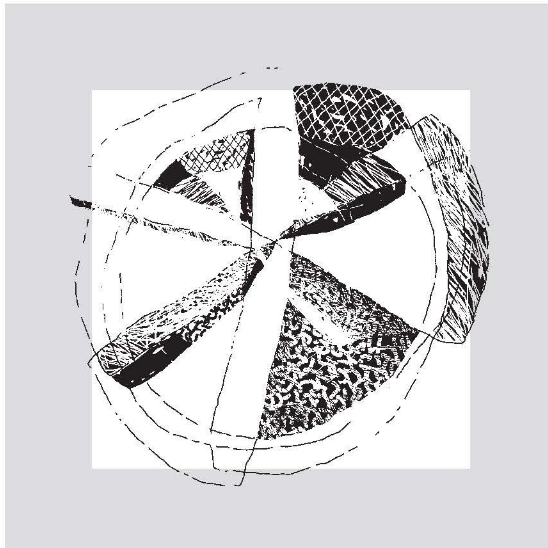
2001-2002



Economic survey

OF LATIN AMERICA AND THE CARIBBEAN

UNITED NATIONS

ECLAC

Chapter I

CURRENT CONDITIONS AND OUTLOOK, 2002

A. General trends

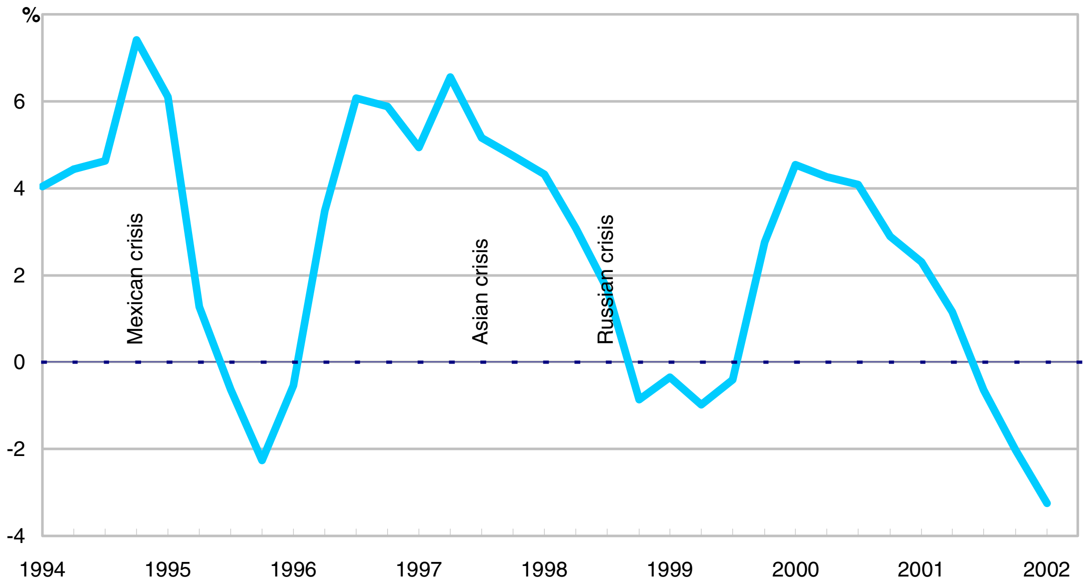
1. Introduction

Against the backdrop of a very sluggish international economic environment, the reactivation that began in Latin America and the Caribbean in 2000 was short lived. After having stalled in 2001, economic growth is expected to be negative (-0.8%) for 2002, and unemployment is projected to reach a record of over 9%. The severe crisis in Argentina accounts for a great deal of this downturn, however; the growth rates of the rest of the economies in the region have also slackened, but will nonetheless be positive in most cases. In fact, if Argentina is factored out of the totals, then a modest expansion (slightly over 1%) of the region's GDP is projected. Inflation has remained low in most of the countries, with the rise in the regional indicator being attributable to the effects of major devaluations in Argentina and Venezuela.

Given the slow pace of the industrialized economies' recovery and the still low prices being brought by the region's main commodity exports, its external sales of goods are likely to decline by a further 1.5% in 2002. The improvement in the regional trade balance is primarily a reflection of plummeting import demand in Argentina. Flows of direct investment, which have been the largest component in the region's inflows of external capital since the mid-1990s, will continue to dwindle, and financial capital will remain scarce. The terms and conditions for external financing continue to be less favourable than they were prior to the Asian crisis and, as a result, the region is expected to register a net outward transfer of resources for the fourth year running.

Unlike the crises that occurred in the 1990s, which affected a limited group of countries, in 2001 the recession engulfed all of the region's economies. This contractionary climate remained in evidence during the first quarter of 2002, as is shown by the fact that regional GDP was 3% lower than it had been in the first quarter of 2001 (see figure I.1). Thanks to a more flexible management of fiscal, exchange and monetary policies in 2001 and 2002, however, most of the countries have managed to avert a full-blown crisis. These measures have, however, revealed just how little manoeuvring room is available for domestic economic policy. Unlike the situation in the industrialized economies, where a more expansionary monetary and fiscal policy stance has been adopted in order

Figure I.1
LATIN AMERICA AND THE CARIBBEAN: GROSS DOMESTIC PRODUCT[a]
(Percentage variation with respect to the same quarter of previus year)



Source: ECLAC, on the basis of official figures.
[a] Includes Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela.

to counter the recession, the region's governmental authorities have come under increasing pressure to cut back spending in order to control a public debt that has been inflated by a five-year-long uptrend in the fiscal deficit. Private firms also have less breathing space, as several years of sagging profits have undermined their capital base. Despite the monetary authorities' efforts to expand the money supply and lower interest rates, however, in most of the countries the private sector's supply and demand for domestic credit continues to shrink. The banking system in several of the MERCOSUR countries has also become quite fragile as a result of the crisis.

Looking beyond the immediate situation, there is concern about the possibility that the prevailing economic climate in the region may become one of low growth, worsening domestic conditions and bleak prospects for the future. Within this context, the words "adverse expectations" reappear as a *leitmotiv* in economic analyses, and the fixed investment coefficient has dropped to a 10-year low. The economic situation in 2002 clearly reveals the disparity between the expectations awakened by the new economic model that took hold in the region during the 1990s and current growth prospects, thus revealing the existence of a gap that is raising a series of questions as to the economic and social sustainability of existing development patterns. As has been seen in a number of cases, the protracted economic recession, high unemployment and the limitation of social expenditure are creating social tensions that undermine domestic governance and make it harder for national authorities to implement needed economic reforms and policies.

Hopes for the start of an economic reactivation in the region in the second half of 2002 are based on projections of a definite upturn in the United States economy and better economic conditions in Europe. Any improvement in the international environment ought to be reflected first in the Mexican, Central American and Caribbean economies, which have close trade relations with the United States. However, as of June 2002, a deterioration in the international financial situation and market speculation against the Brazilian economy, together with continuing uncertainty in neighbouring Argentina, had again raised the spectre of financial contagion of the entire region as well as of other emerging economies. Within this context, no more than a moderate recovery of regional GDP is likely in 2003, with projected growth of between 2.5% and 3% –enough for a slight rise in per capita GDP, but not enough to boost employment indicators.

The economy's weak performance in 2002 fits in with the stage of slow growth that began with the Asian crisis. Although the different countries' experiences cover a wide spectrum, the ensuing economic slowdown has been widespread, and per capita GDP has declined in a large number of them. As a result, 2002 will mark the fifth "lost year" in a row, with per capita output slipping to a level nearly 2% below where it stood in 1997. Within this context, the increasingly evident conflicts arising between the external economic environment, domestic macroeconomic policy, and economic and social development processes pose a series of challenges for the Latin American and Caribbean countries.

Thanks to more flexible exchange-rate regimes and the adoption of macroeconomic policies based on inflation targets, a number of the countries have improved their macroeconomic policies since the mid-1990s. In the realm of fiscal policy, however, further progress needs to be made in correcting procyclical biases, increasing tax revenues, improving taxation structures and raising the quality of public expenditure. Moreover, little headway has been made in implementing reforms to promote more dynamic changes in production patterns, whose materialization depends on a number of other factors in addition to a strong macroeconomic performance. Even though public social spending has been increased and steps have been taken to improve the design of social policy, much remains to be done before new patterns of development benefit the population as a whole.

This situation underscores the importance of building a new consensus based on global initiatives to improve the developing countries' position within the world order and facilitate more active sorts of national and regional development policies than most of those implemented over the past decade.[1] The decision taken by the member countries of the World Trade Organization when they met in Doha in November 2001 to launch a new "development round" and the United Nations International Conference on Financing for Development that was held in March 2002 in Monterrey, Mexico, attest to the international community's political will to take more energetic steps to promote a development agenda and reduce the asymmetries spawned by globalization. The fact remains, however, that the deterioration in the international situation has sparked a resurgence of protectionist trends in the industrialized countries, and there is a disturbing tendency to adopt a relatively passive attitude towards severe financial crises such as the one currently affecting Argentina. Action at the regional level should play a more central and strategic role in this respect, not only because of the growing importance of intraregional trade in recent years, but also because the regional arena appears to be the most promising forum for dialogue and consensus-building regarding national policies to meet the challenges posed by the external environment.

2. External conditions continue to trouble the region

In 2002, trends in international trade, the regionwide effects of the serious economic crisis in Argentina and the volatility of financial markets have combined to generate an adverse external environment. The current account deficit on the regional balance of payments is estimated at some US$ 40 billion for 2002 (2.2% of GDP), and this comes on the heels of a US$ 51 billion deficit in 2001 (see figure I.2). The decrease is chiefly accounted for by a sharp reduction in the trade deficit, which is in turn primarily attributable to the larger trade surplus that will be posted by Argentina as a result of its devaluation and recession. The other economies will run trade deficits once again, although they will be smaller than before. All in all, the trade deficit for goods and non-factor services is expected to total some US$ 5 billion.

In addition to this shortfall, net payments of profits and interest will amount to approximately US$ 55 billion, which is quite similar to the figure for 2001. As in the past few years, the region's deficits on the trade and capital income accounts will be partially offset by current transfers, which in large part are made up of family remittances. Such remittances are expected to total around US$ 20 billion in 2002, or 15% less than in 2001.

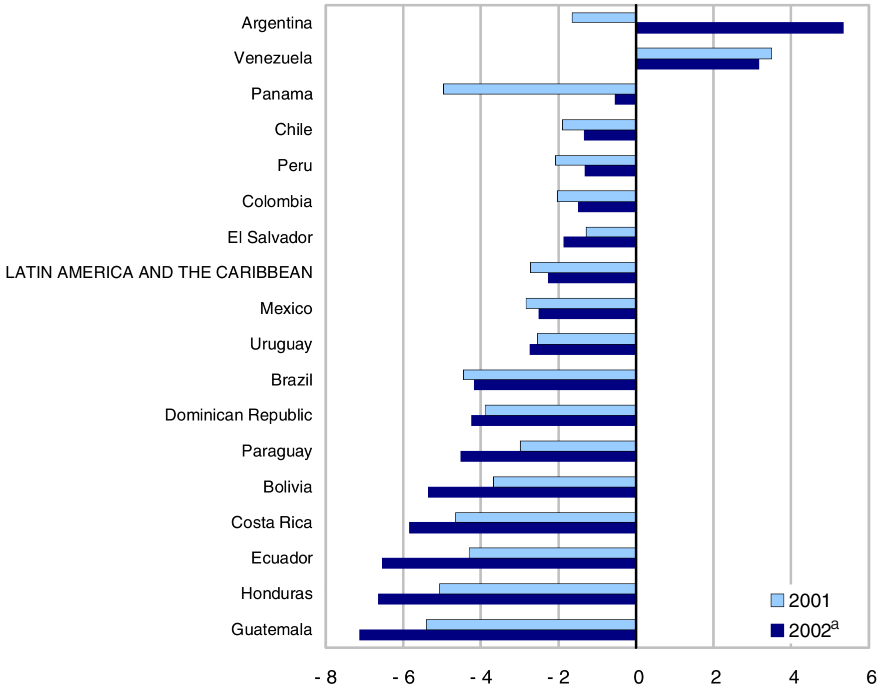
For the fourth consecutive year, total capital inflows are unlikely to be enough to balance out the region's payments of profits and interest, and it will consequently register a net outward transfer of resources once again. A fundamental change has been observed in recent years in the composition of private resource transfers, since

1 For further information on the global development agenda proposed by ECLAC, see *Globalization and development*, which was presented at the twenty-ninth session of the Economic Commission for Latin America and the Caribbean (Brasilia, Brazil, 6-10 May 2002) (LC/G.2157(SES.29/3)), Santiago, Chile, April 2002.

Figure I.2

LATIN AMERICA AND THE CARIBBEAN: CURRENT ACCOUNT BALANCE

(Percentages of GDP)



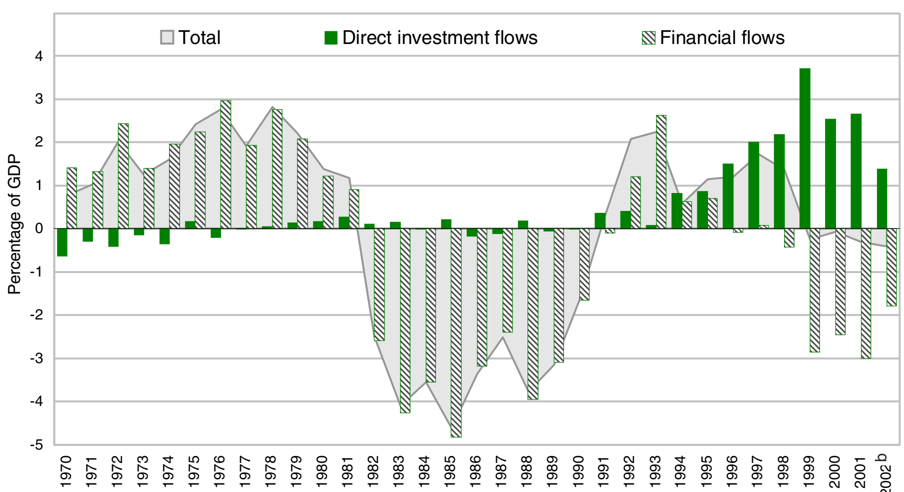
Source: ECLAC, on the basis of figures from official sources and from the International Monetary Fund.

[a] Projections.

positive transfers to Latin America and the Caribbean have consisted entirely of foreign direct investment (FDI), whereas transfers of financial resources have been markedly negative since 1999 (see figure I.3). The downturn in net FDI flows that appears to be in the making for 2002 is therefore a cause of concern, since these funds, together with emergency loans from international financial institutions, were the only factor that prevented net resource transfers from being starkly negative in 1999-2001.

Figure I.3

LATIN AMERICA: NET TRANSFERS OF EXTERNAL RESOURCES [a]



Source: ECLAC, on the basis of figures from the International Monetary Fund.

[a] For the definition of this term, see chapter III.

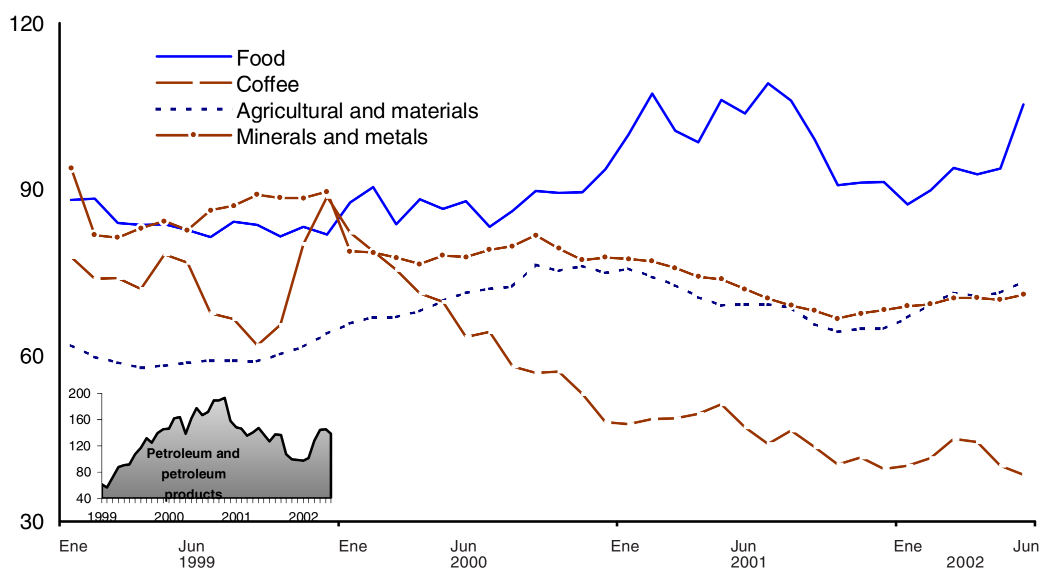
[b] Preliminary estimates.

3. The contractionary trend in foreign trade strengthens

In 2002, the impact on the region's external trade flows generated by the performance of the world economy –whose slowdown in 2001 led to a contraction in the region's external trade– was compounded by the deep economic crisis in Argentina. These two determining factors have thus combined to prolong the downward trend in foreign trade. In fact, if the region's trade performance for the first few months carries over into the rest of the year, 2002 could end up being one of the region's worst years in decades. If this occurs, both sluggish export volumes and weak prices will be to blame.

