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Latin American Outlook

Latin America and the Economic Crisis: Going It Alone

By Roger F. Noriega

In Latin America, 2008–2009 will be recorded as a profound crisis that took the wind out of the sails of important regional economies, many of which had strung together years of significant growth. But the good news is that most of these nations have adhered to market solutions, rejected protectionism, controlled spending, contained inflation, and kept their economies open to more foreign trade and investment. The Western Hemisphere can only hope that Washington's spendthrift policies will not stall a natural recovery in the U.S. economy or that the politics of protectionism will not prevent President Barack Obama from demonstrating some economic statesmanship, particularly on trade.

Most Latin American governments, which, in the last decade, came to recognize the benefits of orthodox economic policies coupled with targeted antipoverty programs, have managed to prevent a free fall in their economies and appear to be on their way back to decent growth next year. Key Latin American economies were growing at near double-digit rates before the economic crisis—driven by high commodity prices and reinforced by responsible economic policies. That ground to a halt after the economic meltdown last fall, and only a handful of countries are expected to record any growth this year. Brazil, Colombia, Chile, and Argentina are expected to shrink by up to 2 percent in 2009, according to the International Monetary Fund (IMF) and independent analysts; Mexico's U.S.-dependent economy (hit hard by panic over drug violence and the flu pandemic earlier this year) may suffer a historic contraction.

High commodity prices (oil and gas, copper, and soybeans) had fueled growth in many regional economies. Reduced demand for these goods due to the global downturn has hurt export revenues. For example, Venezuelan oil is down to $61.30 a barrel, down from a peak of $129 in July 2008—although crude oil prices have rebounded by over 30 percent since April.[1] Copper prices are at $4,569 a ton today, compared to a peak of $8,443 at this time last year. Soybean prices have been a bit steadier, but today they are about 20 percent below the average price they commanded in 2008.[2]

Foreign direct investment (FDI) also poured into the region over the last several years, posting substantial gains just before the crisis. The brakes

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Key points in this *Outlook*:

- A prolonged recession in the United States and uncertainty in the financial markets may threaten recovery in Latin America.
- The region's principal economies are undergoing very different tests, but many are mustering successful free-market responses.
- The Obama administration's protectionist impulses may undermine what the United States has to offer the region.

were put on late last year, and FDI peaked at about $130 billion in 2008—a 13 percent increase from the previous year. But this rate of growth was down sharply from the 52 percent gain recorded in 2007.[3] The United Nations Economic Commission for Latin America and the Caribbean predicts that FDI may drop by 45 percent this year.[4] Inasmuch as the United States accounts for about a quarter of FDI to the region, a prolonged recession and uncertainty in the financial markets may threaten the nascent Latin recovery.

Mexico and Central America will be hit hardest by a significant drop in remittances sent home by immigrant workers in the United States. In April 2009, Mexico received 20 percent less cash from remittances compared to the same month last year. For these nations, remittances have become the second largest source of hard currency, following only oil or tourism revenues, depending on the country. It remains to be seen whether or how quickly remittances will bounce back, as workers forfeited jobs in the face of a slowing U.S. economy and a crackdown on illegal immigration.

The performance of regional stock markets suggests that the economic downturn may have bottomed out last month. For example, in late May, Brazil's benchmark stock index Ibovespa registered eight-month highs, with strong gains by the country's largest steelmaker. Since the nadir in early March, the Brazilian and Mexican stock markets have recovered over 40 percent of their value.[5] Others have recorded healthy gains, although analysts predict a correction in regional stocks. Meanwhile, currencies that lost significant value against the dollar have recovered substantially and stabilized. Only Venezuela's inflation rate seems to have galloped out of control, but that trend predated the current crisis and was caused by President Hugo Chávez's incompetence, corruption, and statist policies.

In the several years ahead, each country will have to contend with resurgent poverty brought on by the current slowdown and tame inflation that might stem from stimulus spending and growing debt. Mexico and Venezuela—for very different reasons—are facing deeper crises, but the way in which those two governments respond will prove, once again, that sound market policies pay dividends and socialism leads to bankruptcy.

The region's principal economies are undergoing very different tests, but most are mustering free-market responses. Only Venezuela appears to be compounding its troubles with wrong-headed policies.

