy. Import duties on manufacturing sectors that had enjoyed extensive protection over the previous decade were dismantled. The capital account was significantly liberalized, alongside a wide range reforms to strengthen the business and investment environment (such as relaxing industrial licensing and ownership rules, as well as tax incentives and targeted allowances for foreign direct investments), leading to massive FDI inflows into the manufacturing sector. As a result, the economy shifted toward greater reliance on

⁸ Prepared by Cindy (Xin) Xu, in consultation with Alexandros Mourmouras (APD).

manufacturing. Reforms during this period also focused on investing in infrastructure through increased expenditures on the transport and energy sectors, but also through privatization (e.g., telecommunications). Economic diversification, coupled with financial deregulation and liberalization helped spur the development of the banking system and capital markets. These reforms helped to transform Malaysia into an upper middle-income country by mid-1990s. However, the rapid pace of financial liberalization and deregulation, combined with a pegged exchange rate, also brought a surge of speculative capital inflows, increasing vulnerability in the financial sector.



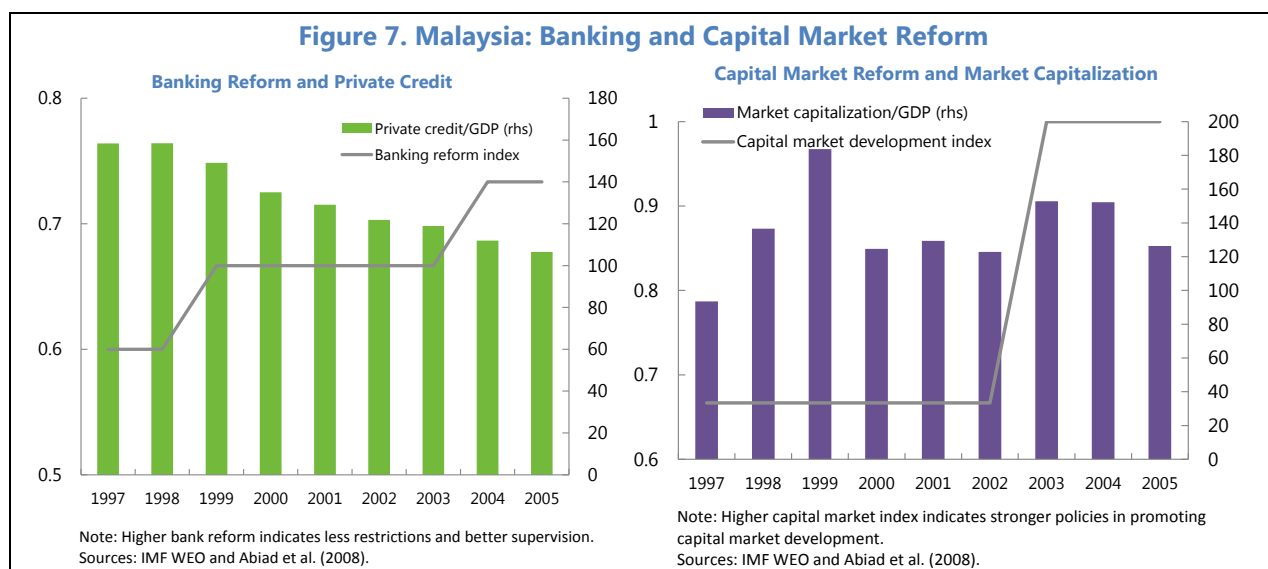
28. During this period, the government also implemented comprehensive fiscal reforms, with large-scale expenditure cuts and institutional changes to the budget process. Tax reforms also sought to lower the tax burden and incentivize private investment. A sound resource wealth management framework—with natural resource rents being invested in productive capital and saved abroad rather than being consumed—also helped to create conditions conducive to productivity growth and macroeconomic stability. Structural reforms, coupled with prudent macroeconomic policies helped restore fiscal sustainability and put the economy on a rapid private sector-led growth trajectory. As a result, the overall budget deficit dropped from 10.5 percent of GDP in 1986 to near balanced budget in the 1990s. Private investment surged from 14 percent in 1986 to 32 percent of GDP in 1997, and annual growth averaged around 8 percent over the same period.

Second Generation Reforms

29. The strong economic performance continued until the 1997–98 Asian Financial Crisis, during which Malaysia experienced a severe currency and banking crisis, with large depreciation and massive capital flight. Austerity measures—a significant interest rate increase and expenditure cuts—were adopted at the beginning of the crisis to help stem capital outflows and the depreciation, but instead exacerbated the economic downturn. In the latter half of 1998, the policy direction shifted to support demand with monetary easing and fiscal stimulus. Around the same time, the Government embarked on a new round of structural reforms under the *National Economic Recovery Plan* to address the crisis legacy of slow growth and weak financial system.