The downward trend in commodity prices appeared to bottom out, in most instances, in late 2001, but no clear turnaround has yet been seen that would permit prices to regain the ground lost the year before. In fact, in the case of coffee, the upswing seen in the first quarter of 2002 stalled in the second, and prices returned to the weakening trend that had begun in late 1999 (see figure I.4). As a result, a comparison between the average prices brought by the region's main commodity exports in 2002 and 2001 reveals a general decline. The categories of products whose mean prices have fallen in the past year –such as minerals and metals, petroleum and coffee– continued to post declines in the first half of 2002, although the decreases were smaller. Average food prices were down, after having risen in 2001, with the exception of meat, whose international prices have continued to climb, albeit more slowly. Overall, the price index for Latin American and Caribbean commodity exports was 15% lower in the first semester of 2002 than the average for 2001 (5% if petroleum is not included).

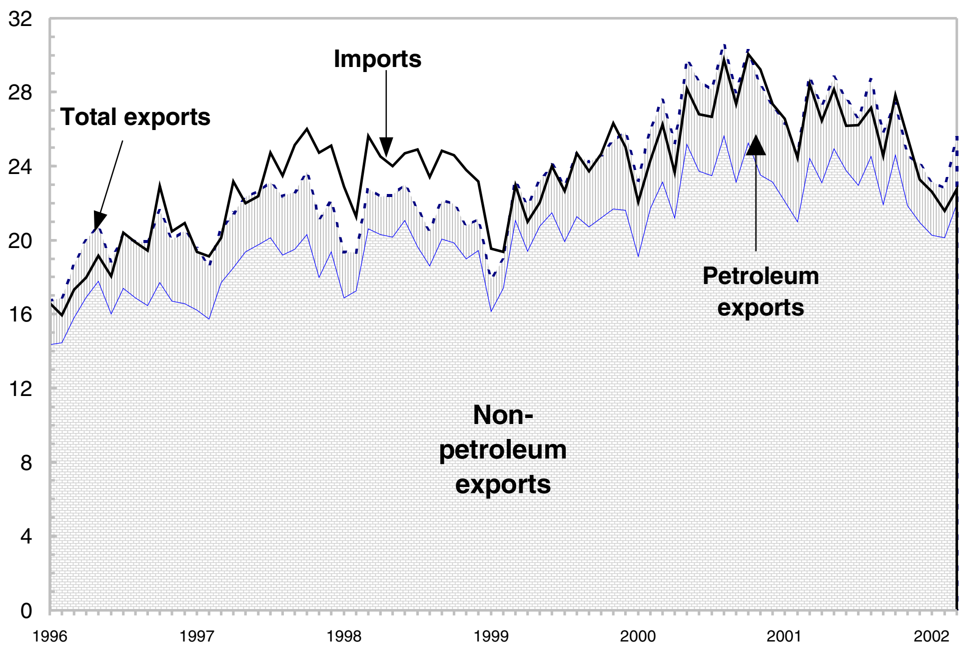
Figure I.4
PRICE INDEXES OF LATIN AMERICAN AND CARIBBEAN NON-FUEL COMMODITY EXPORTS [a]
(Indices 1995=100)



Source: ECLAC, on the basis of official figures.
[a] Indices weighted by the proportion of the region's exports represented by each product.

This price trend is in keeping with the overall decline in export values seen in the first quarter of 2002, which reflects even sharper decreases (including double-digit reductions in many cases) than those of 2001 (see figure I.5). Costa Rica was the only country that succeeded in halting the downturn in its exports, which for the last two years had been hurt by lower coffee prices and the critical situation in the United States technology market. In the services sector, the picture in the tourism industry, which is of such great importance for many Caribbean countries, was quite similar to that of merchandise exports. Tourist arrivals continued to dwindle in the early months of 2002, with the reduction amounting, for example, to 8% in Barbados.

Figure I.5
LATIN AMERICA AND THE CARIBBEAN: MONTHLY GOODS TRADE [a]
(Billions of dollars)



Source: ECLAC, on the basis of official figures.
[a] Includes Argentina, Brazil, Chile, Colombia, Costa Rica, Ecuador, Mexico, Paraguay, Peru, Uruguay and Venezuela, which together account for 93% of the region's trade.

Trends in raw material prices and, to a great extent, in the value of Latin American and Caribbean exports throughout the rest of the year will be strongly influenced by the situation in the world economy and, in particular, the United States. This country's economy exhibited a strong upturn in the first quarter of 2002, but there is a great deal of uncertainty as to how it and the other developed economies will fare during the remainder of the year. A reactivation in the United States would be of particularly crucial importance in reversing the downward trend seen in Mexico's, Central America's and the Caribbean countries' exports in the first quarter.

Although it is reasonable to hope for an improvement in the case of Mexico, the prospects for the Southern Cone have been dimmed by the effects of the Argentine crisis. The largest losses of export earnings in the first quarter of 2002 were sustained by the MERCOSUR countries, Chile and Ecuador. In Argentina, the decrease in external sales caused by lower international prices and the turmoil in the country's financial system was checked by the steep devaluation of the peso.

The situation with respect to Argentina's imports was much more dramatic. The contraction of this country's imports to around one third of their former level was largely to blame for the downswing in the exports of its neighbouring MERCOSUR partners. This was especially true of the smaller members (i.e., Paraguay and Uruguay), but Brazil, which sells almost one fourth of its total merchandise exports to Argentina, was also affected.

The striking drop in Argentine imports overshadowed the overall trend in the region, which has also been moving downward, in some cases quite sharply. Bearing in mind the results for the first quarter and the unfavourable trend of economic activity in the countries of the region, the descent of the region's imports appears to be on its way towards doubling the 2.5% drop posted in 2001.

Apart from Argentina, the steepest decreases have been registered by Uruguay (in keeping with the economic recession in that country), Paraguay (where both the economy in general and transit trade, in particular, have exhibited a slight contraction) and Brazil (where domestic economic activity has also been flagging). In all of these countries, the reductions have amounted to 25% or more. Smaller but still quite sizeable declines have been recorded by all the Andean countries except Ecuador. In Mexico, the drop in imports has been smaller (8% in the first quarter). As was also true the year before, in every case a portion of the decrease in the value of imports has been due to lower import prices. As in 2001, the conspicuous exception in this regionwide import picture is Ecuador, where a real appreciation of the currency has continued to help boost imports, which jumped by 30% in the first four months of the year.

Two major determinants of foreign trade activity accounted for the mixed performance of intraregional trade in the first quarter of 2002. In the Central American Common Market (CACM), the slowdown in the United States economy caused exports to destinations outside the subregion to fall much more steeply than exports within the zone (26% versus 2%). Just the opposite occurred in MERCOSUR, where intra-zone exports plummeted by 41% as compared to a decline of just 11% in exports to other countries. As a result, trade among the CACM countries continued to account for an increasing share of the total, as it reached posting a record figure of 35%, whereas in MERCOSUR this indicator slumped to a low (12%) not seen since the start of the 1990s. The Andean Community's intra-zone trade expanded by 18%, but sales to other countries were dragged down sharply by the slump in oil prices.

4. Capital flows remain limited and unstable

Total capital inflows to Latin America and the Caribbean in 2002 are estimated at around US$ 50 billion, which is a far cry from the US$ 74 billion per year that the region averaged in 1996-1998. For 2002, autonomous capital inflows are expected to amount to about US$ 38 billion, in addition to the US$ 11.5 billion in compensatory financing that has already entered the region. The main component of private inflows will continue to be FDI, as has been the case throughout the last decade. In contrast, net flows of debt and other private capital will be negligible.

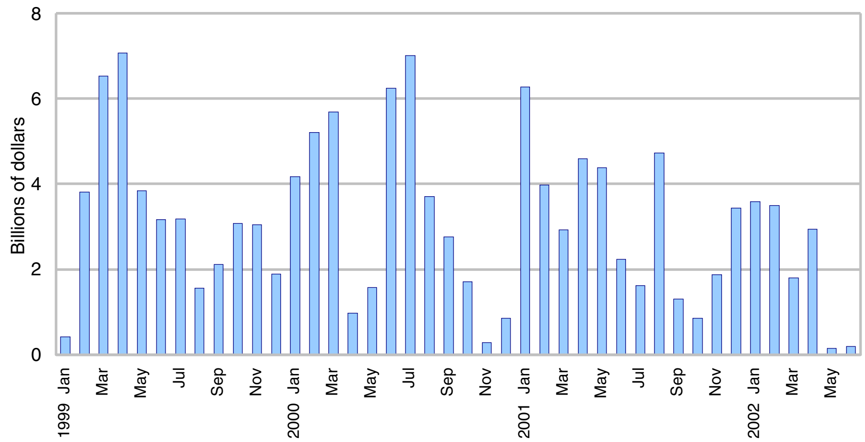
External finance has continued to be unstable and volatile (see figure I.6) as international investors become increasingly risk-averse. This is partly due to fallout from the Argentine crisis, but it is also attributable to political uncertainty in the region. From mid-2002 on, an additional factor has been the heightened volatility of the world's stock markets caused by the discovery that large-scale frauds have been perpetrated in many major United States firms.

Problems in obtaining external financing on the market during the first semester are reflected in recent trends in international reserves. As of May, reserve assets totalled some US$ 150 billion, one of the lowest levels to be recorded since the Russian moratorium. During the early months of the year, significant reductions in the reserves of Argentina, Brazil, Uruguay and Venezuela were too large to be outweighed by the increases posted in Chile, Colombia, Mexico and Peru.

Following the external debt swap conducted by Argentina in June 2001 and given the deep discount at which Argentine debt has been selling on the secondary market since then, the restructuring plan offered in late 2001 proved to be unviable, and the Argentine Government proceeded to suspend payments on its public debt. As of mid-2002, attempts to reinstate its agreement with the International Monetary Fund (IMF) have not borne fruit, although the Fund did agree to the deferral of amortization and interest payments falling due during the first semester. Once Argentina succeeds in putting its agreement with IMF back on track, it will be able to obtain further disbursements, begin negotiations on the restructuring of its external public debt and embark upon the task of rebuilding its economy's monetary and financial foundations.

For the time being, however, the Argentine crisis has had a contagion effect on the other economies in the region (see the section on this topic below). In June, a

Figure I.6
LATIN AMERICA AND THE CARIBBEAN: INTERNATIONAL BOND ISSUES



Source: ECLAC, on the basis of figures from the International Monetary Fund and Merrill Lynch.

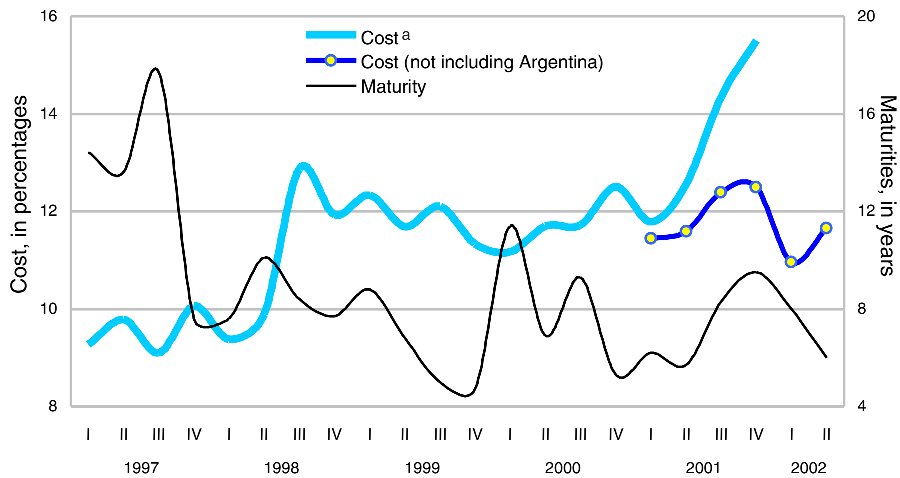
US$ 1.5 billion credit was approved to help Uruguay recoup the international reserves it had to use during the recent banking crisis. In addition, volatility in Brazil's markets prompted it to make use of US$ 10 billion in IMF disbursements in order to build up its international reserves.

The region's FDI inflows are expected to shrink significantly in 2002, falling to around US$ 40 billion. This is far from the yearly average of nearly US$ 73 billion received in 1997-1999, a period when FDI inflows were growing year by year. Meanwhile, as in 2001, direct investment abroad will be virtually nil. This marks a sharp contrast with the situation in 1997-1999, when an average of US$ 7 billion was invested abroad each year, almost all of it by residents of Argentina, Brazil and Chile. The slump in FDI in 2002 is partially accounted for by the sharp reduction in purchases of existing assets. Some of the hardest-hit countries are Argentina, Brazil and Mexico, which posted record levels in 1999, 2000 and 2001, respectively, thanks to large-scale corporate acquisitions in those countries.

Placements on international bond markets in the first semester amounted to just US$ 12 billion; this was only half as much as in the first semester of 2001, and almost all of the proceeds have been used to amortize matured debt. The bulk of these operations involved sovereign bond issues placed by the region's traditional lenders (Brazil, Colombia, Mexico, Panama, Uruguay and Venezuela), but they were joined by the Governments of Chile, El Salvador, Jamaica and Peru (the latter for the first time since 1928). PEMEX and PETROBRAS were among the few corporations in the region to float bond issues.

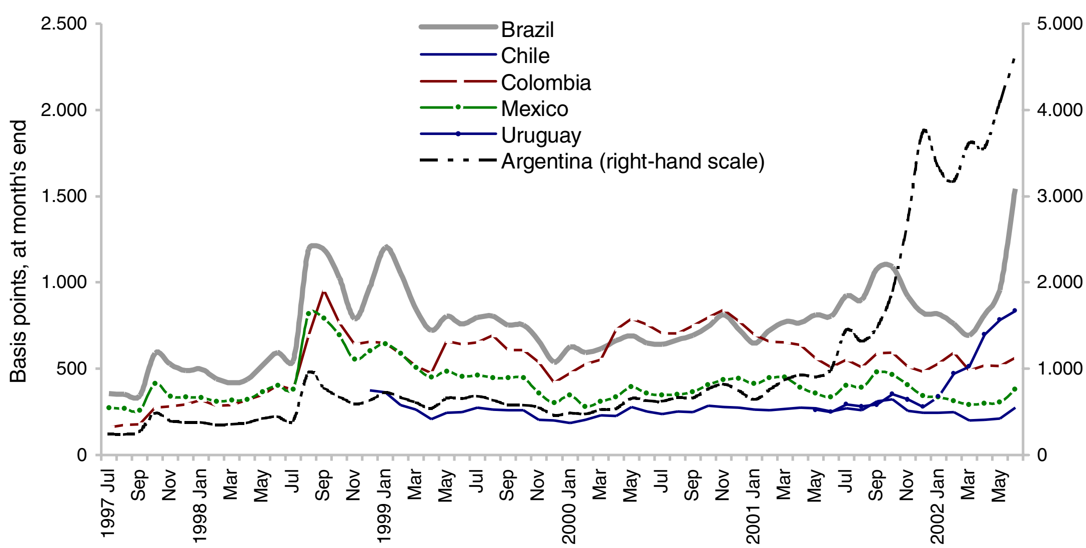
The terms and conditions for external finance had shown an improvement in January-April 2002 over the situation in late 2001 (with the exception of those available to Uruguay), but they took a sharp turn for the worse starting in May (see figure I.7). In the first four months of the year, the cost of external financing fluctuated around 12%, which was also the mean rate applied to new issues by countries of the region. In May and June, however, conditions deteriorated, and by late June the cost was approaching 14%, which was close to the rate seen at the time of the Russian moratorium in August 1998. In this instance, the main factors underlying the increase were the deep discounts applying to Argentine and Brazilian paper on the secondary market. If these two countries' securities are not taken into account, then the cost of external financing for 10 countries of the region amounted to an annual rate of 11% in June (between 7% and 8% for Chile, Costa Rica and the Dominican Republic; between 9 and 10.5% for Colombia, Mexico, Panama and Peru; and from 14% to 16% for Ecuador, Uruguay and Venezuela). The rise in the cost of financing for the region was attributable to a heightened perception of risk, as measured by the variation in spreads, since the yield on United States Treasury bonds held steady in the first semester at around 5% per annum. The average spread for the region as of late June was 900 basis points. Argentina, Brazil and Uruguay witnessed the steepest increases, with their spreads widening to almost twice as much as they had been in late 2001 (see figure I.8).

Figure I.7
LATIN AMERICA AND THE CARIBBEAN: COST AND MATURITIES OF INTERNATIONAL BOND ISSUES



Source: ECLAC, on the basis of figures from the International Monetary Fund, J.P. Morgan and Merrill Lynch.
[a] Sum of the average spread for bond issues and yields of long-term United States Treasury bonds.

Figure I.8
SPREADS ON EUROBONDS
(Over yields of United States Treasury bonds)



Source: ECLAC, on the basis of figures from J.P. Morgan.

5. A shift in macroeconomic policy

Within this complex external context, the available information for the early months of 2002 points towards a change for the better in the contractionary monetary and financial conditions observed in 2001. This more expansionary monetary policy stance has not yet, however, sparked a recovery in domestic credit. Meanwhile, a change in the more expansion-oriented fiscal policy implemented in 2001 is expected. On more than a few occasions, pressure generated by the external environment and dwindling net financing have obliged the authorities to take steps to scale back public expenditure.

