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Latin America and the Caribbean Increasing Foreign Economic Association

During the 1990s, changes in the orientation of economic policy have increased the degree of international integration taking place for the South American and the Caribbean region. Almost all countries have moved away from a protectionist, import-substitution model to promoting more market-based, outward-oriented economies. Easing or lifting of restrictions on foreign capital, privatization schemes, progress in regional integration schemes, lifting of trade barriers and fostering the development of entrepreneurial spirit have sparked a growth in the region's international trade and foreign direct investment.

FOREIGN SALES SUFFERING

Overall, the value of exports for the region dropped by 1.7 percent in 1998 compared to the previous year, after increasing by 11.4 percent in 1997. This contraction represents the first time the value of exports has fallen in twelve years. Exports for most South American and Caribbean countries declined primarily in response to the combined effects of the Asian flu and Russian financial crises as well as numerous natural disasters in the region. Exports were negatively effected by a sharp decline in international prices for commodities in 1998 and the first half of 1999 resulted from a slowdown in economic activity in Asia and to a lesser extent Europe. The decline in commodity prices has led to a deterioration in the region's terms of trade since commodities remain a significant export for the region. As 1999 has run its course, the strengthening world economy has led to a recovery in commodity prices and thus in the value of exports for the Latin America and the Caribbean region as a whole.

The decline in exports led to a sharp decline in the trade balance for Latin America and the Caribbean in 1998. This decrease in the trade balance, led to a dramatic increase in the current account deficit for the region to US$84 billion in 1998 from US$64 billion the previous year. The current account deficit amounted to more than 4.5% of GDP in 1998 more than double the 1996 figure. The current account deficit is expected to improve to the 3-4% range this year as exports have started to recover while imports have been curtailed. The easing of the current account deficits in 1999 has eased demands on foreign exchange and thus pressure on exchange rates for countries in the region.

SHIFTING SANDS

A dichotomy has continued to develop between South America and the rest of the region. Economic problems in Asia and Europe in 1998 and the first part of 1999 caused South American exports to drop more dramatically than the rest of the region, since the former has greater exposure to these markets. In particular, Peru and Chile experienced troubles since Asia represents a key market for them. In addition, intra-regional exports for Latin America and the Caribbean also slumped during 1998 and 1999. The drop in intra-regional trade was more acute in the countries located in the Southern Cone, owing to the economic problems in Brazil and Argentina and the sharp depreciation of Brazil's real in the first quarter of 1999 altering their relative competitiveness. In contrast, the Caribbean Basin countries and Mexico have continued to experience a growth in exports, although at a lower rate. Because of deals allowing them greater access to the US market, these countries have experienced a shift in trade orientation and thus benefitted from increased sales to the robust US economy. Problems in sales to the rest of the world have only accentuated the shift in trade orientation.

SOME CALLS FOR PROTECTION

In the face of these growing external imbalances, popular sentiment for free trade has diminished. Pressures by firms and labour unions to protect local markets in the face of greater foreign competition have intensified and caused the erection of some temporary trade barriers. So far, these measures have not significantly reversed the steady trade liberalization that has occurred. Although pressure to enact barriers to trade will continue to exist until strong economic growth returns, the chances of the region reverting back to a protectionist policy stance seem slight.

Despite the rise in tension, the four trade groups in the region (Mercosur, the Andean Community, the Caribbean Community and the Central American Common Market) have continued to make head way with the implementation of their integration agreements, albeit at a slower pace during 1999. Chile for example decided to lower its external tariffs to an across the board 6 percent within the next five years. Central American countries have also proceeded with their plans to reduce their level of external protection. On the other hand, some countries have protected their local markets by enacting temporary measures such as Mexico raising its external tariff by 3 percent in January 1999 and Ecuador introducing a 2-10 percent surcharge a month later.