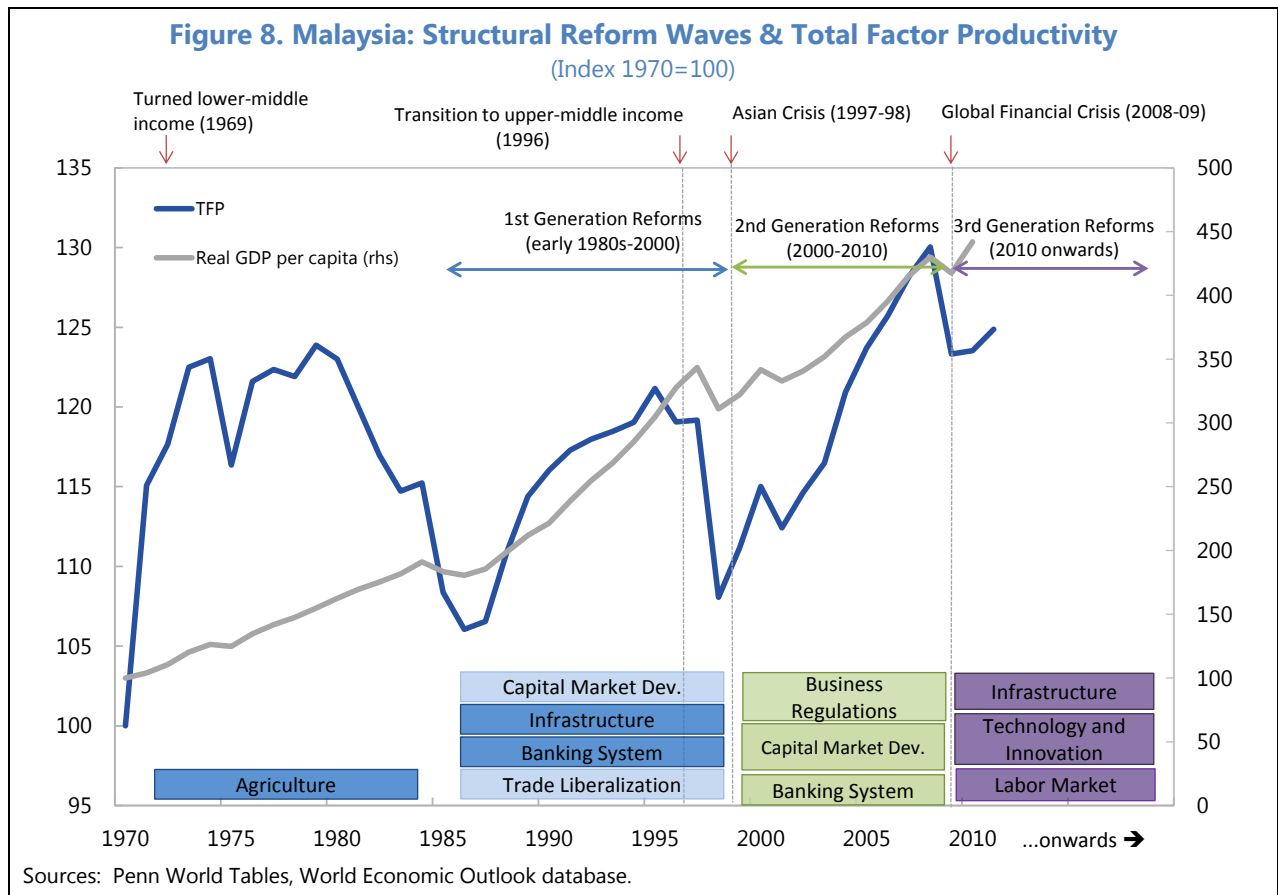
30. This second generation of reforms was implemented in stages through the late 1990s and 2000s, including temporary controls on capital flows and comprehensive financial sector reforms. Capital and currency controls on short term portfolio flows were adopted during the crisis to reduce volatility, and were gradually eased as recovery took place. From 2005 onward, the exchange rate and capital flow policies were almost fully liberalized. More fundamental reforms were undertaken in financial and corporate sectors, including upgrading regulation and supervision in line with international best practices. Banking groups were strengthened and consolidated, and foreign entry was allowed to enhance competition. Equally important was reforms to develop and diversify the capital markets, including liberalization to allow foreign corporations to raise funding.

31. This well-rounded package of reforms helped create a deep and liquid financial system that relies more on the market rather than credit financing, and is more resilient to shocks. Reforms to improve the business regulatory environment also proved very successful boosting Malaysia's reputation as a model for doing business internationally.



Third Generation Reforms

32. With the aim of reaching high income status by 2020, Malaysia launched (in 2010) a new generation of reforms targeting private sector-led growth by moving into higher value-added activities in both industries and services. These reforms include shifting from industrial policies toward innovation and technology policies, improving the quality of infrastructure, and addressing skills shortages in the labor market. Substantial progress has been made in raising school enrollment though challenges remain in further improving the quality of education. Social protection was also improved by introducing the minimum wage in early 2013.



PERU⁹

This country case study focuses on the wave of structural reforms implemented by Peru between 1990 and 1997, including (i) trade liberalization (ii) financial sector reforms; (iii) labor market reforms, (iv) industry and business reforms; (v) fiscal structural reforms; and (vi) monetary structural reforms.

33. Today, Peru is an upper–middle income country and one of the best economic performers in Latin America. From 2002–13, GDP growth averaged 6.2 percent—this is the second highest in the region and Peru’s longest economic expansion on record. By 2013, Peru also ranked 61st (of 148 countries; and 3rd in Latin America) in the World Economic Forum’s Global Competitiveness Report.