6. A more cautious fiscal policy

The dilemma facing fiscal authorities in choosing between the objectives of maintaining the sustainability of public finances by adopting a more austere policy stance and of using fiscal instruments to soften the impact of recessionary trends has become all the more difficult in 2002. This has been especially true from May onward because of the uncertainty generated by the possibility of contagion from the troubled situation in Argentina. Following a moderate expansion the year before, expenditure is expected to either remain constant or increase only slightly in 2002.

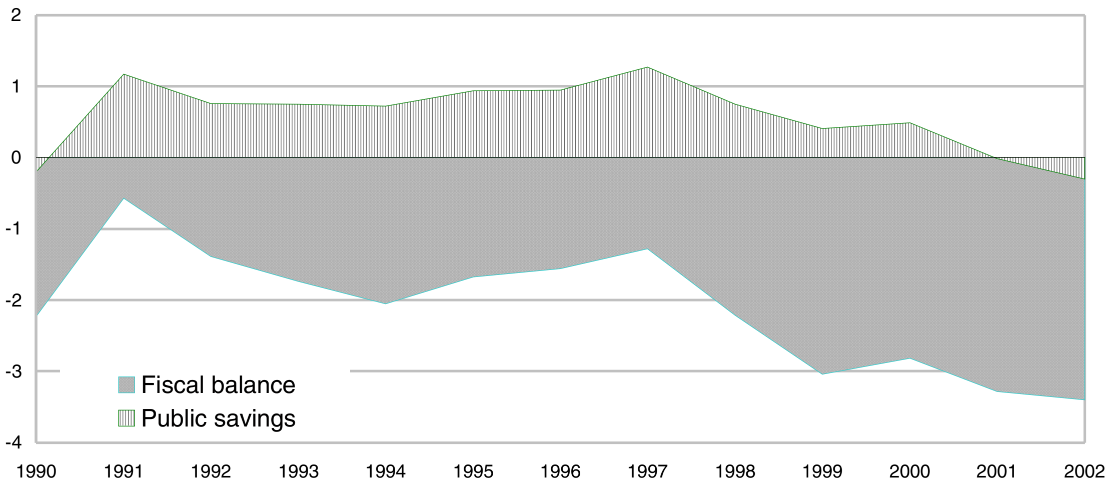
In the first few months of the year, fiscal indicators continued to worsen as revenues declined in most of the countries. Income was down very sharply in Argentina and Venezuela and was somewhat lower in Barbados, Jamaica, Mexico, Peru and Colombia. In Brazil, Ecuador and the Dominican Republic, fiscal revenues were higher; this resulted in a larger primary surplus in the first of these countries, but spending increased even more sharply in the other two. Fiscal receipts in the Caribbean countries were also hurt by the slump in tourist arrivals, which have made no more than a partial recovery in the wake of the events of 11 September 2001.

The management of monetary and exchange-rate policies has also had an effect on public finances. Lower interest rates have reduced the cost of domestic borrowing, but devaluations have complicated the situation for national treasuries by increasing the relevant countries' external debt burdens. In fact, in the case of Brazil, the rate of devaluation actually increased, while interest rate hikes and the indexation of government paper drove up the cost of domestic borrowing.

As a result, the objectives of keeping the fiscal deficit in check and controlling the size of the public debt have prevailed over the pressing need to reactivate the economies of the region. One of the factors that has exacerbated the situation in 2002 is the fact that the economic authorities had already made use of fiscal policy to smooth out the business cycle the year before, and the degrees of freedom available to the countries' governments are thus more limited than ever due to the deterioration of the fiscal situation in 2001. In fact, the deficits of the countries' non-financial public sectors and central governments are, on average, in the range of 3%-4% of GDP (see figure I.9). Even in Chile, which is in a sounder fiscal position that most of the countries in the region, the discussion regarding the role that macroeconomic policy should play in reactivating the economy has, at least for the time being, led to the advocacy of a cautious fiscal stance and a more active role for monetary policy.

Another source of pressure will be the problem of how to finance those fiscal deficits and refinance the existing public debt, especially in countries where the debt is equivalent to a high percentage of GDP. Given the conditions prevailing on international financial markets, the funds to cover the countries' fiscal deficits are going to have to be obtained from domestic creditors or multilateral agencies. Consequently, many countries in the region have announced policy changes or even more specific measures aimed at maintaining fiscal discipline. Some of the measures that have been unveiled so far are a reduction in capital expenditure equivalent to one point of GDP in Colombia, widespread spending cuts in a number of countries, tax hikes in Uruguay and plans for further tax reforms in Colombia and Nicaragua. The postponement or suspension of planned privatizations in Ecuador, Paraguay and Peru has also obliged the authorities in these countries to seek alternative sources of fiscal revenue or, failing that, to scale back expenditure.

Figure I.9
LATIN AMERICA AND THE CARIBBEAN: SAVINGS AND FISCAL BALANCE OF CENTRAL GOVERNMENTS
(Percentages of GDP)



Source: ECLAC, on the basis of official figures.

All of these measures will have a recessionary impact on the countries' already low levels of economic activity. In addition, political factors are also generating uncertainty, thereby making the job of managing fiscal policy even more difficult in 2002, since presidential elections are to be held this year in various countries (Bolivia, Brazil, Colombia and Ecuador) and, in others, a heated debate has arisen regarding the direction of economic policy.

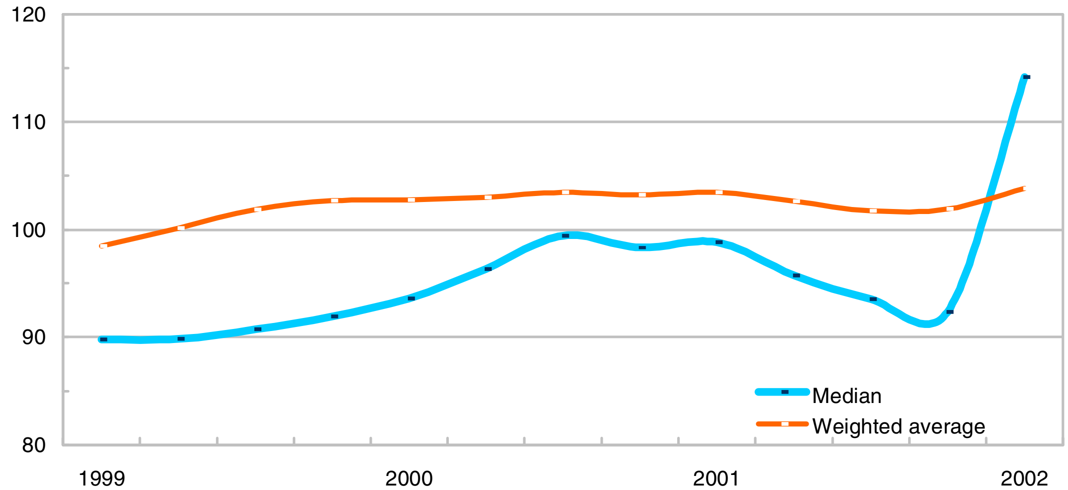
7. Monetary variables reflect a more expansionary stance, but the supply and demand for credit are unresponsive

The monetary authorities made a determined effort to increase the monetary base and lower interest rates during the first half of 2002 in an attempt to counteract the contractionary influence of the external economic environment. In countries with more flexible exchange-rate systems, these measures were also aimed at taking advantage of the greater autonomy in the sphere of monetary policy afforded by those regimes. These efforts succeeded in reversing the contractionary trend of monetary and financial variables seen in 2001. The median value of the summary indicator used by ECLAC to track these trends rose considerably, reflecting a more expansionary monetary policy orientation (see figure I.10).

In fact, the information available for most of the countries as of May 2002 indicates that eight of them increased their monetary bases by between 18% and 58% in a 12-month period (Argentina, Colombia, Costa Rica, Guatemala, Haiti, Jamaica, Mexico and Paraguay). In contrast, only four countries' monetary bases showed negative variations for the same 12-month period (–20% in Uruguay, -17% in Venezuela, –1.7% in Chile and –0.1% in Ecuador).

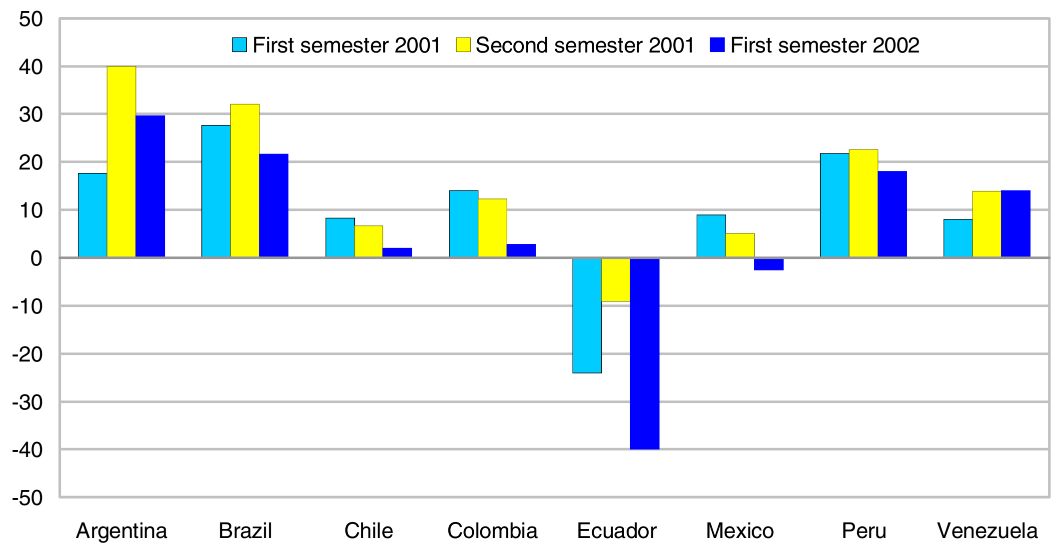
Chile and Colombia posted very steep decreases in their central bank intervention rates, which were near or slightly lower than their rates of inflation at mid-year (see figure I.11). In Brazil, on the other hand, the overnight rate (the Selic rate) stayed at 18%, despite the central bank's repeated announcements regarding its intention to lower it. This level is similar to what it was in mid-2001, which, given the country's annual inflation rate, is quite high. In Mexico the downward trend in the benchmark Cetes rate was reversed in May, and the Cetes rose from around 5.3% to 7%.

Figure I.10
LATIN AMERICA AND THE CARIBBEAN: INDEX OF MONETARY CONDITIONS, 1999-2002 [a]
(Index 1995=100)



Source: ECLAC, on the basis of figures from official sources and the International Monetary Fund.
[a] An increase in the index reflects more expansionary conditions

Figure I.11
LATIN AMERICA AND THE CARIBBEAN: ANNUALIZED REAL INTEREST RATES [a]
(Percentages, semester averages)



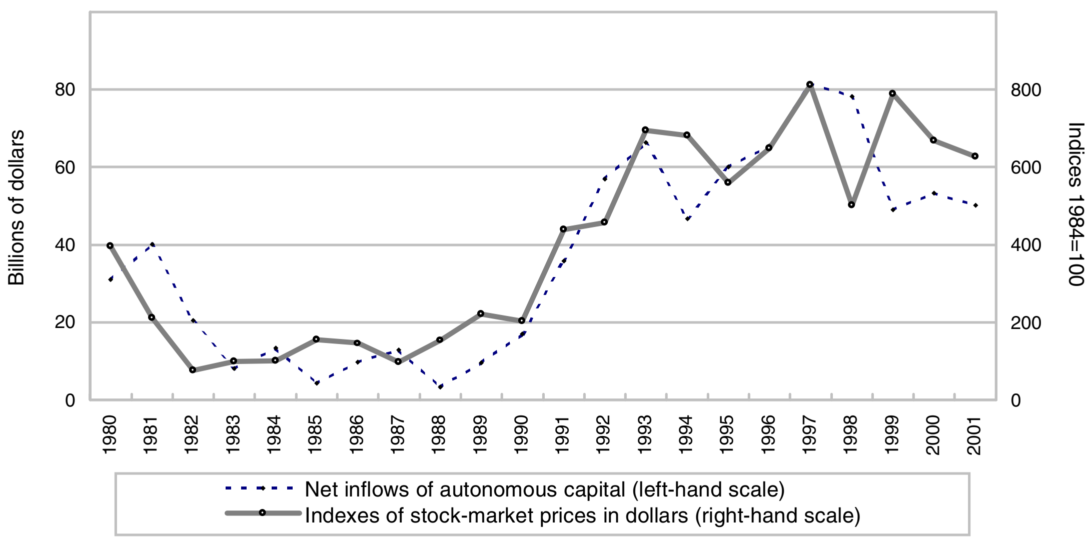
Source: ECLAC, on the basis of figures from the International Monetary Fund.
[a] Short-term lending rates, deflated by the consumer price index

The move towards a more expansionary monetary policy has not had the hoped-for effect in most of the countries because of slack demand for money and credit. Credit growth rates lagged behind increases in the monetary base in Colombia, Mexico, Costa Rica, Guatemala, Honduras, Jamaica and Peru. This reflects a conservative lending policy on the part of the banking system and a cautious attitude on the part of investors, both of which were in evidence the year before as well.

In 2002, these tendencies have been even stronger in many of the Latin American countries' financial sectors. Due to these economies' degree of integration in the international financial system and their great vulnerability to external shocks, the main factors that have aggravated the situation have to do with the behaviour of the international financial market (especially in the United States) and the depth of the crisis in Argentina. Smaller bank capital flows for many countries and the losses sustained by Argentina have also led to the adoption of a very conservative position by foreign banks, many of which have begun to take local contingent liabilities into consideration when calculating their exposure.

Investor caution has also hurt financial flows to local capital markets, which has in turn depressed local stock indexes (see figure I.12). In fact, equity prices, as measured by the International Finance Corporation Global (IFCG) index, dropped by 7.2% in the first half of 2002. Some countries have witnessed even sharper decreases (e.g., Brazil, Chile and Venezuela), and the steep downward trend that began in the second quarter of 2000 in Argentina has continued.

Figure I.12
LATIN AMERICA AND THE CARIBBEAN: STOCK-MARKET PRICES AND CAPITAL INFLOWS



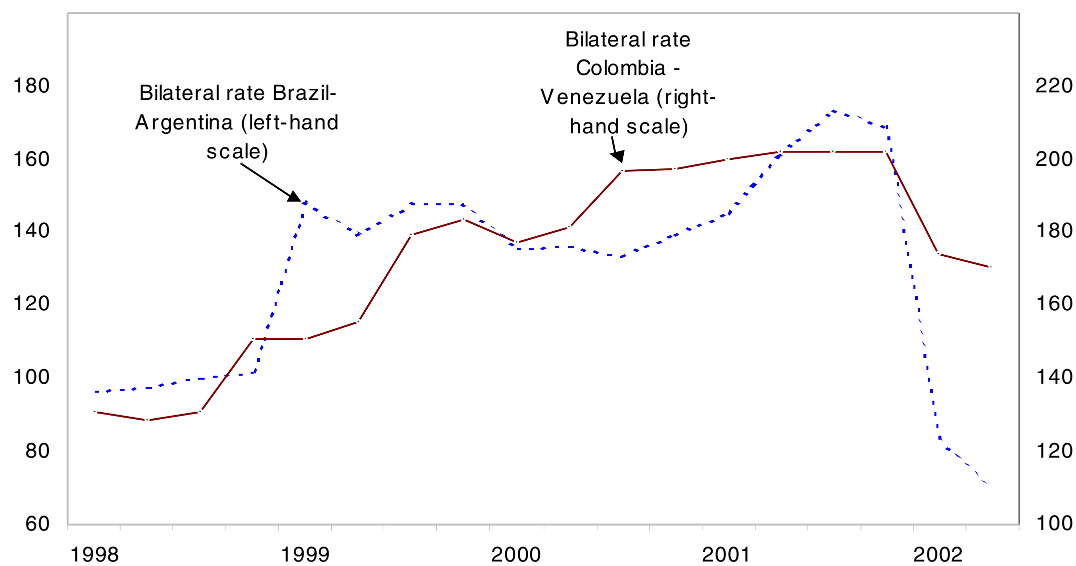
Source: ECLAC, on the basis of figures from the International Monetary Fund and the International Finance Corporation.

8. Real exchange rates move in opposite directions

When two more countries (Argentina and Venezuela) decided to float their currencies early in the year, dirty floats (with the frequency of central bank intervention varying from case to case) became the predominant exchange-rate regime in Latin America and the Caribbean, at least among the larger countries. This has given the region's economies greater flexibility in dealing with external shocks and in devising more active monetary policy responses.

The scale of the devaluations of some of the larger Southern Cone countries' currencies against the dollar has adversely affected their trading partners. In what amounts to a zero-sum game for the region's countries as a group, these devaluations have enabled some economies to improve their competitive positions, but at the cost of a reduction in the competitiveness of their neighbours' real effective exchange rates (see box I.1). The outcome has been a very slight depreciation in real effective exchange rates and, in contrast, a very steep depreciation in real bilateral exchange rates against the dollar (see figure I.13). The latter has eroded the capital base of private and public agents holding dollar-denominated debt.