Brazil

Back in March, Brazilian president Luis Inacio Lula da Silva said that the global economic crisis was "caused and encouraged by the irrational behavior of white people with blue eyes."[6] Yet despite such bombastic rhetoric, Lula has governed responsibly during these turbulent months. Latin America's largest economy will likely shrink by around 1 percent this year, but the government predicts growth of 3–4 percent in 2010—driven by a strong internal consumer demand and countercyclical measures applied by the Brazilian government.[7] The country also announced that it would buy $10 billion in IMF bonds in order to diversify foreign currency reserves and gain leverage over global financial policies.[8] Nevertheless, unemployment is expected to climb to over 9 percent before the economy recovers its footing. Conditional cash transfers, supplementing the income of millions of the nation's poorest families, have softened the blow of the economic crisis and may keep millions from sinking back into dire poverty.

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Brazil has vowed to continue the $235 billion in capital improvements announced during the last two years, targeting modernization of logistics (railways, roads, ports, and airports), energy (generation, grids, oil and gas, and renewables), and social infrastructure (sanitation, housing, potable water, and electrification). In March, Lula announced a $15 billion low-cost housing program to create jobs and affordable homes.[9]

The federal government's decision to suspend an industrial tax on cars, paired with the decision by banks to extend the auto loan maturities to six years, produced an 18 percent increase in General Motors sales in May, compared to the previous month. Fiat and Volkswagen logged lesser gains, helping the industry as a whole boost its sales to last year's levels. (That car tax break is set to expire at the end of June, although there is some talk of an extension.)[10]

The substantial modernization of Brazil's productive infrastructure will likely make the country even more competitive after the global economy recovers. Moreover, the massive oil reserves discovered in recent years will be an extraordinary boon to the economy as

international capital markets return to such ambitious projects and as oil prices increase enough to make the costly production profitable.

Mexico

Perhaps no country is more tied than Mexico to U.S. finance, trade and remittance flows, and unease over a stubborn recession north of the border. Prolonged uncertainty in the United States has made it difficult to peg the depths of Mexico's expected recession. President Felipe Calderón had clearly hoped to reassure the country regarding the severity of the crisis, and government analysts predicted that the damage to the economy would amount to less than 6 percent of GDP.[11] In early June, however, a private survey of independent analysts predicted that the economy will shrink by as much as 9 percent in 2009—the largest contraction in nearly eighty years.[12]

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Even before the global recession and the financial uncertainty in the United States reached their peak, Mexico had been confronting remarkable challenges in the last twelve months in the form of falling oil prices, antidrug violence, and the H1N1 flu scare. The dramatic reduction in petroleum and tourism dollars took a big bite out of government revenues, and the flu pandemic sucked an estimated $2.3 billion out of the Mexican economy and required costly public health measures. Falling remittances from U.S.-based workers cost the economy another $2 billion in 2008, and that critical number is expected to drop again this year.[13] In the important automobile sector, car and light-truck production fell nearly 40 percent in May, compared to the same month last year.

The state of Mexico's economy has led to some speculation that its debt rating might be downgraded. During the last year, the IMF has issued a series of increasingly negative estimates of the depths of the crisis in Mexico but insisted in an appraisal early this month that Mexico is "very well positioned to weather the global economic crisis."[14]

The Mexican Treasury and development bank have moved decisively on many fronts to meet the multifaceted threats to their economy. Since 2008, they have targeted about $80 billion to support small and medium enterprises, housing, antipoverty programs, and the pork-producing sector; to bolster oil prices to around $70 per barrel; and to prevent the collapse of the Mexican peso. In mid-April, Mexico was the first nation in the world to access the IMF's new Flexible Credit Line, designed to help otherwise sound countries fortify their economies against a currency crisis. In late May, the government announced savings and austerity measures, ordering agencies to reduce personnel costs by 3.5 percent and administrative overhead by 6.4 percent; social programs and other stimulus spending were not affected.

Consumer prices in Mexico are fairly stable. With inflation under control at around 6 percent, Mexico's central bank is said to have the green light to continue reducing benchmark interest rates—as it has in the last five consecutive months—with the aim of boosting production and consumer spending and giving the economy some lift.[15]

Additional measures and reforms will likely have to await the July 5 congressional elections. The opposition Institutional Revolutionary Party (PRI)—which governed Mexico for over seventy years before losing power to the National Action Party (PAN)—has a narrow lead over the PAN in recent polling, although the PRI is expected to fall short of an outright majority in the lower house, where spending is approved. Central bank governor Guillermo Ortiz suggested that reforms might include improvements in tax collection and modernization of the nation's labor code.[16]

Venezuela

Venezuela's oil-dependent economy is staggering as inflation soars to 30 percent and government revenue is sapped by lower oil prices, massive corruption and inefficiency, unaccounted social spending, growing debt, and Chávez's costly support for a coalition of client states. The politicized state oil company, Petróleos de Venezuela, is unable to pay its bills, with production very inefficient and revenue disappearing into so-called social funds managed by Chávez and his cronies. The flagship of Chávez's social "missions" is a chain of popular grocery stores intended to offer staples to the very

poor at affordable prices, but currency controls limit the importation of such basic goods, which Venezuelans are unable to produce internally.