34. The policies and reforms of the 1990s helped to lay the foundations for this impressive performance. Between the mid-1970s and 1990, Peru suffered a “lost decade and a half,” characterized by boom-bust cycles, hyperinflation and negative growth. Persistent negative terms-of-trade shocks, policy missteps and a sharp fall in exports led to two major output collapses at the beginning and end of the 1980s. The steep contraction and socioeconomic turbulence during this period created the necessary conditions for a sustained period of economic reform.

35. Economic performance between 1990 and 1997 was much stronger—Peru implemented a successful macroeconomic stabilization and adjustment program, putting an end to hyperinflation, debt crisis and falling GDP per capita. Sustained fiscal consolidation strengthened fiscal buffers and the deepening of financial intermediation promoted financial stability. A radical structural reform agenda was also implemented to liberalize and privatize the economy.

Focus of Reform Efforts

36. The comprehensive suite of structural reforms included:

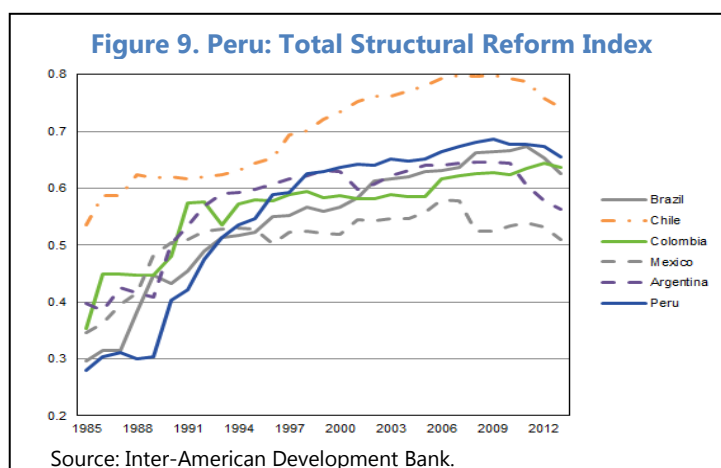
- ***Trade liberalization.*** Reforms began in 1990 with the abolition of quantitative import restrictions and import tariff exonerations. The tariff system was simplified by consolidation to fewer rates at a much lower level - the maximum rate was reduced from around 120 percent to 25 percent, with most transactions subject to a lower 15 percent rate. A series of further tariff cuts followed in 1992, 1997, 2004 and 2008 as a result of various free trade agreements. By the mid-2000s, the average tariff was around 10 percent, down from 66 percent in 1990.
- ***Financial sector reforms.*** In 1990, the legislation nationalizing the banking system was repealed, interest rates were liberalized and marginal reserve requirements on banks’ domestic currency liabilities were reduced from 80 percent to 40 percent. Restrictions on international transactions and financial intermediation in foreign currency were also lifted. The government’s retrenchment from the financial sector continued with the liquidation of state development banks. Separately, a new financial system law was adopted in 1991, including reorganization of the bank

⁹ Prepared by Michael Perks (SPR), in consultation with Kevin Ross (then WHD).

supervisor, extension of the supervisory framework to non-bank financial intermediaries and development of a deposit insurance system. The law regulating the stock market was also overhauled in order to increase transparency, create a guarantee fund, and enable the establishment of new institutions, such as risk rating agencies and mutual funds.

- *Labor market.* Hiring and firing costs were reduced, starting with legislation in 1991 to widen the grounds and speed procedure for the dismissal of workers. This was followed by the relaxation of collective bargaining processes, the introduction of temporary employment contracts, the lowering of severance payments, and the adoption of the new 1993 constitution, which replaced absolute employment protection with a performance-based measure. The 1990s saw steady reform and improvement in the labor market after experimentation with government intervention in the 1980s,
- *Industry and business.* Reforms centered on removing price controls and obstacles to private investment. In 1991, public sector monopolies on basic foods, fishmeal, gold salt, advertising and reinsurance were eliminated and an initial list of 23 industries were identified for privatization, including the energy, telecommunications and transport sectors. While privatization started relatively late in Peru, outcomes quickly outpaced those in other Latin American economies, including Mexico, Colombia and Brazil. Most public enterprises were privatized during 1993–98, leading to substantial government receipts and investment flows.
- *Fiscal structural.* Between 1991 and 1998, a series of reforms were implemented to improve public expenditure management, and simplify and broaden the tax system, including the elimination of value-added, excise and income tax exemptions, and the abolition of taxes with negligible yield. The pension system was also reformed by introducing a fully-funded defined contribution private capitalization system of individual accounts. The transition to this new system was partially financed by privatization receipts.
- *Monetary structural.* During 1990–93, important steps were taken to strengthen the central bank's (*Banco Central de Reserva del Peru, BCRP*) independence, at the same time as unifying and floating the exchange rate and shifting to a regime that targeted monetary aggregates.