Figure I.13
REAL BILATERAL EXCHANGE RATES
Brazil-Argentina and Colombia-Venezuela (Base year 1995=100)



Source: ECLAC, on the basis of figures from official sources and from the International Monetary Fund.

In Mexico, on the other hand, the strength of the peso –which has been fortified by the abundant capital inflows received by the country in recent years– drove down the real exchange rate to very low levels. The peso did begin to reduce this exchange-rate lag towards the end of the first semester of 2002, however.

Box I.1

A WIDENING GAP BETWEEN EFFECTIVE EXCHANGE RATES AND BILATERAL EXCHANGE RATES AGAINST THE DOLLAR

In 2001-2002, a number of countries in the region witnessed an atypical widening of the differential between the real effective exchange rate and their real bilateral exchange rate against the United States dollar. This was particularly true of the MERCOSUR countries and their associates (Chile and Bolivia). As is shown in figure I.14, bilateral exchange rates depreciated quite sharply against the United States dollar, but this was not reflected in those same countries' effective exchange rates, which appreciated or changed very little. This phenomenon serves to illustrate the undesirable effects that devaluations or depreciation have had on trading partners within the region.

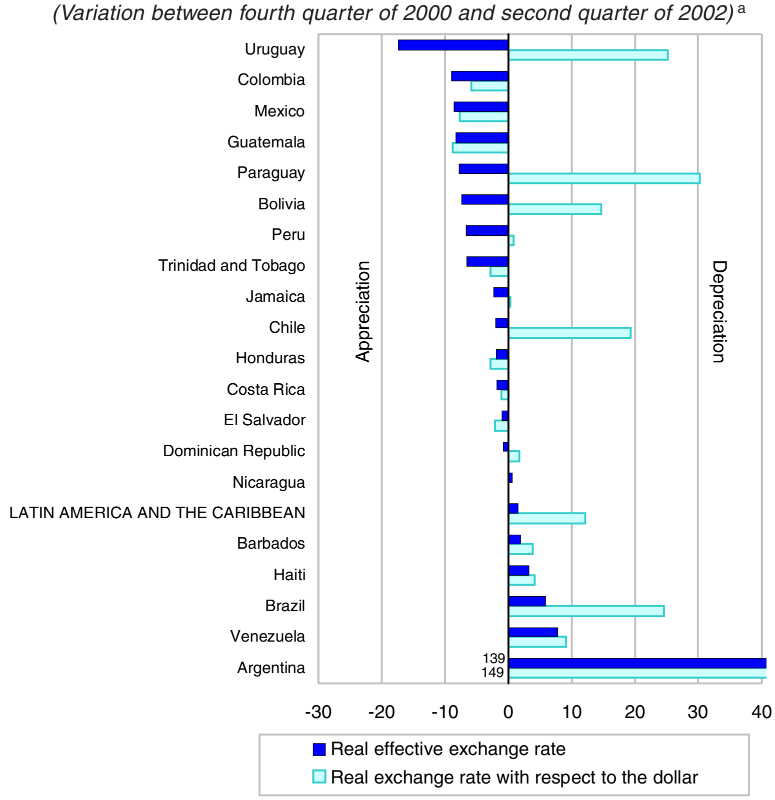
Although a real devaluation does increase the external competitiveness of tradeable goods and services produced by the devaluing country, when intraregional trading activity is quite active –as it typically is in the case of trade in manufactures among all the members of the various subregional integration schemes in Latin America– then a devaluation will reduce the competitiveness of trading partners in the region. Moreover, if the variations are sizeable, then the resulting gains are usually short lived. Since the affected trading partners can also devalue *their* currencies, the end result may be that the export capacity for manufactured products of *all* the countries in the region may be damaged, inasmuch as –unlike commodity exports– these exports can not readily be diverted to other markets. Since the presence of small and medium-sized enterprises in international trade flows is generally significant only in terms of sales to neighbouring countries, these firms are the most vulnerable to sudden changes in exchange rates within any given subregion.

This situation illustrates just how complicated it is to manage national macroeconomic policies within a context of increasing globalization and regional integration. Another example is provided by the events that took place in Europe in the 1970s, when the destabilizing effects of a series of competitive devaluations drew attention to the need to coordinate foreign-exchange policies and ultimately led to the formation of a monetary union. For today's emerging economies, these trade-transmitted direct costs are augmented by the effects of financial contagion. Thus, as a group, the countries of the region would be better off if they succeeded in coordinating their macroeconomic policies (and exchange-rate policies, in particular) more closely.

Figure I.14

LATIN AMERICA AND THE CARIBBEAN: REAL EFFECTIVE AND BILATERAL EXCHANGE RATES

(Variation between fourth quarter of 2000 and second quarter of 2002) [a]



Source: ECLAC, on the basis of official figures.

[a] An increase denotes a real devaluation.

9. The reform process continues to lose momentum

The economic slowdown has taken its toll on reform programmes in the region, which have also been affected by the run-up to elections in several countries and political troubles in others.

Privatizations have taken the brunt of the downswing's impact. In Ecuador, Paraguay and Peru, scheduled projects have been suspended altogether, while in other countries auctions have aroused less and less interest among investors. As part of the effort to modernize the State apparatus, bills designed to strengthen the tax base have been introduced in Colombia, Guyana, Mexico and Nicaragua, and the Government of Ecuador has passed a law establishing a petroleum stabilization fund. The efforts of the Governments of Antigua and Barbuda, Grenada and Saint Vincent and the Grenadines were rewarded in March 2002, when these countries were removed from the Organisation for Economic Co-operation and Development's list of uncooperative tax havens.

The institutional development of regional integration processes has been patchy in 2002. The greatest difficulties have arisen in MERCOSUR, whose members are all experiencing economic problems. It is noteworthy, however, that in view of the limited scope of national responses to regional and international disturbances, a number of subregional groupings have taken steps to increase the coordination of their macroeconomic policies (e.g., the Andean Community) or have carried forward plans for monetary union (e.g., CARICOM) (see box I.2). In June 2002, Chile completed its negotiations with the European Union and signed a political and economic association agreement under which 85% of Chilean exports to the European Union will enjoy tariff-free treatment.

Box I.2

REGIONAL INTEGRATION PROCESSES IN THE FIRST SEMESTER OF 2002

MERCOSUR has undertaken a number of joint initiatives in order to tackle the problems facing some of its members. At the group's latest biannual summit meeting, held in Buenos Aires on 7 July 2002, discussions revolved around the crisis in the host country, and Argentina and Brazil signed a letter of intent to conclude an agreement on the automotive industry.

In 2002 the **Andean Community** established a basic set of regulations and standards for its common external tariff. The members have already submitted proposed lists of goods to be included under each of the agreed tariff levels, and those lists are now under review. The Advisory Council of Ministers of Economic Affairs has continued to make headway in the sphere of macroeconomic coordination and has adopted new convergence criteria regarding fiscal matters and public debt.

In March the countries of the **Central American Common Market (CACM)** signed a plan of action for economic integration and an agreement on investment and trade in services. The aim of the agreement is to establish a legal framework with clear, transparent and mutually beneficial rules on the promotion and protection of investments and trade in services in order to facilitate the participation of different economic agents.

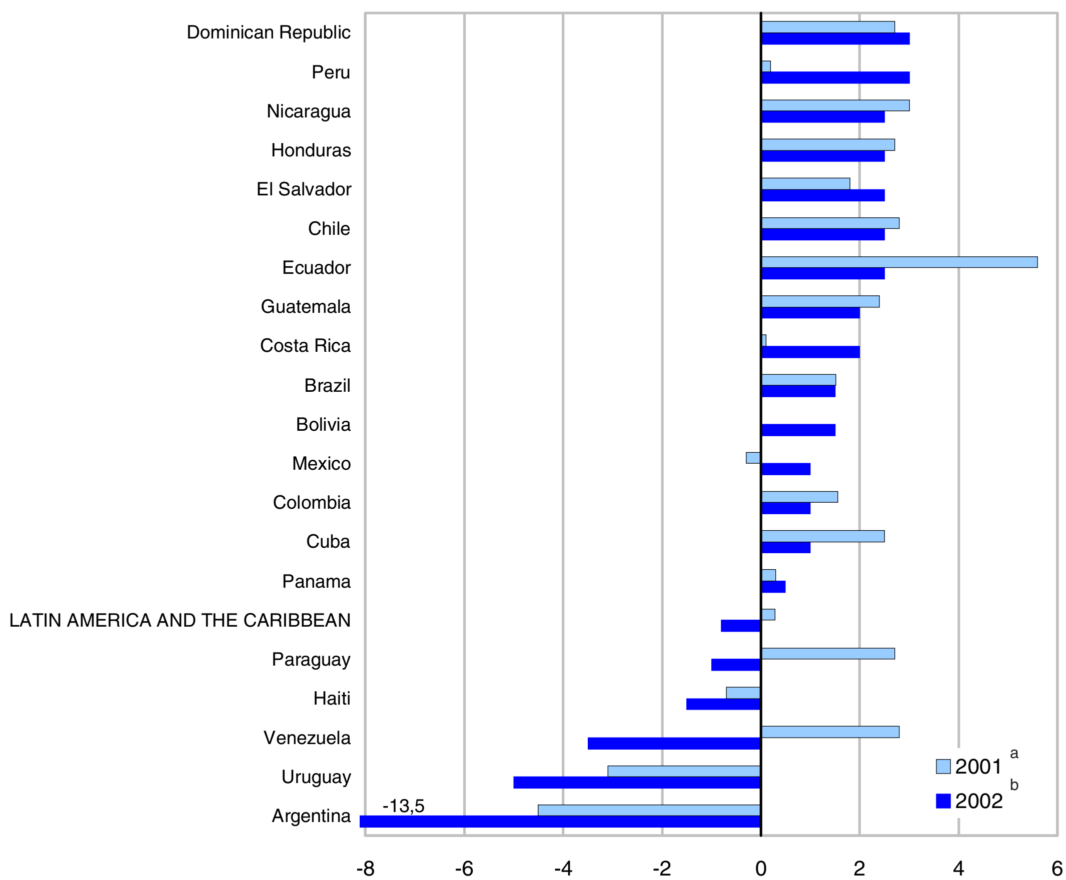
The most significant advances made by the **Caribbean Community (CARICOM)** were reflected in additional protocols to the Revised Treaty of Chaguaramas which provide for the free movement of people, capital and services and which safeguard the right of establishment. A deadline of July 2002 was set for the entry into force of the provision on the free movement of persons. At the twenty-third Meeting of the Conference of Heads of Government, which took place in Georgetown, Guyana in July 2002, the countries examined the status of the integration process and reaffirmed their commitment to make joint preparations for future negotiations in connection with the Free Trade Area of the Americas, the World Trade Organization and the European Union.

In early July 2002 **Mexico** took a step towards developing closer relations with the MERCOSUR countries by signing a trade agreement with Brazil in which the two countries agree to lower agricultural and industrial tariffs on some 800 products. Within the framework of the North American Free Trade Agreement, in January 2002 it also began to reduce tariffs on some US$ 5 billion worth of products, including footwear and motor vehicles.

10. The anticipated upturn in growth is delayed

The economic growth outlook in Latin America and the Caribbean for 2002 is not promising. After expanding by a mere 0.3% in 2001, regional GDP is expected to contract by 0.8%, while per capita GDP will slip by 2.4%. The recession that began in the third quarter of 2001 was deepened by a decrease of over 3% in output in the first quarter of 2002 (see figure I.15), and six of the region's countries –Argentina, Brazil, Haiti, Mexico, Uruguay and Venezuela– posted negative growth rates for that period. The situation in the region brightened somewhat in the following months, however, and it is expected that the economy will see a more solid improvement in the second semester. Even if an upswing does occur, however, it will not be strong enough to make up for the ground lost during the first half of the year.

Figure I.15
LATIN AMERICA AND THE CARIBBEAN: GROSS DOMESTIC PRODUCT
(Annual growth rates)



Source: ECLAC, on the basis of official figures
[a] Preliminary estimates.
[b] Projections.

The weakness of economic growth in 2002 is largely attributable to the collapse of production activity in Argentina and its implications for the region. The other countries will grow by around 1%, which is lower than the estimated world average for 2002 of just under 2%, and well below the 3.2% forecast for developing economies. What is more, the great majority of the countries will turn in a worse performance than in 2001, with Belize, Costa Rica and Peru being the main exceptions to this rule.

This means that in 2002 the region will have lost a full half-decade of growth. In that time per capita GDP will have fallen to a point nearly 2% below its 1997 level. All of this is compounded by extreme volatility. The region has not experienced such an adverse situation since the debt crisis during the first half of the 1980s, when output grew by less than 3% in five years and per capita GDP contracted by more than 7%, also under highly volatile conditions.

The Latin American countries fall into two groups in terms of their growth prospects for 2002. In the first group, composed of Argentina, Paraguay, Uruguay and Venezuela, output is expected to decline. In Argentina, the recession that has gripped the country since 1999 has taken a turn for the worse, and the level of activity is forecast to fall by about 13.5% in 2002. The sharpest contraction occurred in the second semester of 2001 and the first quarter of 2002, however, when GDP shrank by 16.3% with respect to the same period of the preceding year. Since then, there have been signs that the sharp downward trend in production activity is beginning to ease. The Paraguayan economy will witness a severe slowdown in GDP growth, which is expected to slide from its 2001 mark of 2.7% to -1% in 2002, chiefly because of the Argentine crisis. Uruguay is in a similar position, as the decline in activity has intensified in 2002 (see the section on the transmission of the Argentine crisis to neighboring countries). Venezuela is also expected to post a negative growth rate (-3.5%) amid political problems compounded by the impact of adjustment measures adopted to deal with the macroeconomic disequilibria that had built up in previous years. In the first quarter, economic activity slid by 4.2%, with activity down by 7.6% in the petroleum industry and by 2.6% in the non-petroleum sector.

The Latin American countries in the second group are expected to turn in moderate growth rates of between 0% and 3% of GDP. Brazil's GDP decreased by just under 1% in the first quarter, and any prospect of an upturn in the second semester will be limited by strong pressures from financial markets. In Chile, growth projections point to a 2.5% rate owing to slack domestic demand and a downturn in investments that have been exacerbated by the adverse international and regional environments. Mexico's output shrank by 2% in the first quarter, thus completing nine consecutive months of declining production activity. This performance is attributable to sagging domestic demand. The second quarter of 2002 brought some signs of an upturn; whether or not this trend holds up will depend on the duration and magnitude of the recovery of the United States economy.

Peru is expected to perform well in 2002, with a growth rate of 3%, thanks to an upsurge in primary activities and construction together with an increase in the volume of exports. Economic activity in Colombia has continued to be constrained by sluggish domestic demand and slackening industrial activity in the first quarter of 2002, all of which has been exacerbated by a loss of momentum in export activity. On the basis of the first-quarter results, when GDP grew by a scant 0.5%, analysts agree that the economy will perform poorly for the year overall, with a growth rate of around 1%. In Ecuador, economic activity has been trending sharply downward, and the high growth rate of 5.6% posted in 2001 will drop to around 2.5% in 2002. The boost provided by investment in a new oil pipeline will mainly benefit the construction industry. The Bolivian economy appears to be headed for a growth rate of around 1.5%, which would fall within the lower range of official estimates.

One of the traits shared by the Central American countries is the continuation of a relatively slow-growth scenario. In the first quarter of 2002, economic expansion was moderate in Costa Rica and Panama, and the outlook for the year as a whole is muted. In Guatemala, an upturn that began in June 2001 carried over into early 2002; in February, the gain was fairly limited, however, with a year-on-year rate of 0.3%. This lacklustre performance reflects a downturn in exports together with sluggish private investment, with the latter being a reflection of a controversy between the government and the private sector that remains unresolved. In El Salvador, an upsurge in construction –boosted by increased government spending and reconstruction projects– could spur activity in the wider economy, reactivate employment and rekindle the *maquila* sector by attracting new investments to it.

The situation in the Caribbean countries is very mixed. In the Dominican Republic, the economic policy adopted in 2001 continued to fuel domestic demand in the early months of 2002. The economy grew by a robust 4.3% in the first quarter, though this was far short of the high growth rates (7.2%) recorded in the second half of the 1990s. Sustained flows of FDI and of remittances from Dominican nationals living abroad shored up growth. External demand remained lethargic, however, and this was reflected in a downturn in exports from both the export processing zones and domestic sources, as well as in a decline in tourism revenues. Cuba's growth rate is expected to stall, while in Haiti, where the situation continues to give cause for concern due to adverse domestic conditions, a contraction in GDP is projected.

The CARICOM economies will see GDP grow by a projected 1% in 2002. This net result will be a reflection of a decline in output in Barbados, Dominica and Saint Kitts and Nevis, together with positive growth rates in the other economies. Jamaica's growth rate is expected to be around 2.5%, while the economy of Trinidad and Tobago is likely to post a 3% growth rate. The countries whose economies depend on tourism were hit hard by the drop-off in this activity that came in the wake of the 11 September attacks in the United States. This phenomenon carried over into the first semester of 2002, and any improvement in the following months will largely depend on the performance of the United States economy. The external environment exerted a negative influence on both output and exports of such agricultural products as sugar and bananas.

11. Investment and saving take a turn for the worse

Investment and saving have failed to show any sign of improving upon the mediocre figures posted in 2001. National saving will remain low, in keeping with the trend of recent years, while external saving is expected to drop to just over 2% of GDP. Given the existence of idle production capacity and the absence of any clear signs of an upturn, regional investment is likely to remain slack.

