

## **Latin American/Caribbean Economic Performance and Perspective**

After a year of solid economic growth, 4% in 2000, the weighted average growth rate in Latin America and the Caribbean dropped drastically in 2001, to 0.3%-0.5%. The outlook for 2002 is for a continued decline in per capita incomes with stagnant economic growth (ECLAC predicts 0% and the World Bank foresees a slight decline). The recession continued in first quarter 2002 with a drop of 3% in GDP region wide. Unemployment is estimated to exceed 9% this year. In most countries, inflation remains under control, except for the effects of the devaluations in Argentina, Venezuela and Brazil. However, capital inflows are projected to decrease in 2002 to about \$50 billion (\$38 billion in autonomous flows and \$12 billion in compensatory flows) from an average of about \$74 billion in the late 1990s.

The major cause of this continued poor economic performance is the general slowdown in the world economy, particularly in the US. World and Latin American trade volumes fell in 2001. Europe also had low GDP growth in 2001 and Japan was in its third and worst recession of the past decade. Consequently, commodity prices have been weak, especially coffee. Foreign remittances are down, as are regional exports. The economic crisis in Argentina has impacted neighboring economies somewhat and its drastic decline has pulled down the averages for the region. Droughts and then floods also played a role in some Central American countries.

### **MERCOSUR**

MERCOSUR has been weakened first by the Brazilian devaluation and then the Argentine meltdown (GDP fell 16.3% in the final two quarters of 2001 and the first of 2002). Brazilian markets are jittery, reflected in a weakening of the real, as leftist Workers Party candidate Luiz Inácio da Silva increases his standings in the polls leading up to the presidential elections. Slight growth is the best that Brazil can hope for this year, after GDP decreased by about 1% in the first quarter. Uruguay and Paraguay are projected to show a decline in GDP as well. Uruguay suffered from an outbreak of hoof and mouth disease and its third year in a row of declining GDP. In this setting, some MERCOSUR members modified the Common External Tariff and others unilaterally imposed new barriers to trade. Intraregional trade dropped by 13% in 2001 over 2000.

Despite these trends, meetings to further integration among the member countries continued throughout 2001. An agreement was signed in October to integrate the automobile market by 2005, followed by an agreement to continue negotiating liberalization of the services sector, but tariff reductions were slowed to 1% from the 2.5% agreed to earlier. In April, representatives of MERCOSUR and the European Union met to discuss a trade agreement and after four more meetings the EU presented an offer and negotiating text. MERCOSUR responded with a

counteroffer and successive meetings continue to work on the agreement. Reportedly, the South Americans are a bit disappointed in the provisions for market access for their agricultural products. MERCOSUR also held talks with the Andean Community in June and presented a proposal for a free trade area to be achieved over 10 years. In August, the AC responded with a counteroffer and two more meetings are being held this Autumn to negotiate differences.

### ***Andean Countries***

The Andean countries can be divided into two tiers, with the southern tier (Chile, Peru, Bolivia and Ecuador) performing better than the northern tier (Colombia and Venezuela). Chile is projected to have a GDP growth rate of about 3%, Bolivia 1.5%, Peru 3% and Ecuador 2.5%, although the terms of trade for these countries have turned unfavorable since 1997.

Peru may slip more with interest rates expected to rise, thus slowing private investment. The government's privatization program was brought to a halt after demonstrations that also cost the government of President Toledo further drops in its already weakening popularity. Ecuador has had the best performing economy in recent years and appears to have responded positively to dollarization of the economy. Although its growth is dropping off this year, it compares favorably with most countries in the region, especially those to its north. Bolivia avoided a return to its fractious past by electing (barely) former centrist President Gonzalo Sánchez de Lozada. He should keep the country on a steady growth path.