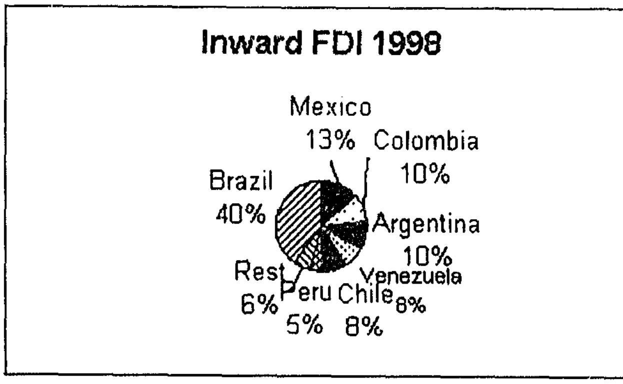
Currently the largest potential for problems exists between the Mercosur countries, the largest trading bloc in the region. Both Brazil and Argentina have experienced significant economic difficulties during 1998 and 1999. In response, they have adopted protectionist measures in sectors such as motor vehicles and sugar. To further complicate matters, the relative competitiveness of the countries has changed dramatically by the real's fall in the value. The increased competitiveness of Brazilian products has led to exchanges of rhetoric. Increased public pressure by businesses and may cause Argentina to enact further protection measures. However, ongoing dialogue between them provides grounds for optimism, especially since discussions have broached key topics such as greater policy coordination.

RENEWED INTEREST BY INVESTORS

With a growing commitment to market reforms and a greater tolerance of foreign ownership, foreign direct investment (FDI) into Latin America and the Caribbean has renewed during the 1990s after having stagnated during the previous decade. Privatization programs in many of the countries, opening of restricted areas of economy to foreign ownership and continuing the integration process through the regional trading agreements implies the region has reemerged as an important destination for inward FDI [1]. The region now rivals South and East Asia in per capita terms.

FDI into the region has surged from US$9.2 billion in 1990 to US$33 billion in 1995 to US$65 billion in 1997. According to figures for 1998, FDI into Latin America and the Caribbean will match those in the previous year although the size of the flows tailed off at the end of the year. During 1999, flows increased after the first quarter and the year's total should match that for the two previous years. The transfer of public and private assets has been particularly strong in the larger economies such as Brazil, Argentina, Mexico, Colombia, Venezuela and Chile.

Among individual countries, Brazil recovered its position as the chief destination for inward FDI in the region, replacing Mexico in top spot in 1996. In 1998, Brazil share of inward FDI for Latin America and the Caribbean region jumped by 10 percent. Inward FDI for Brazil surged because of the privatization of several large state firms.



During the first half of the decade privatization was the chief mechanism for attracting FDI. The privatization process encompassed a wide range of sectors including telecommunications, public utilities and postal services. The privatization of state assets still accounts for the lion's share of inward FDI in Brazil, Colombia and Venezuela.

INVESTMENT PROCESS MATURING

There are signs the investment process is maturing for the region as a whole. For countries in the later stages of their privatization programs (Argentina, Chile, Mexico and Peru) transactions between private agents are the chief source of inward FDI. In many instances foreign investors are teaming up with local firms to form strategic alliances as a means of diversifying risks. Although such mergers have not directly increased the productive capacity, these investments will strengthen the competitiveness of the recipient country over time. In most cases, the investing firm will transfer critically required know how and technology. Another recent change has seen foreign companies already in the region invest in modernizing plant and equipment. Greenfield investments are also becoming more important.

During the last part of the 1990s, investment between countries of the Latin America and Caribbean region has increased, although the process is still in its infant stages. Shortcomings on statistical data make concrete statements difficult, but estimates peg the amount below that existing for the developing economies of Asia. The greatest amount of intra-regional foreign investment has been in the Southern Cone area. Chile is the largest source of intra-regional FDI, in part its reform process has been in place the longest, with Mexico, Argentina and Brazil also becoming important. As regional integration and trade liberalization deepens, intra-regional investment will likely continue and thus spurring the development of larger regional firms.