Most of the countries for which data are available recorded hefty decreases in investment in the early months of 2002 (-4.4%). In fact, seven of the nine reporting countries posted sharp downswings: Argentina (-46.1%), Brazil (-8.4%), Chile (-2%), Colombia (-6%), Mexico (-1%), Peru (-3.5%) and Uruguay (-34%). This group includes the region's three largest domestic markets, which indicates that the generalized downturn in the external environment has engulfed the whole of the region's internal economy.

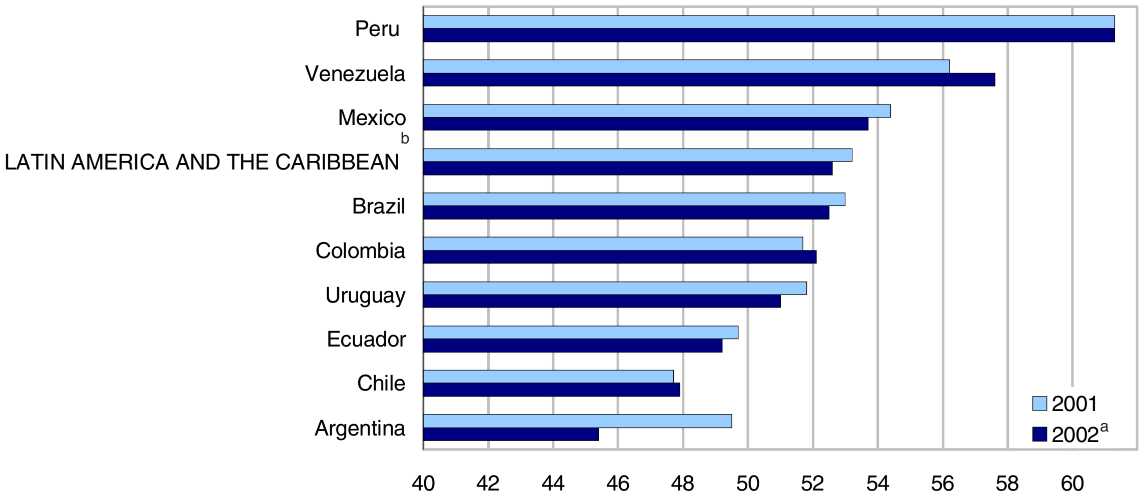
In Argentina, investment has fallen to nearly half its former level due to outflows of private capital and the continued erosion of international reserves. In Bolivia, private investment –the main factor underlying the slackening of domestic demand– has failed to recover despite the downward trend in interest rates seen throughout the preceding year and abundant liquidity. Domestic investment in Brazil has faltered in an atmosphere marked by uncertainty and high interest rates. After a small upswing in January, investment in Mexico receded again in February and March. In Peru, domestic demand remains weak, especially in the case of investment, which in the first quarter exhibited a year-on-year decrease in both the public and private sectors. Uruguay has seen investment figures fall sharply.

Costa Rica and Ecuador are the only countries to have seen a significant increase in investment in the first half of 2002. In Costa Rica, investment will probably weaken as the year goes on and will be concentrated in high-technology and energy projects. Public investment will remain low after dropping sharply in 2001. In Ecuador, the upturn in investment has carried over into 2002 thanks to the construction of a new pipeline for heavy crude oil and to exploratory and drilling activities, especially in the petroleum sector.

12. The labour situation continues to deteriorate

With economic activity weak, labour demand remained sluggish in the first semester of 2002, and in most of the countries for which data are available –Argentina, Brazil, Ecuador, Mexico and Uruguay– the rate of employment was lower than it had been a year earlier (see figure I.16). The rate remained stable in Chile and Peru, and Colombia and Venezuela posted increases. The regional employment rate (the weighted average for these nine countries) therefore declined once again (from 53.2% to 52.6%).

Figure I.16
LATIN AMERICA AND THE CARIBBEAN: EMPLOYMENT
(Employed persons as a percentage of the working-age population, first semester of each year)



Source: ECLAC, on the basis of official figures.
[a] Preliminary figures.
[b] Weighted average.

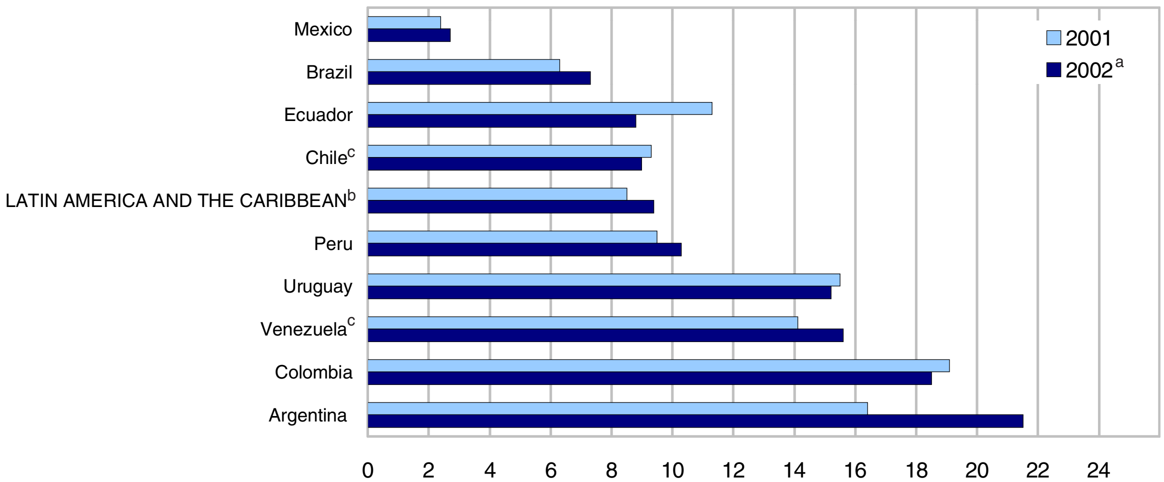
Private formal-sector employment fell back sharply in Argentina, dropping by around 5% between January and May of 2002, and by around 10% with respect to the same period of 2001, with data from Greater Buenos Aires showing heavy job losses in construction and commerce. In Mexico, formal employment fell by 2.5% in the period January-April 2002 with respect to the same four months of 2001. The number of formal-sector wage earners is bouncing back, however, as the April figure was 1.5% higher than in January. The downward trend in *maquila* employment levelled off at the beginning of 2002, but losses remained very heavy by comparison with the year before, since the rate was down by 17.5% in the first quarter of this year as compared to the same period of 2001. The outlook is brighter in Brazil, where formal employment in the first five months of the year was 2.3% higher than in the same period a year earlier, and in Chile, where the number of workers in the formal sector rose by 2.5% between March 2001 and March 2002.

After an abrupt drop in the labour force participation rate in 2001, in line with the general economic situation, the two variables continued to move in tandem in seven of the nine countries for which information is available. In Peru, for example, output and labour force participation increased, while both variables trended downward in Argentina and Uruguay. Exceptions were Venezuela, where the rate of participation increased despite a downturn in output, and Ecuador, where the employed labour force shrank even through economic growth was relatively strong.

At the regional level, the mixed performance of the various countries combined to hold the labour force participation rate relatively steady and this, together with the marked downtrend in employment, pushed the rate of unemployment up sharply (from 8.5% in the first semester of 2001 to 9.4% a year later). A rate of 9.3% is expected for the year 2002 overall. If this projection is borne out, this alarmingly high annual rate will set a new record for the region (see figure I.17).

Wages were affected by the depressed level of economic activity in several countries in the early months of 2002. In Brazil, the year-on-year decrease in real wages for the period from January to April amounted to 6%, although this decline is now easing off. In Mexico, the strong upward trend in real wages that took shape in 2001 as inflation subsided has come to an end. Although wages in the first quarter of 2002 were up by 3.4% on the rate recorded for the same period of 2001, the data for early 2002 already show a decrease with respect to the second semester of 2001. In Argentina and Uruguay, rising inflation has cut into real wages, which declined by between 3% and 4% in the early months of the year. The downtrend in real wages grew steeper thereafter, especially in Argentina. In contrast, reductions in what were already low inflation rates helped to drive up real wages by 2.5% in Chile and by 3.3% in Colombia in the period January-April 2002 as compared to the same period of 2001.

Figure I.17
LATIN AMERICA AND THE CARIBBEAN: URBAN UNEMPLOYMENT
(Percentage of the economically active population, first semester of each year)



Source: ECLAC, on the basis of official figures.
[a] Preliminary figures.
[b] Weighted average
[c] Nationwide.

13. Inflation remains low in most of the countries of the region

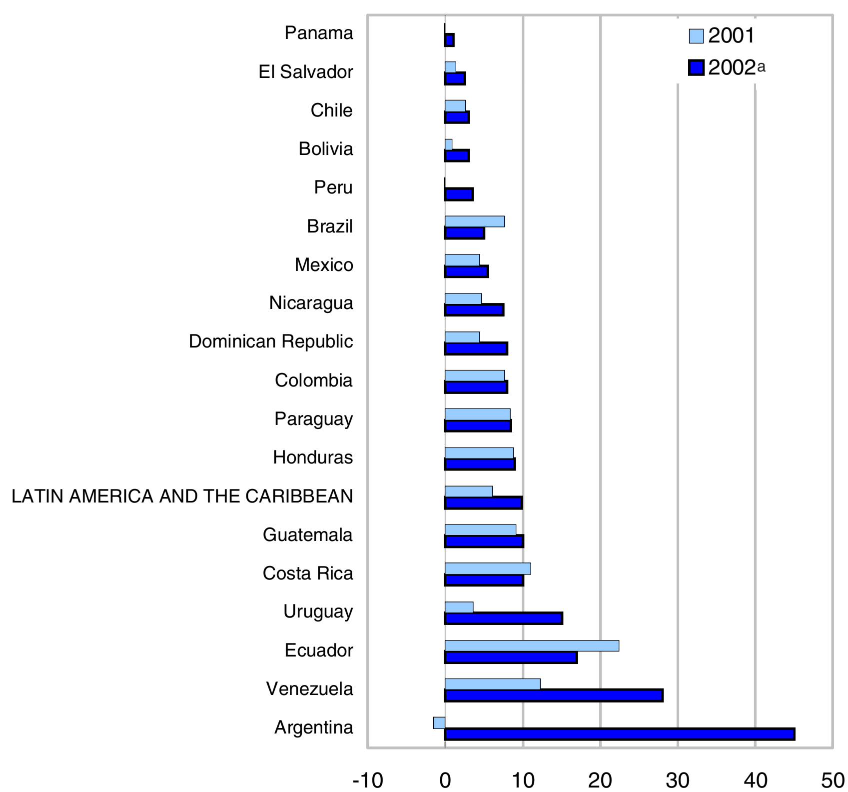
In the first half of 2002, at an annualized rate of just over 8%, the rate of inflation for the region as a whole was up by two percentage points over its 2001 level. Wholesale prices increased more sharply, with the 12-month rate rising to 14.4%, which was nine points higher than the year before. The higher regional rate masks large differences, however, as it is attributable almost entirely to the steep hike in Argentina, where inflation soared by 30% in the first semester owing to the steep devaluation that followed the demise of the convertibility regime early in the year. Inflation was also up in Uruguay and Venezuela, with increases of between five and seven percentage points on the figures posted in 2001. In these cases, too, substantial devaluations were to blame for the rise. The other countries continued to register the moderate rates of inflation observed in past years (see figure I.18).

Apart from these inflationary surges in particular countries, the regional inflation picture was therefore quite favourable, as shown by the fact that only three economies posted double-digit rates. This was attributable to virtually the same factors as in 2001. These primarily structural factors, such as economic liberalization and the sound management of monetary policy, continued to contribute to regional inflation's convergence towards the rates seen in developed countries. Other aspects of current economic conditions also played a role, however, particularly the recession now troubling the Latin American and Caribbean economies. The stability of the exchange rate in a number of countries has also helped to keep inflation low. In countries that have witnessed larger devaluations, inflation is higher, but still well below the rise in the exchange rate.

The outlook in terms of inflation in the second semester of 2002 is uncertain in several countries –including Argentina, Brazil, Paraguay, Uruguay and Venezuela– given their rising exchange rates and the upswing in wholesale prices. Nevertheless, in the first semester of 2002, as in 2001, the impact of devaluations was mitigated by the severe recession that has engulfed the region. In a number of countries, including Argentina, most of this impact was absorbed in the first semester, and the direct inflationary pressures generated by devaluations began to ease midway through the year.

In the other countries, the prospects for the second part of the year are bright. The country in the best position is Ecuador, which has recorded another substantial decrease in inflation thanks to the dollarization of its economy, although it will be hard-pushed to achieve a single-digit figure. Producer prices display a smaller increase than consumer prices, making it likely that Ecuador's inflation will soon be nearly on a par with the regional average. The fact remains, however, that the competitiveness of its economy has been eroded by the steep hikes in domestic prices seen in 1999 and early 2000. Costa Rica has also turned in a good performance, as inflation is down to less than 8% after several years of double-digit rates, and this may be taken as a signal that its stabilization process may be well on its way towards consolidation. Inflation is also considerably lower in Colombia and Nicaragua. Colombia has managed to consolidate the ongoing stabilization process it began several years ago, this time thanks to a lower rate of devaluation. Barbados and Panama have continued to post their traditionally low rates of inflation. The fact that Bolivia, Chile, the Dominican Republic, El Salvador, Guatemala and Peru have again recorded very low rates clearly signals the consolidation of these countries' stabilization processes. The same can be said of Mexico, although a slight upswing in inflation is expected for 2002.

Figure 18
LATIN AMERICA AND THE CARIBBEAN: CONSUMER PRICES
(Twelve-month variation)



Source: ECLAC, on the basis of official figures.
[a] Projections.

B. Regional repercussions of the argentine crisis

The severe crisis in the Argentine economy has not only affected all domestic economic activity in that country but has also shaken neighbouring economies. Argentina's imports from its neighbours are expected to tumble from US$ 6.5 billion in 2001 to slightly more than US$ 2.2 billion in 2002. The reduction is likely to be somewhat steeper for Paraguay and Uruguay.[2]

The magnitude of the crisis is a cause of serious concern in Latin America and the Caribbean. In addition to its direct effects on the region's economies, it is also exacerbating the difficulties that the countries were already facing as a result of their own domestic problems and the series of shocks they have sustained in recent years. The greatest danger of all, however, is that these disturbances could be transmitted to other economies. Contagion of this sort could trigger a systemic crisis in the region and perhaps even in other emerging economies. This threat is particularly serious because of the current fragility of the world's financial system. The problems that have beset the Brazilian economy (including, in particular, the marked volatility of its foreign-exchange market) since May 2002 have provided further grounds for these concerns. Brazil served as an anchor for the region in 2001 and following the breakdown of Argentina's convertibility scheme, but its performance of that role now appears to be faltering. It should be noted, however, that the principal indicator of perceived risk in emerging markets (the JP Morgan Emerging Market Bond Index, or EMBI), which had reached its lowest point since the August 1998 Russian crisis at the end of the first quarter of 2002, is now beginning to rebound.

The Argentine crisis' regional repercussions have taken various forms. Firstly, it has had a strong impact on trade in both goods and services with Argentina, and this in turn has driven down the level of economic activity and employment. Secondly, its effects on the financial market have had an adverse influence on the flow of external resources to the region, the countries' banking systems and the profits of foreign firms that have invested in Argentina and in the rest of the region, thus unsettling stock markets outside the region as well. In addition, the crisis has heightened the volatility of foreign-exchange markets and has influenced economic policy, as some governments have been obliged to take action to address its implications for their countries. Uruguay, in particular, has had to adopt drastic adjustment measures in order to counteract its impacts; these steps have included a steeper rate of devaluation and the introduction of fiscal provisions designed to shrink the public deficit.

Events in Argentina and the other MERCOSUR countries have rekindled the debate as to what types of exchange-rate regimes are most suitable for emerging economies. They have also, in particular, laid bare the practical limitations of the two "corner solutions" of dollarization or a pure float in a context of macroeconomic and institutional fragility combined with commercial and financial interdependence. The need to align and coordinate macroeconomic policies within the region has also become evident.

(a) *The impact on trade*

The striking drop in Argentina's imports, which are estimated to have plunged by approximately two-thirds their former level during the first four months of 2002, has left them at around the same levels as in the 1970s. The sharp devaluation of the currency and the weakness of domestic demand have both been important factors in this regard and have been reflected in a steep decrease in shipments to Argentina from its MERCOSUR partners and Chile. In some of these countries, exports to Argentina represent an appreciable percentage of their total foreign sales. Thus, the already very tense situation in MERCOSUR caused by the January 1999 devaluation of Brazil's currency has been aggravated by the sharp depreciation of the Argentine peso. The economies of the region have also had to deal with a considerable decline in services trade, much of which is attributable to the abrupt decrease in the number of Argentine tourists.