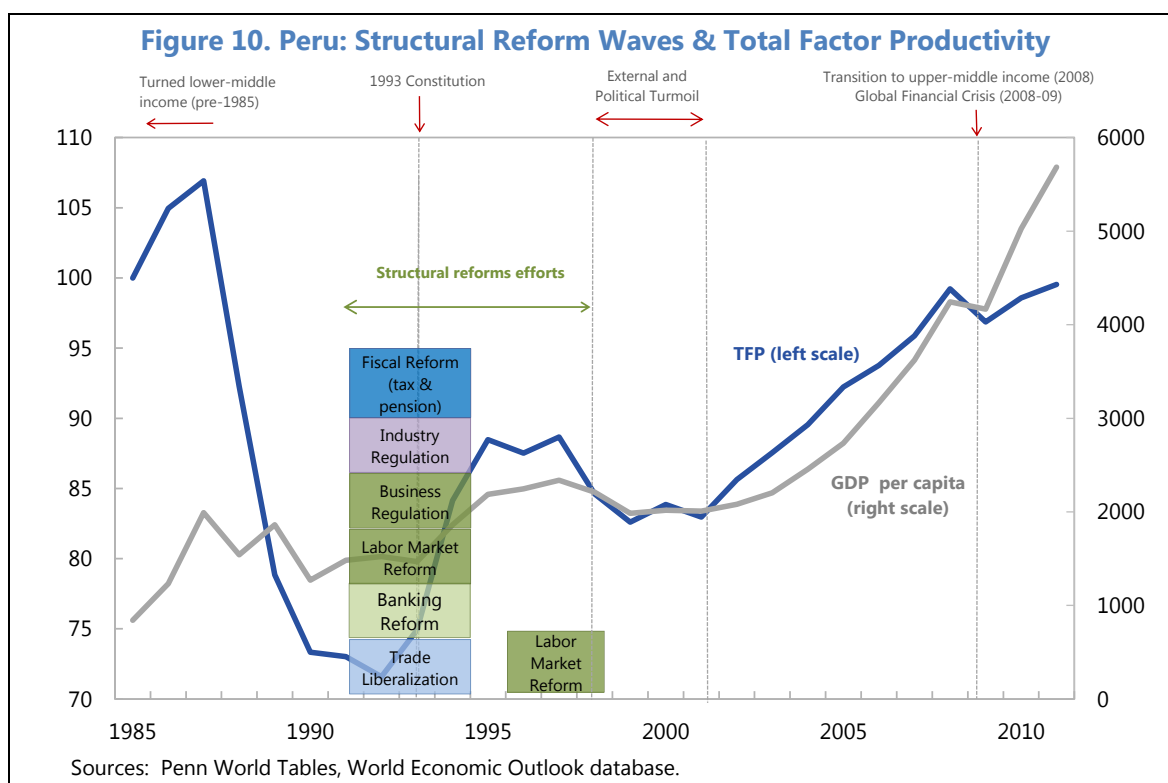
37. While quantifying structural improvements is difficult, a Structural Reform Index developed by the Inter-American Development Bank suggests that improvements in these five areas during 1991–97, moved Peru



from last to second place among the six financially open Latin American economies between (Figure 9).¹⁰ While prudent macroeconomic management and cyclical convergence can explain part of the recovery and expansion, evidence suggests that the acceleration in structural reform was a bigger factor in Peru's dramatic change in economic fortunes.

Productivity and Output Performance

38. Structural reforms improved the allocation of resources and the competitiveness of the economy. Reform coincided with a steep upturn in TFP growth (Figure 10). After declining in the 1980s and part of the 1990s, TFP growth reached an annual average rate of about 2½ percent—among the highest in the region.



39. Growth accounting analysis by Ross et al (2015) finds that this boost in TFP, in turn, played a key role in raising output during the period.¹¹ TFP's contribution to growth swung dramatically from an average of -3.8 percent in the 1980s to around 0.8 percent on average from 1990 to 2003, with average GDP growth reaching 3.2 percent during this period. Furthermore, during 2004–13, the contribution of TFP increased further to 2.4 percent on average, and average GDP growth climbed to

¹⁰ Lora, E (2012) "Structural Reform in Latin America: What Has Been Reformed and How to Measure It," IDB Working Paper Series No. 346, Inter-American Development Bank, Washington, DC.

¹¹ Ross, K. and Peschiera-Salmon, J.A., "Explaining the Peruvian Growth Miracle", *Peru—Staying the Course of Economic Success*, 2015.

6.4 percent. Using long-run co-integration equations, they confirm that structural reforms have played an important role in Peru's long run per capita GDP, along with macroeconomic stabilization and strong external conditions.

	Growth Accounting (In percent)				
	Average GDP Growth	Contributions			Growth rates
		Labor	Capital	TFP	Per capita GDP
1970-79	3.5	2.6	1.8	-1.0	0.6
1980-89	0.4	2.9	1.2	-3.8	-1.8
1990-20	3.2	1.2	1.3	0.8	1.3
2004-20	6.4	2.0	2.0	2.4	4.2

Source: Ross et al (2015).