HOW WILL REGIONAL INTEGRATION PROCEED?

Most countries in Latin America and the Caribbean appear committed to continued international liberalization, although minor setbacks will likely occur during periods of economic turbulence. The future direction of international trade and foreign investment flows will depend on how integration schemes proceed. Of particular importance will be how hemispheric trade (FTAA) talks proceed. Without a concrete agreement on the FTAA, foreign ties will develop faster between members that have concluded sub-regional arrangements than would be the case other wise. For example, the agreements providing Mexico and the Caribbean countries with greater access to the US market, provides a greater incentive to strengthen ties with their northern neighbor.

The two largest South American economies appear to favour a go-slow approach to the FTAA. Both countries have indicated the FTAA represents a secondary priority, taking a back seat to strengthening Mercosur and expanding its links to create a South American Free Trade Area. Consolidating a regional power base, they believe, will give them a stronger basis for negotiating trade liberalization with the USA. They feel any deal should avoid links to labour and environmental issues. There has also been concern that past agreements, e.g. the WTO, have failed to benefit South American countries, in part because of the use of non-tariff barriers by the developed countries such as the USA.

	Exports of Goods			Imports of Goods		
Country	**1996**	**1997**	**1998**	**1996**	**1997**	**1998**
Argentina	13.6	9.9	-0.8	18.5	28.2	3.1
Brazil	2.7	10.9	-3.5	7.3	15.1	-6.2
Chile	-3.9	9.9	-11.9	12.6	10.4	-4.5
Colombia	4.0	10.2	-5.8	-0.6	12.9	-5.0
Dominican Republic	7.2	13.9	8.1	10.8	15.3	14.9
Guatemala	3.5	16.3	9.0	-5.0	22.9	19.8
Haiti	11.2	21.0	45.7	-3.6	2.7	25.2
Mexico	20.7	15.0	6.4	23.5	22.8	14.1
Peru	5.5	15.5	-16.0	1.6	8.5	-4.1
Venezuela	24.2	0.0	-26.0	-17.7	30.3	7.8
LAC	11.6	11.4	-1.7	10.9	18.8	5.2

Balance on Current Account			
Country	**1996**	**1997**	**1998**
Argentina	-1.8	-1.4	-1.2
Brazil	-5.9	-6.2	-7.0
Chile	2.3	1.9	0.7
Colombia	-2.0	-3.6	-3.4
Dominican Republic	-0.4	0.8	-0.6
Guatemala	-0.1	-1.1	-1.6
Haiti	-1.6	-2	-1.2
Mexico	-0.1	-0.4	-1.4
Peru	-1.0	0.0	-0.1
Venezuela	7.6	2.3	-5.7
LAC	-1.3	-1.4	-2.4

Gross Fixed Capital	Formation	
Country	1990	1998*
Argentina	11.9	22.5
Brazil	21.3	20.8
Chile	19.2	25.1
Colombia	13.7	21.6
Dominican Republic	19.0	30.4
Guatemala	11.6	16.8
Haiti	12.0	13.4
Mexico	19.0	21.8
Peru	17.0	24.0
Venezuela	14.3	16.5
LAC	18.2	21.5
* Preliminary Data		

FDI inflows (millions of dollars)				
Country	1991	1995	1997	1998**
Argentina	2439	4783	6326	5800
Brazil	989	4859	19652	24000
Chile	661	2978	5417	4700
Colombia	501	2227	5982	6000
Dominican Republic	15	54	20	n/a
Guatemala	91	75	84	n/a
Haiti	14	7	5	n/a
Mexico	2549	9526	12477	8000
Peru	41	2000	2030	3000
Venezuela	451	985	5087	5000
LAC	13085	30400	61392	n/a
** Estimates				

[1] For more information, see the UN Economic Committee on Latin America and the Caribbean's 1998 report on "Foreign Investment in Latin America and the Caribbean".