Uruguay has unquestionably been hit the hardest by the Argentine crisis and its impact in compounding the negative fallout from Brazil's 1999 devaluation. Trade flows with Argentina have been cut back considerably in 2002, with Uruguay's merchandise

2 For further information on the situation in Argentina, see the section on that country in the second part of the ECLAC *Economic Survey of Latin America and the Caribbean, 2001-2002* (LC/G.2179-P), Santiago, Chile, 2002.

exports to that market in the first four months of the year plunging to a level 70% below the figure posted for the same period the year before. The situation is even more serious than it might first appear, given the fact that exports had already fallen sharply in 2001. In addition, Argentine importers have had great difficulty in paying for the products that Uruguay has exported to them, due to the blockage of their funds and their loss of access to credit of any sort whatsoever. Meanwhile, tourism from Argentina to Uruguay has slumped to almost half its former level. The direct impact of the Argentine crisis is calculated at somewhat more than two percentage points of GDP, with a decrease in exports amounting to nearly US$ 500 million.

Brazil has also been hurt by the Argentine crisis, even though its economy is three times as large as its neighbour's and its markets are considerably more diversified. The steep slide in Brazil's exports to Argentina has caused its total merchandise exports to shrink by almost 6% (in 2001 Argentina bought 8.6% of Brazil's exports, and the figure rises to nearly 25% in the case of exports of manufactured goods). This has led to a substantial downturn in sales, especially of motor vehicles and parts, iron and steel products, petrochemicals and electronics, many of which are difficult to divert to other markets in the short run. Brazilian exporters, like their Uruguayan counterparts, also have had difficulty in obtaining payment for what they do manage to sell. In fact, as of early 2002, payment was outstanding on US$ 1.4 billion in exports. Tourism has also been stifled, especially in the southern part of the country, which had been a popular destination for Argentine visitors in recent years.

Paraguay, too, has been shaken by the turmoil in Argentina, which has magnified the country's pre-existing domestic problems. The suspension of the sale of the telecommunications firm Compañía Paraguaya de Comunicaciones has generated a great deal of uncertainty, since that operation would have brought in around US$ 200 million in one-off foreign-exchange revenues. Paraguayan exports to Argentina sank by almost two thirds in early 2002 owing to the devaluation of the peso, thereby paring down Paraguay's total merchandise sales by nearly 12% from the preceding year's level.

The Argentine crisis also had an impact on the real sector of the Chilean economy. Bilateral merchandise trade, tourism and the profits of Chilean firms with branches in Argentina are the areas in which its effects have been the most conspicuous. Although exports to Argentina represented just 3.2% of Chile's total exports in 2001, the impact of the downswing seen in the first quarter of 2002 was quite appreciable (–61.5%). Three fourths of the decrease corresponded to industrial products. The impact on industrial value added is estimated at a reduction equivalent to fourth tenths of a point of its growth rate; in terms of GDP, the direct impact is calculated at one tenth of a point and the indirect effect of purchases of intermediate goods from the rest of the economy is estimated at another three tenths. Tourism in Chile was down sharply in early 2002, and the contraction in tourism revenues is calculated at US$ 50 million (equivalent to a decrease of one-tenth point of GDP growth, which could rise to two tenths when indirect effects are taken into account).

Despite its magnitude, the devaluation's effect in boosting the price competitiveness of Argentine goods has not yet served as a stimulus. On the contrary, in the period January-April, total Argentine exports declined by 5% and those destined for neighbouring countries (MERCOSUR and Chile) were off by 17%. The financial crisis has seriously disturbed trade flows, and the lack of credit, the need to pay cash for raw materials and the higher cost of inputs have, at least for now, offset the effects of the devaluation.

Remittances from emigrants working in Argentina have also been hurt by the sheer drop in wages and the sharp devaluation of the currency. The countries that have been the most seriously affected by these trends have been Bolivia and Paraguay, where current transfers represent around 5% and 2% of GDP, respectively, and a considerable portion of those sums (as much as one half in Paraguay's case) comes from Argentina. This situation has a much more severe impact on low-income sectors of the population in these countries.

(b) The financial impact

The Argentine crisis has affected the financial market in many different ways. It is difficult to identify individual effects and still more difficult to measure the incidence of each, however, as the scenario is clouded by the systemic volatility that has been an endemic feature of emerging markets since the Asian crisis.

Firstly, the crisis in Argentina has affected capital flows to Latin America from international financial markets. This was beginning to occur even before the collapse of the convertibility regime due to mounting expectations of a default on debt servicing and to greater risk aversion in general, as reflected by trends in sovereign bond spreads. Bond issues on international markets have borne the brunt of this contraction in capital flows. At the same time, FDI, which had been flooding into the region in recent years, declined significantly in 2002.

The shrinkage of external capital flows raised the cost of borrowing for Brazil and Uruguay, though not for Chile. Brazil's country risk rating rose by over 100 basis points in the second semester of 2001. This was probably due, in large part, to growing fears of a default by Argentina. Towards the end of the year, however, the risk rating began to drop back again. It then continued to decrease even when Argentina abandoned the convertibility scheme and announced that it was suspending payment on its public debt, which shows that the impact of the situation had already been absorbed. Brazil's country-risk rating began to climb again in May 2002, but little of this can be attributed to contagion from Argentina, as it was mainly the result of domestic problems stemming from political uncertainty in the run-up to the October elections and higher risk aversion.

Uruguay's difficulties in reducing its fiscal deficit in the midst of a contraction in international credit undermined its sovereign debt rating, and it eventually lost its investment grade status. This made it more difficult to refinance its external debt and led lenders to raise their interest rates. Late in April, contagion from the profound crisis in Argentina combined with the withdrawal of the country's investment-grade status to undercut the value of official debt instruments on the secondary market. This pushed up Uruguay's country risk rating to around 800 basis points, which was more than three times higher than in late 2001. The situation worsened further when the government abandoned its system of exchange-rate bands and allowed the currency to float, and the country risk rating therefore continues to climb.

Chile's country risk rating has remained very low, but flows have decreased nonetheless. Up to October 2001, this trend was reflected in a devaluation of the currency on foreign-exchange markets. At that point, short-term movements began to become partially delinked from the disturbances in Argentina, and the currency's value began to rise again. In June 2002, however, the worsening financial situation in Brazil generated further currency instability in Chile, and the exchange rate for the peso began to shadow the value of the Brazilian real.

The loss of momentum in FDI flows to the region in 2000 interrupted the steady upward trend that had begun in 1993. This was largely due to the completion of the countries' privatization of their saleable assets, although the effects of the Argentine crisis were also beginning to be felt to some extent. In 2002 the situation has continued to deteriorate as foreign firms operating in Argentina struggle to shake off the effects of the sharp devaluation of the currency and to deal with the problems caused by the readjustment of prices and public utility rates and by restrictions on the exportation of petroleum. This has discouraged investment not only in Argentina but also in other countries of the region. While foreign investment has plunged in Argentina in 2002, in Brazil an existing downward trend has sharpened and Chile has recorded a downturn. The cooling of investor interest stems both from fears that other countries of the region will be pulled into a downward spiral by contagion from Argentina and from the asset losses sustained by international and regional investors in the Argentine market.

A second area in which the impact of the Argentine crisis has been felt is in the solvency of the financial market. The exposure of banks in Argentina has had a considerable impact, but this has not greatly affected financial institutions in the rest of the region, except through specific channels in Paraguay and Uruguay. Large foreign banks operating in Argentina –with parent companies in North America, Spain and other European countries– have been badly hit by the crisis. Some of the Brazilian banks with branches in Argentina have also been affected, but the volume of their operations is small in relation to their assets, so they have been able to absorb the losses without too much difficulty.

By contrast, three Uruguayan banks that were heavily exposed in Argentina are now experiencing serious problems. Its inability to access its deposits in Argentina led to the temporary closure of one Uruguayan bank, most of whose clients were Argentine, when the parent bank cut off its flow of funds. As a result, in early 2002 most of the foreign-currency deposits that had been made in 2001 were withdrawn; consequently, the country's international reserves declined substantially. In Paraguay, the authorities had to intervene in one of the country's major banks to deal with problems generated by its losses in Argentina and the loss of confidence on the part of savers, who shifted their funds into dollar deposits.

The deterioration of the financial system has also been exacerbated by the fact that, contrary to the expectations of savers, foreign-owned banks in Argentina have not always been willing to bring in resources in order to pay out deposits. In fact, several institutions have openly expressed doubts about remaining in the market, and two banks –one Canadian and one French institution– have withdrawn altogether, thereby adding to the atmosphere of uncertainty. In addition, the restrictions placed on the withdrawal of deposits in Argentina have generated serious disturbances in some neighbouring countries due to fears that they may resort to similar measures.

In some cases, investors' misgivings have to do with the sustainability of the countries' macroeconomic policies, since domestic economic growth remains sluggish and it is becoming increasingly difficult for them to finance their fiscal and current account deficits or to refinance existing debts.

Lastly, the effects of the losses sustained by transnational corporations operating in Argentina in terms of those corporations' capital assets could have repercussions for FDI throughout the region. The impact on the capital base of European firms that are heavily involved in Argentina has been very severe, especially in the case of utilities, the oil industry, manufacturing and the financial sector. The sharp downswing in the Madrid stock exchange is partly attributable to the capital losses registered by firms belonging to the large Spanish conglomerates that have invested in Argentina, and this may well represent one of the most extensive forms of contagion. In other European countries, large transnational groups –especially in telecommunications, financial services and the automotive industry– have had to set aside massive reserves to cover the losses of their Argentine subsidiaries. In the region, apart from the repercussions in the banking sector that have already been discussed, the greatest impact has been seen in Chile, whose firms' investments in Argentina amount to some US$ 3.2 billion. These investments have been seriously undermined, with their equity values dropping by 12% in the weeks following the devaluation. Corporate profits plunged from US$ 208 million in 2000 to US$ 114 million in 2001, and returns are expected to fall to zero for 2002. As a result, national income is calculated to have fallen by 0.15% in 2001, and in 2002 a similar decrease is projected. Brazil has fairly large investments in Argentina, but the impact on its domestic economy has been relatively slight.

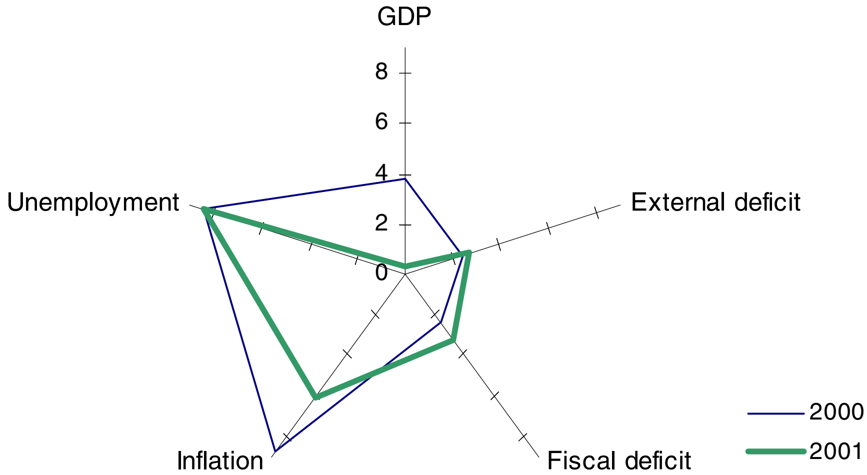
Chapter II

THE REGIONAL ECONOMY IN 2001

The sharply slower growth rates recorded by the Latin American economies in 2001 thwarted the previous year's hope of embarking upon a new growth cycle. As a result of this slowdown, employment fell, although unemployment levels held steady because of a decline in participation rates. The slump was attributable to adverse international conditions combined with a number of worrisome developments within the region. External factors included declining international prices for the region's main exportables (oil, coffee and others) in a rapidly slowing global economy, especially in North America. This was partly due to the financial turbulence associated with downturns on world stock markets and the uncertainty generated by the 11 September terrorist attacks in the United States, which had repercussions on economies around the world, and particularly in Latin America and the Caribbean. These factors resulted in lower export values, dwindling private capital flows (especially to Argentina and Brazil) and rising external debt service. The most critical domestic problems included the financial crisis in Argentina, which had contagion effects on neighbouring economies, and a major energy crisis in Brazil. In addition, a number of natural disasters destroyed physical infrastructure in Central America and the Caribbean, while foot-and-mouth disease made a reappearance in the southern part of the continent.

These developments severely limited the latitude available to authorities in designing and implementing macroeconomic policy. Fiscal deficits widened, but monetary conditions tightened despite policy makers' attempts to boost liquidity. Inflation, meanwhile, continued to slacken (see figure II.1).

Figure II.1
LATIN AMERICA AND THE CARIBBEAN: MACROECONOMIC INDICATORS
(Rates of change)



Source: ECLAC, on the basis of official figures.

A. ECONOMIC POLICY

In this generally recessionary setting, fiscal policy was moderately expansionary, as the countries' governments sought to implement a policy that would soften the effects of the worldwide slowdown on their domestic economies.

Primary public expenditure (i.e., excluding debt service) grew in most countries and rose by 4% in real terms in 2001 for the region as a whole. In over half of the countries, capital expenditure also increased; consequently, unlike other occasions, this was not used as the main public-sector adjustment variable. The regionwide central government deficit grew from 2.9% in 2000 to 3.5% in 2001, while the non-financial public-sector (NFPS) deficit widened from 2.3% to 3% in the wake of higher public expenditure.

Central banks acted to counter recessionary forces by boosting the money supply, but credit expanded less than the monetary base did in most countries. Consequently, the authorities used the supply of base money, together with primary fiscal expenditure, as a counter-recessionary tool; yet these efforts were unable to offset the tightening of monetary conditions generated by interest rate hikes and the external situation. The authorities' weak capacity for the implementation of counter-cyclical policies is one of the main macroeconomic asymmetries facing the developing world. Whereas industrialized economies were able to withstand the world recession in 2001 by deploying expansionary fiscal and monetary policies, emerging economies –including those of Latin America– could do this only partially; and in the end they had to make policy adjustments to limit their exposure to external shocks, at the cost of slower domestic growth and a worsening employment situation (see "Broad macroeconomic equilibria" in chapter III).

Monetary conditions, which generally reflect the final outcome of a variety of forces, contracted sharply in all but four countries: Chile, the Dominican Republic, Guatemala and Mexico. In addition, lending activity remained depressed, as the banking system perceived higher risk levels among its clients in this new recessionary climate, as evidenced by a higher percentage of non-performing loans.

1. The fiscal policy response depended on the particular situation in each country

The economic slowdown had a direct impact on the region's fiscal outturn in 2001. The broad-based NFPS deficit widened from 2.3% of GDP in 2000 to 3% in 2001, while the central government financial deficit (over which governments have more discretion) also worsened, increasing from 2.9% of GDP to 3.5% over the same period. Excluding interest payments and other variables beyond the immediate control of fiscal policy, the virtual balance between primary income and expenditure achieved by central governments during 2000 gave way to a deficit of 0.9% of GDP in 2001. The region's fiscal authorities pursued two conflicting objectives, as they employed their generally very limited manoeuvring room in an effort to shore up weak demand through a proactive policy while at the same time trying to avoid losing the ground they had won in terms of fiscal consolidation.

Consequently, the gradual deterioration in the countries' fiscal performance, which had begun at the time of the Asian and Russian crises, continued during 2001. The narrowing of fiscal deficits seen in 2000 proved to be no more than a brief respite made possible by a temporary upturn in economic activity. Both the fiscal consolidation of the first half of the 1990s and the deterioration of this situation starting in 1998 have closely mirrored the trend of economic activity. The strong cyclical component of the region's fiscal deficits stems from the fact that government revenues are drawn primarily from indirect taxes, which move in line with economic growth, whereas expenditure, especially current spending, generally has a high degree of built-in rigidity. The situation was no different in 2001. Total central government revenues rose only slightly, while overall expenditure climbed by nearly one percentage point from 20.6% of GDP in 2000 to 21.3% in 2001 (see table II.1).

