Economic Recovery in Latin America and Its Political Sustainability

2004 has been a year of almost universal economic growth and recovery in Latin America and the Caribbean. The growth has been based largely on a rebound in the world economy estimated at 3.8%, generating especially strong exports to the US, Japanese and Chinese markets. This trend was boosted by a 7.2% (excluding oil) increase in the price index of basic export products and, more importantly, better fiscal and monetary control policies and competitive exchange rates.

Overall GDP growth for Latin America and the Caribbean will be 4.5% in 2004, according to ECLAC estimates, following growth of 1.5% in 2003. The biggest increase is in countries that fell the farthest in recent years – Venezuela, Argentina and Uruguay. After two consecutive years of growth, the ECLAC economies' per capita income will be about even to where it was in the late 1990s. Only Haiti and the Dominican Republic will experience a small decline in GDP this year.

Unemployment improved slightly over 2003 to 10.3% and is projected to continue to decline. The inflation rate for 2004 is expected to be below the already improved rate of 8.5% for 2003. Fiscal discipline in a majority of the region's countries should produce an average surplus of 1% of GDP, the largest surplus in many years. The growth in public debt is being contained and lending rates to Latin America have dropped to 9.4% (from 9.9% in 2003 and 12.7% in 2002). The region experienced a surplus in the current account of the balance of payments equal to 0.8% of GDP, as export growth outpaced the growth in imports. International reserves increased by $29.6 billion and foreign investment is projected to grow, reversing a four-year decline.

Trade Negotiations

The competitiveness of Latin America's economies and price stability will be improved by trends toward freer trade. These include: 1) advances in sub-regional common market agreements; 2) the ongoing negotiations for a Free Trade Area of the Americas (FTAA); 3) negotiations in the World Trade Organization (WTO); and 4) bilateral FTAs with the US, the European Union and other countries.

The lowering of barriers to trade within economic blocs (MERCOSUR, the Andean Community, the Central American Common Market) seems to be moving slowly except when pushed by the stimulus of free trade negotiations with the US and EU. The FTAA talks have been slowed and weakened by the two-tiered approach that emerged from the Miami Ministerial in fall 2003. The Doha Round of WTO negotiations achieved a major breakthrough in agriculture when a framework for negotiations was agreed to earlier this year. But US bilateral negotiations with the EU, MERCOSUR and the Andean Community are moving slowly and are not likely to achieve a dramatic breakthrough. Negotiations with Central America concluded successfully but the Andean nations are moving ahead piecemeal: Colombia, Peru and Ecuador are actively engaged, while Bolivia is waiting and watching and Venezuela is ideologically opposed to the process.

The Interaction of Economics and Politics

Good economic performance can be reversed or limited by bad economic policies and/or by a deteriorating political environment. In Latin America only Chile has been able to maintain sustained economic growth by implementing sound economic policies and avoiding political crises. The improved economic picture in 2004 will give democratic governments a stronger base and the opportunity to lead their countries toward greater prosperity and stronger institutions, but how and where the various countries will in fact be led is neither uniform nor certain.

MERCOSUR is the biggest market in the region but its leadership on economic and political issues has been inconsistent. Brazilian President Luis Inacio da Silva (Lula) has irritated his leftist supporters and delighted the business community by curbing his leftist rhetoric. However, he appears to reject a strong FTAA that would require exposing inefficient industries to competition. Brazil has enjoyed some success in the WTO with a panel decision against US cotton subsidies and the recent framework for agricultural negotiations. The unforeseen consequence may be that Brazil will think it does not need to make concessions in other areas to achieve its goals, thus dooming the FTAA.

Argentina is experiencing strong growth, but it aims mostly at stability after the country's freefall. President Nestor Kirchner has followed generally populist policies but has avoided scaring off domestic investors. However, he shows no eagerness to tackle tough problems or to increase the competitiveness of the economy. He is a strong backer of MERCOSUR but change there will not bring needed benefits anytime soon.

The Andeans face greater political divisions and internal strife and therefore appear more fragile, but at the same time they appear willing to undertake reforms and engage in real trade liberalization. Colombia is experiencing substantial economic growth in spite of an interminable war against Marxist insurgents. It is engaged in FTA negotiations with the US and there is an attempt to change the constitution to allow popular and successful President Alvaro Uribe to run for a second term. Peru has enjoyed three years of healthy economic growth under President Alejandro Toledo even while his popularity sinks to new lows (now reportedly 8%). Peru is pursuing FTA negotiations with the US and talk of ending Toledo's term early appears to be dwindling. Ecuadorian President Lucio Gutiérrez has angered some of his leftist indigenous supporters by following more orthodox economic policies than they expected. Dollarization has stabilized the currency and tamed inflation but leftist groups oppose its constraints on social spending. Bolivia is politically unstable since the ouster of President Gonzalo Sánchez de Lozada. Leftist indigenous leader Evo Morales continues to exercise enough power to disrupt stability but apparently lacks sufficient backing to win an election.

Venezuela is a special case. Populist President Hugo Chávez has been strengthened by the failure of a recall referendum against him. He promises to deepen his "Bolivarian Revolution," much to the chagrin of the private sector and political opponents who see a grab for more power and control. Economic growth is steady as a result of government expenditures before the referendum but it comes after more than three years of economic decline. The government opposes trade talks with the US and is courting MERCOSUR instead. Medium-term prospects do not look good and the short term depends on the price of oil.

Central America is enjoying political stability and modest economic growth as the Central American Free Trade Agreement (CAFTA) awaits approval by the US Congress. The Central American governments have failed to keep their exchange rates competitive. El Salvador managed to keep a stable exchange rate thanks to remittances even as exports lost their competitiveness, and then made a decision to dollarize the economy. Short- and medium-term prospects for Central America are good but tied closely to the performance of the US and world economies.

In the Caribbean, changes of government in Haiti and the Dominican Republic promise improvements in economic performance and political management. The DR has successfully concluded a FTA negotiation and joined CAFTA. Haiti is about to receive more substantial economic assistance. Barbados had modest growth of 2.2% in 2003, reversing prior years of GDP decline. This trend continues in 2004, as does the improvement in the fiscal deficit. Jamaica also produced a 2.1% GDP growth rate - the highest in ten years – although the government has been unable to bring the fiscal deficit under control. In general, the islands of the Caribbean are participating in the FTAA but want slow change as they lobby for special and differential treatment. They benefit from the Caribbean Basin Initiative and preferences from the Lome Convention, but the governments of the region appear to have little commitment to structural change.

Is Economic Growth in Latin America Sustainable?

The world economy is one of the forces pushing Latin American economic growth, and its outlook is uncertain. China is slowing down its growth rate, Japan seems to veer from slight improvements in economic performance to stagnation, and US economic growth is based on large fiscal deficits that may not be sustainable if inflation returns. The enormous US balance of trade deficit that is assisting Latin American export growth is also not likely to be sustainable. Domestic demand is weak but is expected to strengthen later in 2004 and into 2005. This could sustain the growth trend but individual economic and political policies in each country will play an important role.

Maintaining fiscal and monetary discipline will be essential, along with competitive exchange rates. Savings and investment need to be increased; gross fixed investment as a percent of GDP was 17.9% last year, its lowest level since the 1970s. The World Bank estimates that $70 billion per year is needed for investment in infrastructure alone. There are, for example, 72 million people in Latin America without safe drinking water. And one-third of the region's population continues to live in poverty.

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