# LATIN AMERICA – SITUATION OF ECONOMY

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***Abstract***

*Most Latin America economies were impacted by political instability, indebtness, hyper-inflation, enormous social problems etc. at the beginning of the 90s. At the margin between the 80s and 90s and in the first half of the 90s, many countries reached political stability necessary for the successful development of the region. Some of the long-term military conflicts were ended. The positive political development created positive prerequisites for the market-oriented economic reforms, economic growth vitalisation and the "renaissance" of the regional economic integration in Latin America.*

**Key words:** Latin America, situation of economy, external indebtness, foreign investment, foreign trade

## INTRODUCTION

Changes in the economic policies which were part of the market-oriented economic reforms should have ensured economic stability. The change of the industrialisation strategy from import substitution into the export-oriented strategy as a tool for a more open economy, implementation of the trade liberalisation, privatisation, fiscal restrictions and a more careful monetary policy, financial system reforms and creation of the social insurance system represented the basic reform steps. These changes proceeded rather quickly, but with great differences among the individual countries. They begun to bring first results in the first half of the 90s, but they showed a decisive impact on competitiveness of the Latin America region only in the last decade of the 20$^{th}$ century and the beginning of the new millennium (Craft, 2005).

## MATERIALS AND METHODS

GDP of the Latin America region was outstandingly fluctuation at the beginning of the 90s. Still in 1997, Latin America showed the GDP growth by 5.2%, the following economic crisis in Brazil and its spreading over the whole region caused the GDP growth drop to 2.3% in 1998 and then to 0.4% in 1999. The same development was shown also at the beginning of the next decade (2001). Economic development of the Latin America economies since the end of the 90s then proved their dependence on the external environment conditions development, namely on the foreign capital inflow. Therefore, the foreign capital inflow, namely the foreign direct investments (FDI) are still, considering the low level of home savings and the necessary financial resources for economic reforms, one of the determinants of most of the Latin America countries successful economic development. In the first decade of the new century, the development of GDP deteriorated still more. In 2002, the whole region GDP dropped down into red numbers, while the most steep decline was then recorded, as a consequence of financial crises, namely in Argentina (–11%) and Uruguay (–11%). During the following years, the situation in the region has stabilised and GDP has reached a considerable growth rates up to 5.7% in 2004. In the same year, only the Dominican Republic still recorded a negative economic growth (–0.1%) (Heston et al., 2006).

Part of the market-oriented reforms was reaching macro-economic stability of the Latin American economies. The base was a drastic fiscal moderation followed by the restrictive monetary policy using exchange rate as a stabilisation anchor. Fiscal measures were based on structural and institutional changes enabling the increased and guaranteed fiscal incomes, political, administration and public expenditures aimed at strengthening of their autonomy regarding inflation control. This was reflected in the considerable price increase slow-down. In the decade of the 90s, the anti-inflation policy and currency restriction was applied, which contributed to the gradual decrease of the yearly inflation rate down to 1–2-digit numbers in almost all Latin America countries. In the second half of the 90s, still some big countries like Brazil, Columbia, Mexico, Venezuela and Peru showed a 2-digit inflation rate. At the beginning of the next decade, there

**Tab. 1:** Macroeconomic indicators of Latin America

| Indicator | 1996 –2005 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 |
|---|---|---|---|---|---|---|---|---|---|
| GDP (%) | 2.5 | 0.4 | –0.1 | 1.7 | 5.7 | 4.1 | 5.7 | 5.7 | 4.2 |
| Inflation rate (%) | 9.0 | 6.1 | 8.9 | 10.6 | 6.5 | 6.0 | 5.3 | 5.4 | 7.9 |
| Foreign investments (bill USD) | – | 27.8 | 3.3 | 15.2 | 12.7 | 22.4 | 29.1 | 85.8 | 84.3 |
| External indebtness (bill. USD) | – | 769 | 761 | 780 | 780 | 787 | 745.9 | 835.4 | 878.3 |
| Debt/GDP (%) | – | 40.2 | 44.9 | 44.5 | 39.1 | 35.1 | 23.9 | 22.9 | 20.9 |
| Export volume growth rate (%) | 5.9 | 3.0 | –0.1 | 3.3 | 10.5 | 5.0 | 5.1 | 3.4 | –0.3 |
| Export value growth rate (%) | 5.8 | –4.1 | 1.1 | 11.1 | 24.1 | 11.6 | 19.7 | 12.2 | 16.0 |
| Import volume growth rate (%) | 4.7 | –0.3 | –7.6 | 0.7 | 12.5 | 9.6 | 13.0 | 12.1 | 7.6 |
| Import value growth rate (%) | 5.3 | –1.4 | –8.5 | 4.2 | 22.1 | 15.6 | 18.8 | 19.4 | 20.9 |
| Trade balance/GDP (%) | – | –2.8 | –1.0 | 0.4 | 0.8 | 0.2 | 1.5 | 0.4 | –0.7 |