Colombia, with its intensifying war against insurgency, is projected to have a 1% growth rate (ECLAC) in 2002 after a largely stagnant 2001. However, the need to raise more revenue for the public sector makes this projection for 2002 seem optimistic. President Uribe is gearing up for an all-out effort to defeat the FARC guerrillas. Venezuela seems no closer to solving its internal problems and political uncertainty continues to dampen investment and promote capital flight, even though oil prices have stabilized within the OPEC band. Venezuela enjoyed a GDP growth of about 3.4% in 2001 based largely on government spending, but continued devaluation and inflation, not to mention constant political demonstrations against President Chávez, are the order of the day. Economic stagnation or even recession is probable in 2002.

### ***Central America***

Still reeling from the effects of Hurricane Mitch, the Central American economies were hit by Hurricane Iris (Belize 2001) and two strong earthquakes in El Salvador in early 2001. Added to this were extremely low coffee prices and a region-wide drought in late 2001 and early 2002, as well as generally slack demand in major export markets. The US announced in January 2002 that it was willing to discuss starting negotiations of a possible free trade area with the Central American countries. The sub-region already benefits from the Caribbean Basin Economic Recovery Act, and its benefits were improved with the Trade Act of 2002. Nonetheless, the Central American Common Market increased its share of intra-

CACM trade from 16% in 1990 to 24% in 2001.

The banking sector remains weak, with Honduras and Nicaragua having over 15% of GDP equivalent in bad debts in their banking systems. All of the Central American countries are resorting to issuing sovereign bonds to finance deficits in their current and fiscal accounts.

The CACM countries are projected to enjoy a 2.3% GDP growth in 2002, compared to 1.4% in 2001. Proximity to the US market has cushioned them against the more severe declines experienced this year in MERCOSUR and the northern tier of the Andean Community. Falling petroleum prices also have helped these energy importers. The strongest growth (3%) is projected for El Salvador and Honduras and the weakest for Costa Rica (1%). Panama is expected to see more dramatic improvement, from 0.3% GDP growth in 2001 to 1.5% in 2002.

### ***Caribbean***

The Dominican Republic has been the star performer in the Western Hemisphere in recent years and is projected to reach 4% GDP growth in 2002, up from 2.7% in 2001. On the other side of the island, Haiti is projected to recover from a 1.7% decline in GDP to reach perhaps zero growth. Belize also is projected to improve slightly over 2001 (1.1%) with a 1.9% GDP growth this year.

### ***Mexico***

Mexico, like Central America, is somewhat isolated from the worst of the economic declines in much of South America due to its close trade relations with the US. In spite of a weak international economy and the beginnings of a US recession, Mexico received twice the foreign direct investment in 2001 (\$27.7 billion) as it did in 2000 (\$13.6 billion). Mexico's GDP dropped 2% in the first quarter but is expected to recover during the remainder of this year. Average GDP growth for this year is projected to be 1.5%, after falling by -0.3% in 2001. Mexico also has successfully diversified its exports so that petroleum exports represent only 10% of the total. However, oil profits still have a big impact on the fiscal accounts of the federal government. In 2001, Mexico was able to reduce inflation, the current account deficit and even the fiscal deficit, as well as the debt service as a percent of total exports.

### ***Observations***

The IMF predicted in May that the countries of the region would grow at a 4% rate for the rest of the year, closing 2002 with an overall average growth of about 0.5%. It projected GDP growth for 2003 at 3.5%, compared to ECLAC's prediction of only 2.5%. Inflation is predicted to remain in check. Although not a pretty scene for 2002, even this seems a bit optimistic. In any case, there is no short-term improvement in sight for the 168 million people in Latin America living in poverty (defined as living on less than \$2 per day - of which 77 million are living on less than \$1 per day) out of a total population of 510 million.

Five elections are scheduled for the second half of this year in Latin America, and

some of these could result in changes in economic course. This would be unfortunate. Although times are tough, many achievements have been recorded. If the clock were turned back just as economic growth is returning, it would represent a step backward for the region. It could well mean a delay beyond 2005 in achieving the FTAA and a fracturing of South America in the sense of macroeconomic policy coordination and development direction. Some countries may opt for continued openness and reliance on the private economy for the bulk of economic progress, while others might return to protectionism and statism.

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