Resilience to Shocks

40. The structural improvements of the 1990s helped lay the foundations for recovery, but also left Peru better equipped to deal with periodic shocks which occurred at the end of the decade and into the 2000s. Peru was first hit with a series of external shocks between 1998 and 2001— *El Niño*, a sharp drop in commodity export prices, and the liquidity squeeze that spilled over from EME crises. These were compounded by the political turmoil surrounding the 2000 presidential elections. Output declined and the fiscal position deteriorated sharply. However, by 2001 stability had been restored and, as a more flexible, open and competitive economy, Peru was well placed to bounce back and capitalize on the more favorable external conditions and positive terms-of-trade shocks. In particular, Peru was able to absorb a substantial surge in inward investment, which spilled over to the wider economy, raising domestic activity and investment, and creating a virtuous circle that boosted employment, capital accumulation and labor productivity.

41. The positive upward trajectory in TFP and income per capita resumed in 2001 and endured through most of the 2000s, supported by a second wave of more gradual structural reforms that built on the improvements of the 1990s. Most notably, macroeconomic management was strengthened through reforms of the fiscal and monetary policy frameworks, including adoption of the Fiscal Responsibility and Transparency Law (FRTL) that set prudential fiscal rules, introduced a Fiscal Stabilization Fund and promoted transparency; and formal adoption of inflation-targeting by the Central Reserve Bank of Peru (BCRP) in 2002, which cemented stability and ensured the lowest inflation in Latin America over the next decade. When the global financial crisis briefly broke Peru's historic period of economic growth in 2009, policymakers were able to deploy countercyclical policies, drawing on the space built within these reformed frameworks, to ensure that Peru emerged from the crisis relatively unscathed.

TANZANIA¹²

This case study¹³ covers Tanzania's transformation from a largely agricultural, state-controlled economy to one that is more diversified and market-based one. Wide-ranging structural and policy reforms and macroeconomic stabilization, particularly since mid-1990s, underpinned this transformation.

42. Tanzania experienced macroeconomic stabilization and significant structural transformation over the past several decades. Real GDP per capita nearly doubled in the last forty years. This economic success was largely fostered by sound macroeconomic policies and waves of structural reforms that began in the mid-1980s, and accelerated from the mid-1990s to the mid-2000s. These reforms aimed at reducing the role of the state in the economy and offered fertile ground for private sector development and FDI inflows, and were strongly supported by donors.

43. In response to weak growth, high inflation, and a balance of payments crisis, a first wave of reforms began in the mid-1980s with the Economic Recovery Program launched in 1986.

- The exchange regime was gradually liberalized, first by introducing a crawling peg in 1986 and subsequently by full exchange rate unification in 1993, accompanied by the removal of restrictions on current account transactions and holdings of foreign currency.
- In parallel, export and import procedures were simplified, and tariff and non-tariff trade barriers reduced.
- By 1991, domestic price controls—which affected more than 400 prices in 1990—were lifted on almost all products, except for petroleum and public utilities. State-owned marketing boards were abolished to allow the private sector to take over agricultural marketing and distribution.

44. After a few years, weakening commitment to reforms saw reform efforts wane. This was followed by another episode of poor economic performance and declining donor support. Market-oriented reforms resumed in 1996, with stronger national ownership.

- A comprehensive privatization program was launched and by 2003 most of the underperforming manufacturing and commercial parastatals were restructured, liquidated or privatized.

¹² Prepared by Nikoloz Gigineishvili (AFR) and Annette Kyobe (SPR).

¹³ Sources: *Tanzania's Economic Reforms and Lessons Learned*, World Bank, 2004; *Tanzania: The Story of an African Transition*, Roger Nord et al., IMF, 2009; *Sustaining Long-Run Growth and Macroeconomic Stability in Low-Income Countries—The Role of Structural Transformation and Diversification*, IMF Policy Paper, 2014; *Tanzania—Staff Report for the 2014 Article IV Consultation, the Third Review under the Standby Credit Facility Arrangement, Request for a Waiver for Non-observance of a Performance Criterion, and Financing Assurances Review*.