Table II.1
LATIN AMERICA AND THE CARIBBEAN: CENTRAL GOVERNMENT ACCOUNTS [a]
(Percentages of GDP)

	Total revenue		Current revenue		Tax revenue		Total expenditure		Current expenditure		Interest payments		Public saving	
	2000	2001[b]	2000	2001[b]	2000	2001[b]	2000	2001[b]	2000	2001[b]	2000	2001[b]	2000	2001[b]
Latin America and the Caribbean	**17.7**	**17.8**	**17.0**	**17.2**	**13.5**	**13.5**	**20.6**	**21.3**	**16.6**	**17.3**	**2.7**	**2.8**	**0.4**	**-0.1**
Argentina	15.4	14.6	15.3	14.5	9.8	9.6	17.6	18.5	16.5	17.6	3.4	4.1	-1.2	-3.1
Bolivia	23.2	24.0	20.4	21.0	17.3	17.9	27.6	31.2	23.1	26.1	1.8	1.8	-2.7	-5.1
Brazil	22.5	23.8	22.5	23.8	20.1	21.3	25.7	27.6	24.8	25.7	5.2	5.8	-2.3	-1.9
Chile	24.2	24.5	23.8	24.0	17.6	18.1	24.1	24.7	20.1	20.6	0.5	0.5	3.7	3.4
Colombia	13.4	14.7	11.9	13.4	11.6	13.2	19.4	20.5	18.1	18.5	3.9	4.0	-6.2	-5.1
Costa Rica	12.5	13.2	12.4	13.1	12.0	12.6	15.5	16.1	14.0	14.7	3.6	3.9	-1.6	-1.6
Ecuador	22.9	21.4	22.9	21.4	12.8	12.7	24.0	20.5	19.1	14.9	7.5	5.8	3.8	6.5
El Salvador	12.3	12.2	11.5	11.8	10.4	11.0	14.6	16.7	12.0	12.5	1.4	1.3	-0.5	-0.7
Guatemala	10.5	11.3	10.5	11.3	9.5	9.9	12.3	13.2	8.6	9.4	1.2	1.4	1.9	1.9
Haiti	8.0	7.5	8.0	7.5	8.0	7.5	10.6	10.1	8.2	8.3	0.5	0.3	-0.2	-0.8
Honduras	18.0	18.2	18.0	18.2	16.6	16.6	23.8	25.5	16.6	17.7	1.6	1.3	1.4	0.5
Mexico	17.9	18.3	17.9	18.3	10.6	11.3	19.1	19.0	15.9	15.7	3.2	2.9	2.0	2.6
Nicaragua	31.0	27.5	24.8	22.5	23.9	21.6	38.8	39.0	20.8	24.2	3.4	4.9	4.0	-1.7
Panama	19.7	19.4	19.5	19.2	11.3	10.2	21.0	22.1	19.3	19.7	4.8	4.9	0.2	-0.5
Paraguay	16.1	17.0	15.8	16.8	11.1	9.6	20.4	18.1	15.5	14.8	1.1	1.3	0.3	2.0
Peru	15.0	14.2	14.7	14.1	12.1	12.3	17.7	17.0	14.9	14.7	2.2	2.1	-0.2	-0.6
Dominican Republic	16.0	16.8	14.8	15.7	13.7	15.0	14.9	16.4	11.3	12.1	0.7	0.8	3.5	3.6
Uruguay	18.7	19.5	18.7	19.5	15.0	15.5	22.7	24.2	20.9	22.2	2.0	2.5	-2.2	-2.7
Venezuela	19.6	20.4	19.6	20.4	12.5	11.2	21.2	24.7	16.4	18.9	2.4	2.9	3.2	1.5

Source: ECLAC, on the basis of official figures.
[a] Calculated using figures in local currency at current prices.
[b] Preliminary figures.

On the expenditure side, most countries relied on the operation of automatic stabilizers while policy makers strove to use their generally very limited manoeuvring room to counteract the effects of depressed private-sector activity. Primary expenditure by the region's central governments (excluding debt service) was up from 17.9% of GDP in 2000 to 18.6% in 2001 as a consequence of real increases in 13 countries. Real wages in the public sector rose in several countries, since they tend to be adjusted annually on the basis of expected inflation, and inflation fell faster than expected. The Central American countries had to cope with problems caused by earthquakes, a serious drought and the collapse of international coffee prices, which affected the livelihoods of many small-scale producers. Unlike other episodes during which fiscal performance has deteriorated in the recent past, capital expenditure was not used as the main adjustment variable in 2001. In fact, in over half of the countries capital expenditure actually rose, with double-digit real growth rates being posted in seven countries. The aim here was to make up for the contraction in private-sector activity, since governments have more discretion in the execution of capital projects than they have in other expenditure categories.

Interest payments rose only slightly in the region as a whole, despite sharp increases in countries such as Argentina, Costa Rica, Nicaragua and Uruguay. This was mainly due to public-sector debt restructuring and debt swaps. Such operations were a distinctive feature of 2001, as five countries used reschedulings in order to convert their short-term debts into medium- and long-term obligations. An improvement in the time profile of the debt was accompanied by lower interest rates on international markets, but spreads widened on the interest paid out, which resulted in a slight rise in the interest burden (one tenth of a percentage point of GDP).

The tax authorities also took steps to bolster revenues, and in fact total government income did expand in real terms in 12 of the 19 countries. The steps they took included a combination of new taxes (three countries), higher rates on existing levies (five countries), improvements in inspection and tax collection and the reduction of tax evasion rates (six countries), and the elimination of certain exemptions and a widening of the tax base (four countries). In eight countries (Argentina, Chile, Colombia, Costa Rica, the Dominican Republic, Ecuador, Guatemala and Peru) tax reforms were either adopted or began to take effect. These reform programmes included measures to combat evasion, improve tax collection, expand the tax base and raise existing rates. The only country where an upturn in economic activity generated higher tax revenue was Ecuador. Another unique case was Bolivia, where the government introduced tax breaks in an effort to revive private-sector economic activity. Lastly, in Nicaragua, where fiscal policy was subordinated to the political cycle, various tax rates were lowered and public-sector wages were raised. Countries whose tax systems are heavily influenced by international commodity prices (oil, copper and coffee) suffered as the prices of such goods slumped.

2. Fiscal policy was moderately expansionary

Although fiscal policy was unable to offset the effects of slackening private-sector activity entirely, positive results were obtained from the fiscal components over which governments have some degree of control. Since a large proportion of budgetary expenses are in the form of entitlements, however, it was impossible to broaden the scope for discretionary action any further. A more balanced policy mix would have yielded better results, but monetary policy became increasingly restrictive and the already limited leeway available to fiscal policy makers narrowed still further. A major indicator of this is the fact that central government saving fell by one half of a percentage point of GDP –to zero– in 2001.

Table II.2 provides an indicator of fiscal policy that relates tax receipts to central government primary expenditure. The public sector obtains resources from the private sector in the form of tax revenues, which cuts disposable income in that sector and tends to reduce domestic demand in the short term. In contrast, public-sector primary expenditure[1] stimulates demand. A rise in the ratio of tax revenue to primary expenditure thus has a somewhat recessionary fiscal impact in the short run, although it is beneficial in the long term given its effect in terms of fiscal consolidation.

1 Interest payments on domestic debt also fuel demand, but their importance in the region is limited. For this reason, primary expenditure is a good indicator of public-sector resources that boost demand.

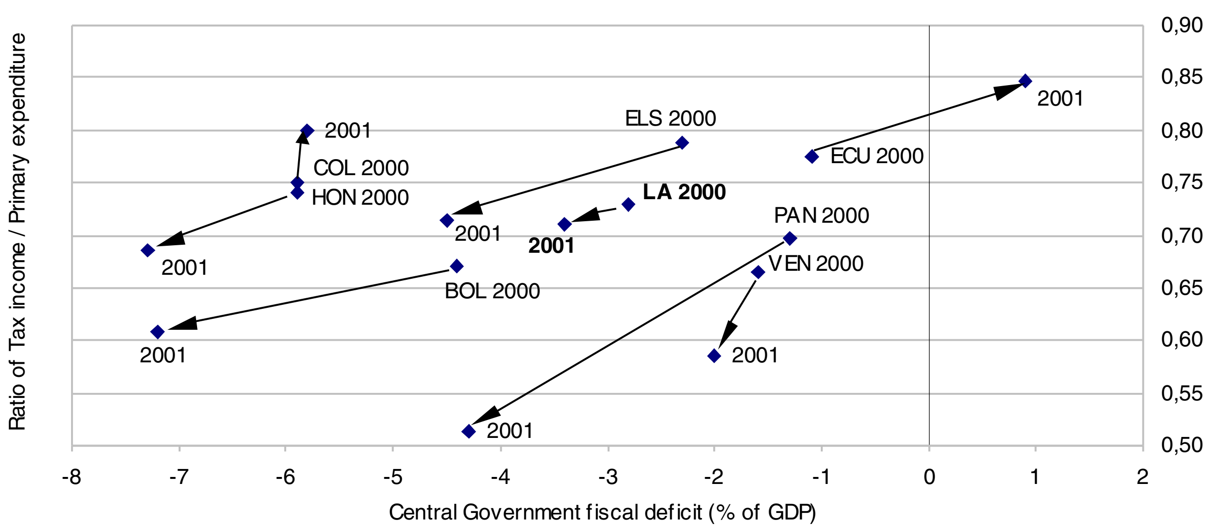
Table II.2
LATIN AMERICA AND THE CARIBBEAN: FISCAL INDICATORS [a]
(As percentages of GDP and real variations)

	Balance of NFPS [b] (percentages of GDP)		CG financial balance [c] (percentages of GDP)		CG primary balance [c] (percentages of GDP)		Total revenue (real variation)	Primary expendi-ture (real variation)	Primary expenditure (percentages of GDP)		Tax revenues/ Primary expenditure	
	2000	2001[d]	2000	2001[d]	2000	2001[d]	2001[d]	2001[d]	2000	2001[d]	2000	2001[b]
Latin America and the Caribbean	**-2.3**	**-3.0**	**-2.9**	**-3.5**	**-0.2**	**-0.9**	**0.9**	**4.1**	**17.9**	**18.6**	**0.73**	**0.71**
Argentina	-2.4	-3.1	-2.2	-3.9	1.3	0.2	-9.3	-2.3	14.2	14.4	0.69	0.67
Bolivia	-4.0	-6.5	-4.4	-7.2	-2.6	-5.4	3.5	14.1	25.8	29.4	0.67	0.61
Brazil	-4.6	-5.2	-3.2	-3.9	2.0	1.9	6.8	7.8	20.5	21.8	1.01	1.01
Chile	-0.6	-0.6	0.1	-0.3	0.6	0.2	4.7	6.6	23.6	24.2	0.75	0.75
Colombia	-3.7	-3.8	-5.9	-5.8	-2.0	-1.8	10.1	4.5	15.5	16.5	0.75	0.80
Costa Rica	-1.9	-1.8	-3.0	-2.9	0.6	1.0	7.1	3.6	11.9	12.2	1.01	1.03
Ecuador	1.7	1.2	-1.1	0.9	6.4	4.6	0.8	-2.4	16.5	15.0	0.78	0.85
El Salvador	-3.0	-3.7	-2.3	-3.6	-0.9	-3.2	0.4	17.4	13.2	15.4	0.79	0.71
Guatemala	-2.2	-3.0	-1.9	-2.0	-0.6	-0.5	7.2	6.1	11.1	11.8	0.86	0.84
Haiti	…	…	-2.6	-2.7	-2.1	-2.4	-12.1	-7.8	10.1	9.8	0.79	0.77
Honduras	-2.1	…	-5.9	-7.3	-4.3	-6.0	4.4	10.0	22.2	24.2	0.75	0.69
Mexico	-1.1	-0.7	-1.3	-0.7	2.0	2.2	3.6	2.9	15.9	16.1	0.67	0.70
Nicaragua	-7.3	-10.0	-7.8	-11.5	-4.4	-6.6	-5.0	6.6	35.4	34.1	0.68	0.63
Panama	-0.8	-1.4	-2.2	-2.7	2.6	2.2	-1.0	1.5	16.2	17.2	0.70	0.59
Paraguay	-3.3	-0.4	-4.3	-1.1	-3.2	0.2	-16.1	-21.4	19.3	16.8	0.58	0.57
Peru	-3.2	-2.5	-2.7	-2.8	-0.5	-0.7	-3.2	-2.0	15.5	14.9	0.78	0.83
Dominican Republic	-2.2	-1.0	1.1	0.4	1.8	1.2	11.8	16.6	14.2	15.6	0.96	0.96
Uruguay	-4.1	-4.3	-4.2	-4.7	-2.2	-2.2	1.9	1.2	20.7	21.7	0.72	0.71
Venezuela	4.3	-4.4	-1.6	-4.3	0.8	-1.4	2.3	14.5	18.8	21.8	0.66	0.51

Source: ECLAC, on the basis of official figures.
[a] Calculated using figures in local currency at current prices.
[b] NFPS: Non-financial public sector.

Figure II.2 relates this indicator to central government financial outturns in countries where the ratio varied by more than five percentage points. The only two countries where the ratio increased were Colombia and Ecuador. In the first case, this helped to cool down the economy, while in the second case it helped to temper demand fuelled by investments in the oil sector. Elsewhere, this fiscal indicator reflects a somewhat expansionary policy stance in the face of weak private-sector demand.

Figure II.2
LATIN AMERICA AND THE CARIBBEAN: CENTRAL GOVERNMENT FINANCIAL BALANCE AND RATIO OF TAX REVENUE TO PRIMARY EXPENDITURE, 2000-2001



Source: ECLAC, on the basis of official figures.

3. Fiscal accounts in Caribbean countries deteriorated further

The global slowdown in 2001 had even stronger repercussions in the Caribbean. Fiscal deficits among members of the Organization of Eastern Caribbean States (OECS)[2] grew from 4.3% of GDP in 2000 to 6.5% in 2001. Public accounts also worsened in several other Caribbean countries,[3] although they improved in the Bahamas and Suriname.

Revenues in these economies are generally based on services, so the world economic slowdown hurt them more than countries with a more diversified production base. Tourism, which is one of the key sources of income in most Caribbean countries, was hit hard, especially in the final quarter of the year following the 11 September terrorist attacks. The drop in the number of tourists was one of the main causes of the downturn in fiscal revenues. A further aggravating factor was the drop in earnings from the financial sector in the wake of a move to crack down on money laundering. Lastly, tariff revenues also declined as advanced phases of the common external tariff came into effect in member countries of the Caribbean Community (CARICOM).

Lower revenues notwithstanding, fiscal expenditure hardly varied at all in comparison to the previous year, which caused a further deterioration in fiscal results. To make matters worse, the Governments of Belize and Jamaica had to take steps to provide relief from the effects of natural disasters. Another exceptional case is Suriname, where fiscal consolidation measures implemented under the macroeconomic stabilization programme initiated in mid-2000 made it possible to slash that year's deficit of 13% of GDP to just 3% in 2001.

4. Monetary conditions in the region tightened considerably

Monetary policies took on a more expansionary stance in 2000, as central banks tried to counteract the contractionary effects of the global situation. Just five countries posted negative variations in their monetary base in 2001, compared to nine in 2000. Mexico, which had adopted a more stringent policy in 2000, expanded its monetary base by a substantial 26.6% in 2001; this was the second largest increase in the region after Dominican Republic (36.1%).

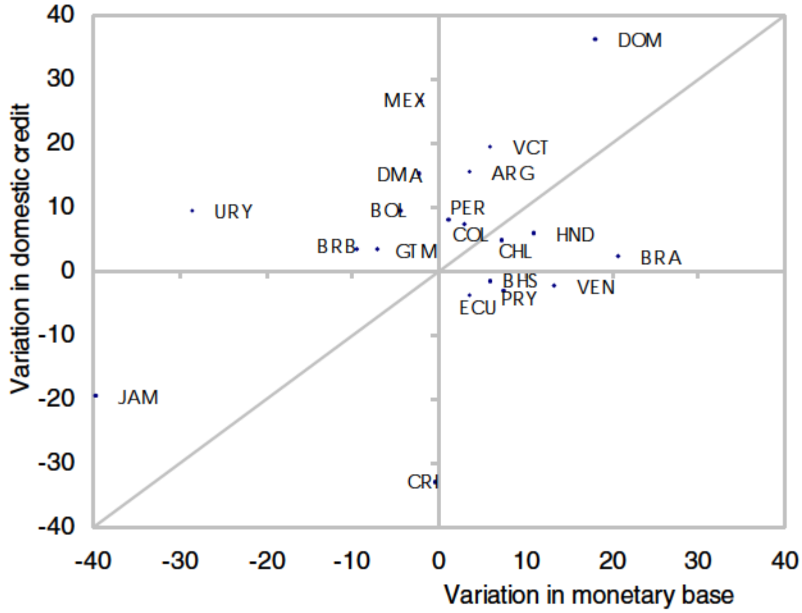
Nonetheless, credit and the demand for money grew by less than the monetary base in several countries, and by substantially less in percentage terms in the Bahamas, Brazil, Costa Rica, Ecuador, Honduras, Paraguay and Venezuela. These figures reflect conservative lending behaviour by the banking system that not only neutralizes reactivation policies based on central-bank interest rate cuts, but also, by reducing the size of loans being rolled over or reprogrammed, aggravates the recessionary climate because of its procyclical nature.

The monthly pattern has been quite different in each subregion, with a downward trend in the demand for money in the Southern Cone contrasting with upswings or an end to downward trends elsewhere.

[2] Anguila, Antigua and Barbuda, Dominica, Granada, British Virgin Islands, Montserrat, Saint Kitts and Nevis, Saint Lucia, and Saint Vincent and the Grenadines.

[3] Barbados, Belize, Guyana, Jamaica, and Trinidad and Tobago.