Source: World Economic Outlook, IMF, Washington, 2009

was at last successfully reached a 1-digit inflation rate (6.1% in 2001) in the Latin America countries average, however, the results for 2003 showed already a repeated deterioration of the situation (increase up to 10.6%). The worsened results reflected namely the Argentina crisis of 2000–2002, which in 2002 evoked a considerable price increase by 26%, and further also the situation in Venezuela, where the inflation overreached the margin of 30%. A similar situation was perceived also in some of the small countries, e.g. Haiti, Dominican Republic or Surinam. In the following year, the situation improved again in average and reached the position from the beginning of the decade. Notwithstanding this, it can be stated that at present, Latin America belongs among a relatively price stable developing regions (Bujard and Shradin, 2003).

The inflow of foreign investments into Latin America, as one of the main source of its external financing, increased during the 90s. In 1996, it even reached the same level as private foreign investments in Asia. The reasons of such growth were basically three, the main one being the extensive privatisation in some countries. In the first half of 90s, an extensive privatisation occurred in Argentina and Mexico, in the second half in Brazil, Columbia and Peru. In Chile, the level of state enterprising was low in consequence of an extensive re-privatisation under the rule of general Pinochet in 80s. In the net decade, privatisation continued with the aim of acquiring further foreign investments namely in the sector of energy (90%), industry (5%) and telecommunications (4%).

The second reason was the ongoing regional economic integration. The third reason of the foreign investments dynamic increase was the extensive liberalisation of foreign trade. The territorial distribution of foreign investments in the region was unequal; the highest inflow was recorded by the big economies of the newly industrialised Latin America countries, i.e. Argentina, Brazil and Mexico. By this the unequal economic development of the whole region still more deepened. The biggest investors were traditionally the USA, followed by Spain and Portugal with a considerable share of Germany. These three European countries investments formed the majority of the EU investments in Latin America; the share of the USA began to decrease in favour of the EU since the end of 90s (Lucas, 2004).

A turn in the positive development of foreign investments inflow into the region started in 1998, when it begun to turn down. Still in 1997, the volume of the foreign investments amounted to 99 bill. USD, in 2002 it was only 3.3 bill. USD. The reason lay namely in the deteriorating economic situation of the Latin America countries, supported by financial crises, in the biggest economies (Brazil and Argentina which went on in the marginal years ) and which lowered the investors interest for the region. According to the latest data, it can be concluded that since 2003, the interest of investors in Latin America increased again, as the indicator began to grow, even if with fluctuations. In 2004, the foreign investments inflow increased to the level of 12.7 bill. USD and the estimates for the following years are almost the double.

## RESULTS AND DISCUSSION

An outstanding problem of the Latin America region still is its external indebtness. The roots of it extend to the 70s, the period of oil crises in the world economy. The indebtness increased considerably in the 80s, when many Latin America countries had to announce insolvency. The situation still further worsened in the 90s. An important shift occurred in 1998, when the total indebtness increased by approx. 85 bill. USD to the total value of 764 bill. USD. The relative rate of the debt to GDP then increased from 33.9% in 1997, i.e. before the Brazil crisis, to 38.1% in the following year. A relative worsening of the situation then occurred again in 2002, when, namely owing to the important loans from the international financial institutions the debt compared to GDP increased up to the value 44.9%. Since then the relative value of the debt decreased, however, not its absolute volume. In 2004, the total external debt of Latin America amounted to 780 bill. USD. In the relative expression the value of the debt to GDP was 39.1%. The IMF estimates hint that its relative value should further decrease (Hardi et al., 2007).