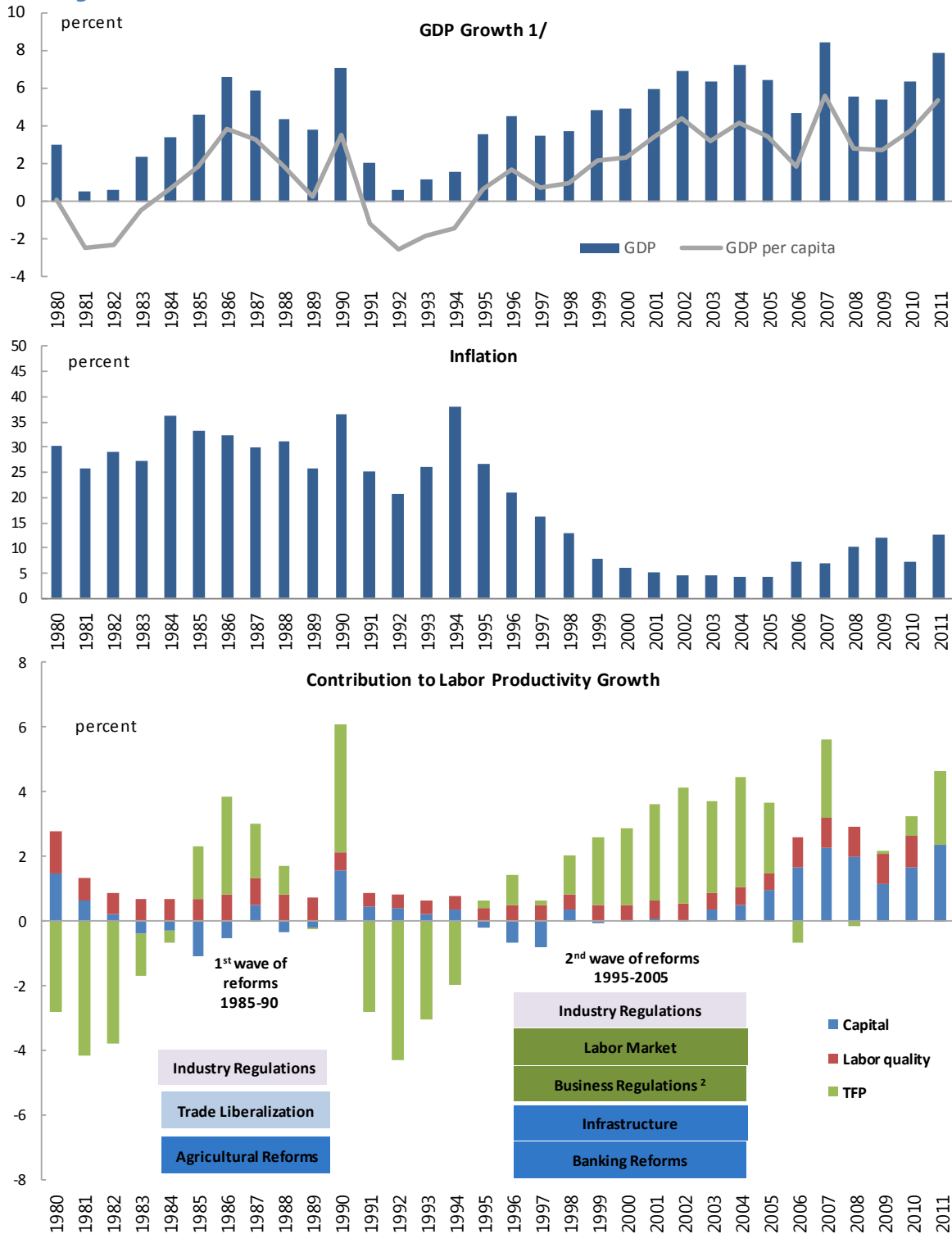
- In the financial sector interest rates were liberalized and banking supervision and regulation strengthened. Foreign banks were allowed to enter the Tanzanian market, while state-owned banks were restructured and privatized.
- Prudent fiscal management during this period was supported by improved budgetary management and the introduction of a cash budget system which constrained government spending. Revenue mobilization was also strengthened through tax policy reforms, including the introduction of VAT in 1998, and improved tax administration.
- In addition, increased public investment in infrastructure, including in the energy sector, provided a platform for productivity growth and expansion of exports. To strengthen the business environment, business licensing and registration were simplified, labor market policies reformed, and property rights strengthened. In response, donor support was also scaled up, which helped increase public investment and poverty alleviation efforts.

45. Tanzania's growth performance appears to have been correlated with the reform efforts (Figure 11). The first wave of reforms helped lift average growth from 2.3 percent in 1981–85 to 4.5 percent in the second half of the 1980s. After declining to 1.8 percent in the early 1990s, the second wave of reforms was followed by growth of up to 4.3 percent in 1996–2000 and to 6.5 percent during 2001–14. More broadly, overall economic performance has improved significantly since the mid-late 1990s. Per capita GDP increased 2.7 times between 1995 and 2014 and overall poverty declined. During this period, inflation fell from the mid-20s to single digits, international reserves increased, and the public debt burden declined substantially in part due to debt relief under the HIPC initiative and MDRI in the mid-2000s.

46. These reforms also helped the Tanzanian economy diversify away from low value-added agriculture. Growth has become broad-based and driven by higher value added services and low-technology manufacturing. The share of agriculture in total output declined from 47 percent in 1995 to 23 percent in 2014, and the agricultural sector itself, which was concentrated in high-volume cash crops such as cotton and coffee, also diversified to smaller-volume crops such as cashew nuts, tobacco, and tea. However, with growth in labor-intensive agriculture lagging, unemployment and underemployment have remained high, especially in rural areas.

47. Moreover, average labor productivity increased by nearly 85 percent during the past last three decades. A growth accounting exercise shows that the contribution of total factor productivity (TFP) was, on average, positive and high during the reform periods (Figure 11). The sustained pickup in TFP is particularly pronounced from mid-1990s, which helped create a virtuous cycle of higher investment, growth and economic diversification.

Figure 11. Tanzania: Structural Reform Waves & Macroeconomic Stabilization



Sources: Tanzania authorities, Penn World Tables, IMF staff calculations.

1/ We use the authorities' national accounts data, which was revised in 2014.

2/ Business regulations include privatization, strengthening property rights, business licensing and registration, tax and PFM reforms.

TURKEY¹⁴

This case study covers Turkey's experience with three waves of structural reforms, including in relation to macroeconomic circumstances and policies, over the past 30–40 years.