One report paints a bleak picture: "Prices for home appliances have skyrocketed, pharmacies are reporting shortages of drugs, and General Motors is planning to stop car production here next month, as measures by the Venezuelan government to conserve dollars ripple through the weakening economy. 'Today, there's no milk, no rice, no beans, no chicken, no meat, no butter and no cooking oil,' Francisco Quintero said as he shopped at a government store that sells subsidized staples for the poor."[17]

Despite record oil revenue, Venezuela's economic growth slowed to about 5 percent in 2008, the lowest rate in five years. The economy is expected to contract by more than 2 percent this year, according to the IMF; others predict a contraction of nearly twice that. Moreover, analysts project no growth in Venezuela in 2010, while other Latin American economies are expected to recover respectable growth rates.

Even with oil prices high, analysts say that the Venezuelan government has been running fiscal deficits for years. In the first quarter of this year, as demand for its lower-grade crude oil dropped, Venezuela experienced a $15.3 billion balance-of-payments deficit—about four times the deficit in the same period last year.[18] With oil prices back down to earth, Chávez has been forced to tap funds reserved for foreign solidarity projects, reduce government spending by nearly 7 percent, and hike a consumer tax to 12 percent to make ends meet.[19] He also has been forced to humble himself before his Brazilian neighbors, seeking a $4.3 billion loan from Brazil's development bank.[20]

Undaunted, Chávez's regime continues to increase the government's bite of what is left of the country's oil industry. In a bid to tame the private sector and pockets of political opposition, Chávez's energy and oil ministry recently announced the expropriation of thirty-five more oil field service firms—in addition to thirty-nine others taken over in recent months.

Peru

Peru's nearly double-digit growth in 2008 made it one of the fastest growing economies in South America. Growth of 9.8 percent last year is expected to be more than halved by the global crisis; still, it will likely be the only Latin country to be spared a recession this year.

Most credit the sound and stubborn economic strategy of President Alejandro Toledo (2001–2006) for putting Peru's house in order by reducing debt; controlling spending; driving down inflation; attracting investment and trade; and maximizing revenue from natural gas, farm products, copper, and silver. Toledo's successor, Alan García, has retained these macroeconomic policies and increased internal investments aimed at ensuring that the very poor share in these gains. In 2008 alone, the percentage of Peruvians living in poverty fell from 39.3 percent to 36.2 percent.[21]

In response to the crisis, the government has implemented a stimulus package that includes public works programs, as well as aid to schools, local government, and poor families. Moreover, authorities say they are finalizing negotiations to attract over a billion dollars in foreign investment in infrastructure projects, with another $4.7 billion in projects out for bid in the energy, ports, telecommunications, and transportation sectors.[22]

Colombia and Chile

Colombia's growth, which slowed to 2.5 percent last year and is expected to be flat in 2009, has been deeply affected by slumping exports to the United States and Venezuela. As far as the internal economy is concerned, housing construction and manufacturing are slowing dramatically, although the financial sector is functioning well. Colombia was the first country in the region to seek to spur the economy by lowering interest rates last December. Last month, the IMF approved a $10.5 billion line of credit, although Colombian officials have indicated that they took this step as a precautionary measure and do not expect to draw down on these resources.[23] The decision by the U.S. Congress to shelve the U.S.-Colombia trade deal has stunted economic growth recently, and successful President Álvaro Uribe may decide that he has no choice but to renew his bid for a third term in order to reassure the nation and consolidate the remarkable gains of the last decade.

Chile's economy has been in a six-month slump, and the 3.5 percent contraction expected this year will be the worst performance in over a decade. With lackluster consumer demand, the central bank is expected to continue cutting interest rates to jump-start growth. The recent economic malaise will likely directly impact Chile's December 2009 presidential elections, with the ruling Concertación Democratica embarrassing itself in

selecting a candidate to compete against popular entrepreneur Sebastián Piñera.

Resurgent Poverty?