Latin America foreign trade showed a growing trade in the 90s. Both export and import of goods in the region grew in the value as well as in the total volume. In 1996–2005, Latin America export increased by 5.9% and import by 4.7%. A critical period for the Latin America trade was the period 1998–1999 an 2001–2002, when the value of all indicators dropped down in consequence of the big economies financial crisis (namely in Brazil and Argentina). On the contrary, the data for 2004 offer further enlivening. The Latin America countries in the 90s were characterised by a continually higher import over export, therefore they recorded (with the exception of Venezuela) the trade balance deficit. The worst situation occurred in the 1998, when the trade balance deficit dropped down to 91 bill. USD, what represented 4.5% of the Latin America GDP. Not sooner than in 2003 the region recorded. For the first time in the decade, a surplus of the balance of 2.3 bill. USD, i.e. 0.4% of GDP. Since then, the balance has shown positive, of minimum, values (Marrewijk, 2002).

Of a considerable importance for the improved position in the international relations of Latin America was without doubt economic integration, which the countries started again to develop in the 90s. It differs considerably from the type of economic integration they applied in the 60s to 80s and it is usually labelled as an “open regionalism”. In the international environment, it was demonstrated by the fact that the countries deepened, on one hand, their mutual economic relationships through their integration groupings, and at the same time strengthened their economic relationships to the integration groups outside the region. As an example of such strengthening external economic relationships, we can mention e.g. the first framework agreement signed with the European Communities in 1993 or the agreement of the MERCOSUR with the EU from 1995. By this approach, the Latin America countries certified that they had understood the necessity to adapt to the globalisation process. Forming of the competitive position in this process became one of the main drives for enlivening of the regional economic integration in the region in the 80s-90s, which is called the “integration processes renaissance”. Enlivening of the regional economic integration brought about a visible increase of the trade among the countries of the region. In consequence of this increase, the importance of export into developed market economies decreased, as most countries multiplied their export into the neighbour countries or to the more distant countries of the same integration grouping.

In the frame of the 90s, most Latin America countries went through considerable changes in their economic policy, which were a part of the market-oriented reforms which should have ensured, among other, economic stability. However, the data on the selected macro-economic indicators, resp. their fluctuating development during the 90s and at the beginning of the next decade, as well as the critical development on the turn of the century, evoke contradictory impressions. As positive, it is possible to evaluate the fact that Latin America has, owing to the restrictive fiscal and monetary policies, approached the economically stable parts of the developing world.

A singularly negative phenomenon of the market oriented economic reforms in the Latin America countries was worsening of life conditions of the prevailing part of the population issuing from the still growing inequality in the income distribution among the individual groups of population. In consequence of the budget cuts in the social sphere, further group down in the level of living of the inhabitants occurred (the poverty level increased), but also the unemployment rate grew up. At the beginning of the new decade, Latin America registered unemployment rate of 7.1%, which in 2002 increased, as a consequence of the above mentioned economic problems, to 10.0%. It is, however, necessary to realise that the real number of unemployed people in these countries is much higher, as a great part of the potentially economically active population is not registered in the unemployed registers. The official unemployment rate does not certify at all about the so-called informal sector functioning. This is not, however, a specific problem of Latin America, but a common problem valid for all developing countries (Ranis, 2004).

At present, the opinion prevails in Latin America in connection to the solution of the unemployment problem, that the active role of the state should be strengthened in the unemployment policy. International organisations are of the opinion, that the unemployment problem could be solved by starting the economic growth. It has shown that this opinion is a rather simplified, as economic growth is just one of the conditions for decreasing unemployment, but not the only and sufficient one. In some cases, the reason of unemployment laid in the decreasing number of employees during the first stage of the reform process. At the same time, it is necessary to increase the education level and to decrease illiteracy, which in some of the Andes region and some Central America countries reaches the alarming level of 30%. Without at least the basic education, it is impossible to count with a more progressive solution of poverty and unemployment in the region. Social differences and the increasing social tension in many countries will continue to be a real threat for the functioning of the hitherto partially reformed economic system in many countries of the region (Mc Kinley, 2006).

## CONCLUSIONS

An enormous interdependence of the economies of the region (financial, marketing, technological etc.) is still valid for the economic relationships of the Latin America states. It was certified by the impacts of financial rises which some of the countries of the region underwent in the turn between the 20th and 21st century. They revealed the contradictions in the undergoing economic and political reforms, as well as the micro-economic and institutional shortcomings which caused the bad state of the banking sector with heavy impacts on the whole national economy of the relevant states. There were mentioned also the risks of the full liberalisation of the economies towards the world as well as the risks of the excessive financial deregulation in the conditions when the necessary level of national savings was not ensured and also the risks of the macroeconomic imbalance before finishing the institutional reforms.

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