48. Turkey in the 1960s and 1970s was the quintessential developing country following an import substitution strategy. Its economic policy goal was to industrialize taking advantage of its large protected domestic market. That strategy succeeded at generating growth in manufacturing output but the performance of manufacturing exports was disappointing. At the time of the first oil shock came in 1973, Turkey relied on foreign borrowing to avoid reducing its imports. That was not longer possible when the second oil price shock came in 1979 and Turkey suffered a severe balance of payments crisis, shortage of essential goods and political instability.¹⁵

49. After two years of negative growth, having to deal with rising budget deficits and balance of payment constraints, Turkey initiated a first wave of economic reforms in 1979–80. At the time, Turkey was essentially a closed economy—exports were only around 5 percent of GDP in 1980. The initial reform effort marked a shift toward the goal of developing a more outward-oriented and market-based economy. While this wave of structural reforms included banking reforms (namely privatizations), the main focus was on capital account opening to facilitate foreign investment and ambitious trade reforms aiming to replace its dysfunctional import substitution with an export promotion strategy.¹⁶ These reforms were remarkably successful—Turkey's merchandise exports rose from 2.6 percent of GDP in 1979 to 8.6 percent of the GDP in 1990,¹⁷ while the economy grew at the annual rate of around 4½ percent during the 1980s. This period also saw a significant investment in infrastructure—transport and energy—laying the foundation for future growth.

50. Notwithstanding these early reforms, economic instability re-emerged by the end of the decade, hinting at where the reform strategy may have fallen short. Fiscal problems interceded to stall that benign, cycle and unleashed a period of high current account deficits and inflation.

51. To avoid heading towards another balance of payment crisis driven by large and unsustainable fiscal and external imbalances, structural reforms regained momentum in the mid-1990s against a backdrop of severe recession and fiscal retrenchment.¹⁸ In its second wave of reforms, Turkey continued its trade liberalization efforts, with milestone agreements with the World

¹⁴ Prepared by Irineu de Carvalho Filho (SPR), in consultation with European Department.

¹⁵ Öniş, Ziya and Steven B. Webb (1994), "Turkey: Democratization and Adjustment from Above," in *Voting for Reform: Democracy, Political Liberalization, and Economic Adjustment*, eds. Stephan Haggard and Steven B. Webb.

¹⁶ Harrison, Rutherford and Tarr (1993) found that Turkey's trade reforms in the 1980s achieved, on average, the goal of removing anti-export distortions. (Harrison, Glenn W., Thomas F. Rutherford, and David G. Tarr, "Trade Reform in the Partially Liberalized Economy of Turkey," *World Bank Economic Review* v7. May 1993 Number 2, pp. 191-218,

¹⁷ Pamuk, Şevket (2007), *Economic Change in Twentieth Century Turkey: Is the Glass More than Half Full?*, mimeo.

¹⁸ Turkey also entered into a Stand-By Agreement with the IMF.

Trade Organization (1995) and the European Union (Customs Union agreement, 1995), which reduced tariff and non-tariff barriers. The government also improved its banking supervision framework and privatized state-owned enterprises. Growth recovered in 1995–97 as the output gap closed, but productivity growth was disappointing, and the problematic fiscal and debt dynamics were not tackled—these factors were again at the forefront of renewed instability in the late 1990s.

52. Close on the heels of the Russian and Asian crises, the devastating Marmara earthquake hit Turkey’s most populous and industrial region in August 1999. The economy contracted sharply as export and tourism receipts plunged, inflation rose and Turkey sought emergency assistance from the IMF. While the subsequent stabilization program, supported by the IMF, succeeded in reducing inflation from high levels, it did not address problems in the financial sector that spurred a full-blown banking crisis in 2001.