Several Latin American countries have achieved and sustained sufficient growth—and invested in effective antipoverty programs—to help millions pull themselves out of poverty. As growth tumbles below 4 percent, it is likely that many who had benefited tangibly from such policies will lose these precious gains and feel more dispossessed than ever. According to Mexico's National Council for Evaluation of Social Development Policy, in 2006, 43 percent of Mexicans were living below the poverty line—down from 69 percent just after the last major recession in 1996. The World Bank's numbers were slightly different but confirmed progress, estimating poverty as falling from 45 percent in 1994 to 32 percent in 2006.[24]

The United States does not have the credibility to advocate fiscal restraint and open markets, nor does it have the resources to increase economic assistance in the region.

As unemployment rises and the economy contracts dramatically, one researcher says poverty could jump 10 percent. Even before the worst of the current crisis is felt, today, 25 percent of the nation's households count on small cash transfers (about $35 a month) under the government's "Opportunities" program.[25] The Mexican government will be hard-pressed to maintain fiscal discipline and increase antipoverty spending during what is expected to be at least a two-year recession.

The United States: Little to Offer

The United States does not have the credibility to advocate fiscal restraint and open markets, nor does it have the resources to increase economic assistance in the region. If President Obama's critics are proven right, massive deficit spending and indebtedness may shake the foundations of the economy upon which many Latin American countries depend for investment and trade dollars, prolonging and deepening the recession in a region that was once our fastest growing trade partner.

Early in the year, brave talk by U.S. trade officials sparked some hope that Obama's campaign rhetoric was misunderstood and that he might exercise some leadership on pending trade agreements. But in the ensuing months, the administration has provoked something of a trade war with its two largest partners, Canada and Mexico. The indulgence of "Buy America" provisions has Canadians claiming that they have been disadvantaged despite language in the law that was supposed to protect our North American Free Trade Agreement (NAFTA) partners. The administration also has buckled under pressure from Congress and the Teamsters union to kill a pilot program unveiled in February 2007 as an overdue step toward complying with the NAFTA commitment to allow Mexican truckers to operate throughout the United States.

With those protectionist measures under the administration's belt, it took some measure of chutzpah for U.S. Trade Representative Ron Kirk to claim that Obama's trade team would be all about "enforcement." In a May 22 speech to the U.S. Meat Export Federation in Washington, Ambassador Kirk shocked his protrade audience by failing to make a solitary reference to pending trade agreements with Panama, Peru, and the Republic of Korea.[26]

Democrats criticized Republican administrations for offering our neighbors "nothing but trade." In the absence of trade, what does a deficit-ridden United States have to offer the region? Well, it is accepted as conventional wisdom that the mere election of the charismatic President Obama would usher in a mutual respect and restored U.S. leadership in the Americas. However, two diplomatic encounters in the Americas in recent months give us a glimpse of the future of a U.S. regional policy that commands neither loyalty nor respect.

In April, President Obama sat quietly as Nicaragua's undemocratic president Daniel Ortega—fresh from stealing Managua's mayoral elections—delivered a fifty-minute lecture on the evils of the U.S. legacy in the region. Then, Obama managed a smile as Venezuelan dictator Chávez handed him a forty-year-old screed on the same subject entitled *Open Veins of Latin America: Five Centuries of the Pillage of a Continent*.[27] President Obama might have impressed his counterparts if he cared enough to defend the United States or merely point to his own election as an example of a country that empowers and ennobles human beings from all walks of life. Alas, his silence must have emboldened U.S. adversaries and disheartened its friends.

In June, the general assembly of the Organization of American States (OAS) provided another indication of

Latin America's appreciation of the new U.S. president. Against strong U.S. objections, twenty-six nations (including key South American powers and erstwhile U.S. friends) signed on to a resolution that would have opened the OAS to the Cuban dictatorship. The vast majority of our neighbors placed solidarity with a gasping dictatorship above the principled arguments mustered by the Obama team.

Do No Harm, and Not Much Else

Latin American countries are making their way through the wreckage of the global economy almost in spite of the United States. Apparently, they realize that they can count on little in the way of genuine U.S. leadership on key issues, and they appear to be content with that arrangement.

As the United States' engagement and credibility recedes, Brazil's relatively stable economic performance and purchasing power will likely advance its ambitions to lead South America. Of course, Chávez can be expected to try to sustain his anti-U.S. coalition, which is making some new headway in Central America and at the OAS. One can only hope that U.S. political leaders will act soon enough to correct excessive spending and to reverse its unilateral trade policy so that the future of the hemisphere and U.S. credibility in the region do not suffer permanent damage.

Notes

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