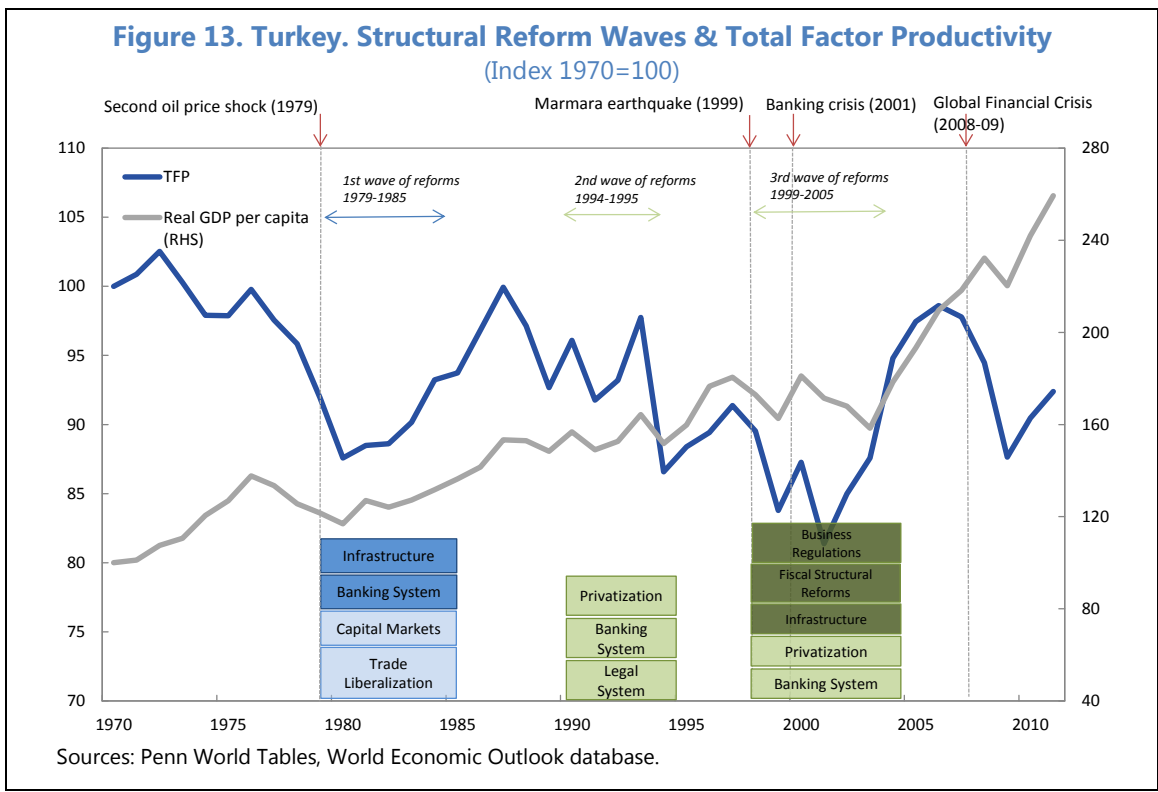
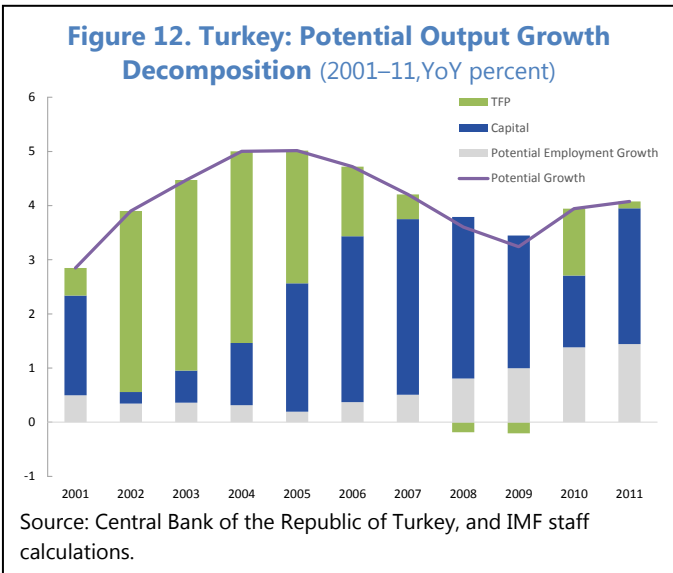
53. In response, Turkey embarked on a more comprehensive and well-rounded wave of reforms, with the continued support of the Fund. The reforms of the 2000s focus on macroeconomic policy frameworks as well as structural reforms that sought to balance the goal of an open, market-based economy with appropriate regulatory checks and balances.¹⁹

- Reforms to the macroeconomic policy framework. Wide-ranging reforms related to macroeconomic management marked a fundamental change in approach. This included adopting a floating exchange rate regime and establishing the independence of the central bank. There were also sweeping changes to the fiscal framework, with the Public Finance and Debt Management Law (2002), new corporate and personal tax legislation (2002), the introduction of a medium-term expenditure framework (2006) and modernizing the debt management system (2003). Laws were also passed to insulate public sector banks and state owned enterprises from political interference.²⁰
- Financial sector reforms. Efforts to restructure the banking system sought to address the underlying regulatory and supervisory weaknesses. Importantly, this included establishing the independent Banking Regulation and Supervision Agency, as well as the Capital Markets Board.
- Business and investment-related reforms. Reforms also continued to promote an environment conducive to private sector led growth, including easing regulations on starting a business and facilitating private investment (including in infrastructure). However, these reforms were not aimed at unchecked regulation. For instance, privatization in the energy and telecoms sectors was complemented by the creation of independent regulatory agencies (e.g., the Energy Market Regulatory Authority in 2001). Further reforms included the new Foreign Direct Investment Law (2003) and, more recently, a new commercial code to improve corporate governance (2012).

¹⁹ *Turkey’s Transitions: Integration, Inclusion, Institutions*, 2014, World Bank.

²⁰ Pamuk (2007).

54. Turkey’s reform efforts have resulted in a considerably more open and globally integrated economy. Since the first wave of market-oriented reforms, Turkey’s share in global imports has more than tripled. Investments in infrastructure—both public and private—Turkey now “ranks among the top 30 countries globally for the quality of its logistics.”²¹ While the pattern of productivity performance is less consistent, particularly following the earlier reform waves, there was a sharp upswing in productivity after 2001 (when it contracted sharply with the crisis and in part reflecting spillovers from the September 11 events). Strong TFP growth was a key driver of the increase in potential output growth around this third wave of reforms, although the upswing in productivity tapered off prior to the Global Financial Crisis. Nevertheless, the comprehensive and more balanced financial sector reforms of the early 2000s resulted in a more robust financial system that helped shore up Turkey’s resilience during the global financial crisis.



²¹ World Bank (2014).