Figure II.3
LATIN AMERICA AND THE CARIBBEAN: GROWTH IN THE MONETARY BASE AND DOMESTIC CREDIT
(Percentage variation 2000-2001)

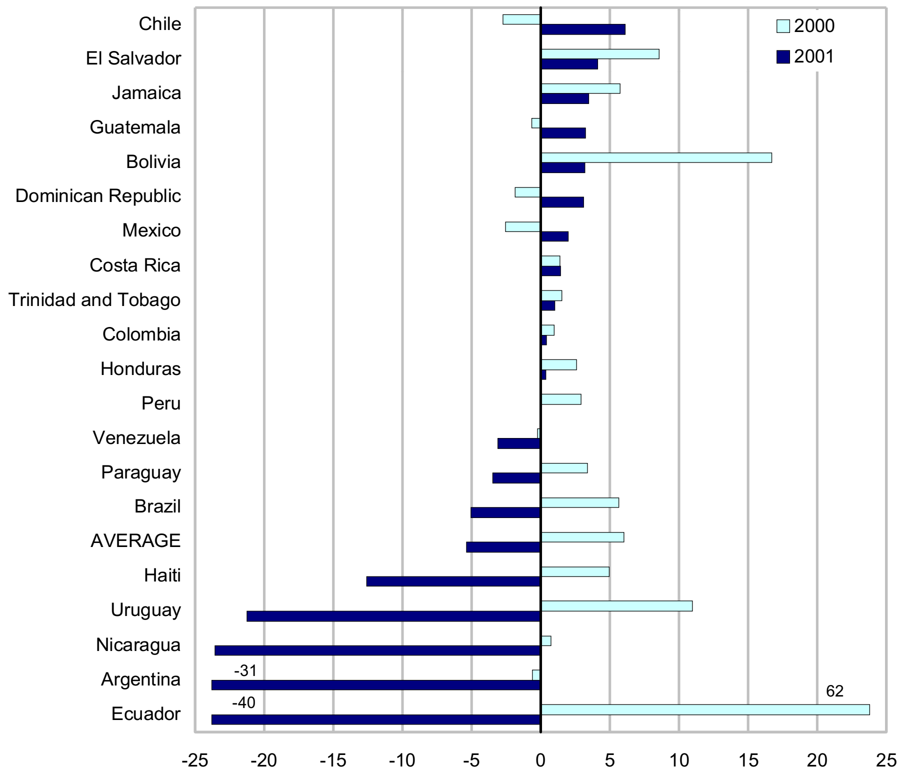


Source: ECLAC, on the basis of official figures.

The regional index of monetary conditions (IMC) remained contractionary in 2001 (see box II.1). This was the result of a variety of forces acting on monetary and exchange-rate conditions (particularly the opposing movements of real exchange rates depreciating against the dollar, while effective exchange rates appreciated). This monetary contraction was widespread, despite differences across countries. Compared to the previous year, the indicator rose only in Chile, the Dominican Republic, Guatemala and Mexico, while falling everywhere else. This mainly reflected the fact that real interest rates rose in most countries, which, as mentioned in the introduction, is symptomatic of the macroeconomic asymmetries faced by the developing world (see "Broad macroeconomic equilibria" in chapter III).

Evidence of monetary tightening is clearest in Ecuador, where the IMC indicator swung from a record expansion in 2000 (62%) to a record contraction in 2001 (-40%). This reflected a dramatic shift from a sharp devaluation of the local currency (arising from the unduly low level chosen for dollarization in 2000) to a real appreciation generated by a substantial rise in domestic prices.

Figure II.4
LATIN AMERICA AND THE CARIBBEAN: AVERAGE ANNUAL VARIATION IN THE INDEX OF MONETARY CONDITIONS, 2000-2001
(Percentages)



Source: ECLAC, on the basis of figures from official sources and the International Monetary Fund (IMF).

Box II.1
INDEX OF MONETARY CONDITIONS

The index of monetary conditions (IMC) quantifies the results of monetary and fiscal policy. It is defined as a weighted average of variations in three variables: the real interest rate on loans, the real bilateral exchange-rate index against the dollar, and the effective exchange-rate index. Accordingly, movements in the IMC may differ from the results of a given monetary policy on domestic monetary aggregates.

The weighted average is calculated using quarterly percentage-point variations in the real interest rate on loans and the percentage change in the real exchange-rate index from one quarter to another.

$$ICM_t = ICM_{t-1} * \left[1 + \theta_1 * \left(TI_{t-1} - TI_t \right) + \theta_2 * \ln \frac{ITCR_t}{ITCR_{t-1}} - \theta_3 * \ln \frac{ITBR_t}{ITBR_{t-1}} \right]$$

The weightings used (θ) are as follows:

θ_1 is the ratio between domestic credit and GDP;
θ_2 is the total value of exports plus imports, divided by GDP; and
θ_3 is value of the external debt divided by GDP.

A fall in the index indicates a potentially negative effect on aggregate demand; this may either be a direct impact on domestic and external demand as a result of interest-rate hikes or a fall in the real effective exchange rate, or an indirect impact on the debt balance due to movements in the real bilateral exchange rate.

The crisis in Argentina accounts for the contractions seen in the index both in that country (-31%) and in Uruguay (-21%); the effect of Argentine interest-rate hikes was important in both cases. In Nicaragua the index also fell sharply (-23%) in the wake of the previous year's banking crisis.

Doubts surrounding the sustainability of the reactivation in the United States also had a major influence in 2001. In the early months of the year, positive expectations for the international scenario encouraged governments to adopt more expansionary policies aimed at underpinning the hoped-for recovery. When the outlook took a turn for the worse, however, most countries (including Brazil, the region's largest economy) were forced to revert to more cautious policies. The exceptions were Chile and Mexico, which persevered with a more expansionary stance.

In Brazil, a major depreciation of the *real*, arising partly from the effects of the Argentine crisis, obliged the authorities to raise the reference interest rate, intervene in the foreign-exchange market and sell dollar-indexed bonds to soak up liquidity.

The Chilean authorities intervened in the foreign-exchange market to slow down the depreciation of the peso, but they continued to allow the money supply to expand significantly in real terms and lowered the monetary policy interest rate; as a result, Chile posted the region's largest average IMC expansion for the year. Mexico, meanwhile, enjoyed a slight loosening of monetary conditions in 2001, following a moderate tightening in 2000. The same was true of a number of Central American countries, which lowered their interest rates in 2001. Despite these lower rates, however, many countries failed to generate a recovery because the banking sector perceived a higher risk level in the indebtedness and solvency status of many enterprises.

The behaviour of monetary aggregates varied widely across countries, ranging from an 18% increase in M1 in Venezuela to a 19% contraction in Argentina.

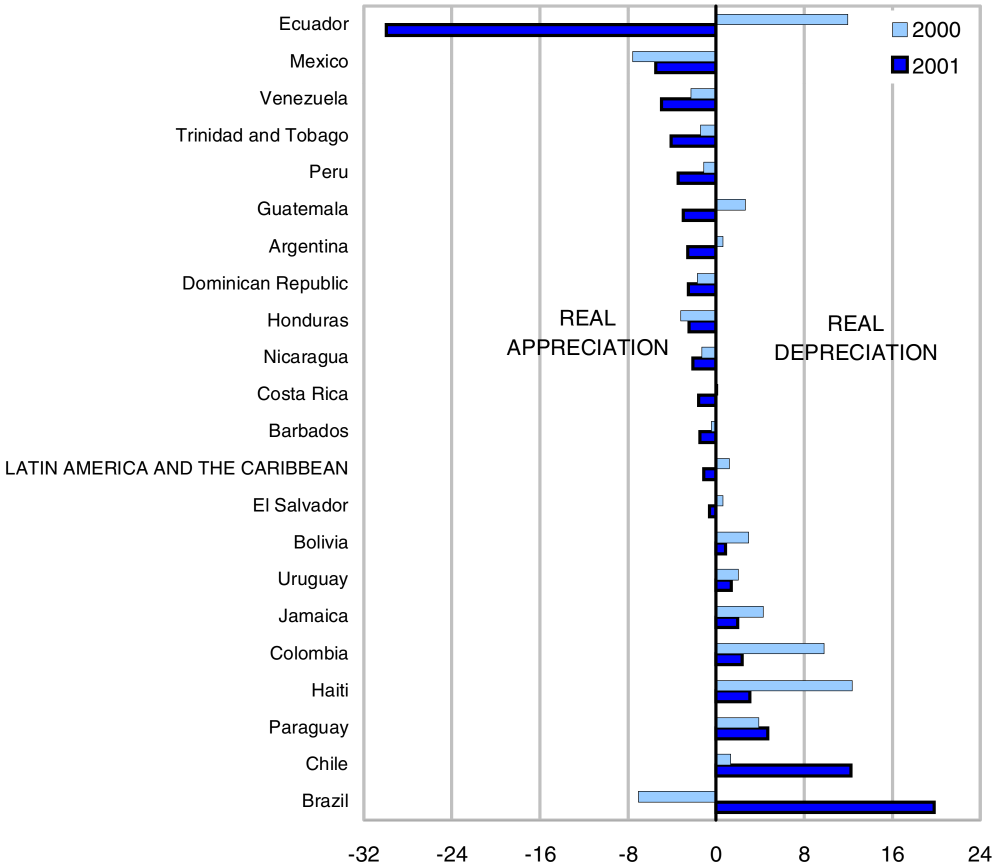
5. Real effective exchange rates appreciated

The main characteristic of real exchange rates in the region was the dichotomy between the appreciation of effective rates (with respect to the currencies of trading partners) and the depreciation of bilateral exchange rates against the dollar. The latter have been depreciating in real terms since 1999, and this has had harmful domestic financial effects which have caused external debt coefficients to deteriorate among private- and public-sector agents.

Appreciation of a country's currency against those of its main trading partners implies a loss of price competitiveness in that country's external trade. Although in this case appreciations partly reflected the dollar's strength against other international currencies, they were also caused by devaluations in several countries, especially in South America. Although countries that devalued their currencies improved their competitive positions, this gain was made at the expense of their neighbours; the cause of concern in this respect is that the latter may themselves be forced to devalue in the future, as happened in Europe in the 1970s. This would have similar negative effects on their neighbours, and the final result would be bad for all countries involved. There is an urgent need for macroeconomic policy coordination in the subregional integration framework to avoid falling into vicious circles of this kind.[4]

4 See H. Escaith, C. Ghymers and R. Studart, *Regional integration and the issue of choosing an appropriate exchange-rate regime in Latin America*, ECLAC, Macroeconomía del desarrollo series, No. 14, August 2002.

Figure II.5
LATIN AMERICA AND THE CARIBBEAN: REAL EXCHANGE RATES, 2000-2001
(Percentage annual variation)



Source: ECLAC, on the basis of figures from official sources and the International Monetary Fund (IMF).

Brazil's and Chile's flexible exchange rates real depreciated by 20% and 12%, respectively, owing to the initial impact of the Argentine crisis. Five other countries (Bolivia, Colombia, Haiti, Paraguay and Uruguay) registered real depreciations of under 5%. The real appreciation in Ecuador was mainly due to the adjustment of prices to the currency's earlier sharp devaluation; in most countries, real effective exchange rates appreciated because of the competitive devaluations described above. Mexico is the only country in which the appreciation of the local currency can be attributed primarily to a net capital inflow from abroad. In 2001, El Salvador began to take steps to adopt the dollar as its unit of account.

6. Domestic credit conditions worsened

Because of the Argentine crisis, domestic financial systems in Latin America and the Caribbean –and the banking system in particular– have once again been a focus of economic debate. Four recent developments are particularly important. Firstly, banking systems remain very fragile in some countries; the most extreme case in this respect is Argentina, which is going through another profound crisis. Secondly, credit is constrained in other economies, which hinders job creation and growth. Thirdly, intermediation spreads remain high, although they are sharply down from earlier levels. Lastly, many local capital markets have suffered from a dwindling number of participating enterprises, having failed in previous decades to develop beyond an embryonic state in the vast majority of countries. The causes and consequences of these factors are key to an understanding of current problems and of the future challenges facing the economies of the region.

Financial systems in Latin America and the Caribbean have always suffered from a high degree of fragility. The crisis in the mid-1990s was largely blamed on the lack of suitable domestic regulation and supervision mechanisms, so a large-scale effort has been made to improve these systems. Major changes in regulation and supervision have been introduced in many economies since 1994. The most important measures of this type include the adoption of the basic capital requirements and rules drawn up by the Basle Committee on Banking Supervision.

These changes notwithstanding, the Argentine banking crisis demonstrates the vulnerability of local banking systems to major shocks affecting exchange rates, interest rates or the level of employment. The vulnerability of the banking sector during a currency crisis stems mainly from two features of bank portfolios in the region: their high proportion of short-term liabilities (fixed-term deposits, sight deposits, savings accounts and others); and their high percentage of dollar-denominated assets and liabilities.

Accordingly, at times of major macroeconomic turbulence, abrupt shifts in interest rates, liquidity and depositors' confidence in a financial institution or in the banking sector as a whole can rapidly undermine the ability of a bank –or, in extreme cases, the entire banking system– to continue operating. In addition, a devaluation crisis simultaneously affects the value of dollar-denominated bank assets (by reducing the payment capacity of debtors who do not receive their incomes in dollars) and the value of local-currency liabilities, which could have negative implications for liquidity and even for bank solvency. Thus, higher levels of dollarization in the banking sector increase the vulnerability of economies suffering from macroeconomic instability and upheavals of various kinds.

In 2001 there were still signs of significant credit stagnation, although lending to the private sector has increased in many economies. This apparent paradox stems from the fact that, in part, the supply of credit is subject to a natural growth rate owing to the rollover of existing loans plus unpaid debt service. Therefore, a gross credit growth rate below total lending rates could actually indicate a credit contraction. In 2001 this occurred in nine of the 13 countries for which data on the relevant variables is available.

Another indicator of domestic credit conditions is provided by bank intermediation spreads. These spreads widened in 10 of the 18 countries in the sample during 2001 (see table II.4). Although this represents a reversal of the downward trend registered up to 2000, spreads are still abnormally wide. A comparison of spreads in Latin America and the Caribbean with those prevailing in OECD and some Asian developing countries shows that borrowing costs in the region are exceedingly high. Both average spreads and borrowing rates are higher in the region, with the average interest rate on loans being four times higher than in Asia and over six times higher than in a sample of developed economies.

Table II.3
LATIN AMERICA AND THE CARIBBEAN: GROWTH OF CREDIT TO THE PRIVATE SECTOR
(Constant 1998 values and interest rates, selected countries)

	Real growth of credit		Real interest rates on loans		
	1997-2000	2000-2001	1997-2000	2000	2001
Argentina	1.4	-17.6	10.7	12.1	29.8
Bolivia	3.7	-5.8	60.2	57.7	18.2
Brazil	11.4	14.4	41.7	30.0	29.9
Chile	6.8	9.1	9.7	9.7	7.4
Colombia	-1.5	12.9	15.1	10.0	13.6
Costa Rica	29.9	26.2	11.1	12.6	11.3
Ecuador	-33.7	85.4	-5.5	38.8	-16.6
Guatemala	12.1	12.4	11.4	14.1	10.6
Honduras	14.8	12.4	13.8	14.2	12.9
Mexico	-4.2	-7.5	7.5	8.0	7.0
Paraguay	-2.2	15.6	18.7	16.4	19.5
Peru	4.2	-2.6	25.0	25.3	22.6
Venezuela	0.2	26.4	0.4	7.5	10.5

Source: ECLAC, on the basis of information provided by the International Monetary Fund (IMF).

Table II.4
LATIN AMERICA AND THE CARIBBEAN: BANK INTERMEDIATION SPREADS
(Percentages)

	2000	2001		
	Spread	Spread	Lending rate	Borrowing rate
Argentina	2.8	10.4	16.2	26.5
Bolivia	19.9	10.1	9.8	19.9
Brazil	19.5	20.7	17.3	38.0
Chile	4.9	5.1	6.0	11.1
Colombia	7.3	9.6	12.4	22.0
Costa Rica	10.4	10.8	11.8	22.6
El Salvador	4.4	6.3	5.6	11.9
Guatemala	4.5	3.9	8.8	12.6
Haiti	10.1	9.5	-0.5	9.0
Honduras	9.8	8.5	14.5	22.9
Jamaica	10.8	10.3	9.7	20.0
Mexico	4.1	3.5	10.1	13.7
Nicaragua	10.7	12.9	9.0	21.9
Paraguay	10.2	11.2	16.2	27.4
Peru	19.5	17.1	7.6	24.6
Dominican Republic	8.5	7.9	15.7	23.6
Uruguay	35.3	36.1	14.0	50.1
Venezuela	8.3	9.0	14.7	23.7
Simple average	11.7	11.3	10.7	22.1
Simple average OECD [a]	3.1	3.7	0.1	3.4
Simple average Asia [b]	3.5	3.5	1.9	5.4

Source: ECLAC, on the basis of official figures.
[a] Includes Germany, Italy, Japan, the Netherlands, Spain, Switzerland and the United States.
[b] Includes Indonesia, Republic of Korea, Malaysia, the Philippines, Singapore and Thailand.

As the region's banking systems are the most important elements of the domestic financial structure, these two factors show that: (i) credit conditions in the region are highly restrictive and therefore represent one of the main obstacles to sustained growth, aggravated by the fact that any change in output levels can have far-reaching effects on borrowers' payment capacity; (ii) the region's competitiveness is seriously undermined by the high cost of financing production and hence exports; and (iii) whether as a result of macroeconomic uncertainty, the increase in overdue debt service or more stringent risk-rating methods, the banking system in Latin America has become more conservative.

In 2001, the behaviour of capital markets was largely determined by foreign capital flows, and this trait became a structural feature of the system in the 1990s (see figure I.12). Given the decline in financial flows to the region in 2001, stock markets, for example, saw their capitalization shrink in dollar terms for the second year running (see table II.5).

The number of listed firms also continued in freefall (see table II.6). This can be attributed to the effects of financial globalization, since the region's capital markets are unable to compete in the international arena. As a result, large local enterprises tend to prefer to issue stock on deeper markets that, in addition, have lower costs.

These two features were evident in 2001 as well. Although they were foreseeable, the year's results are nonetheless quite worrisome at a time when access to international markets is becoming more difficult and costly to obtain day by day.

Table II.5

STOCK MARKET PRICES

(Percentage variation of dollar indices) [a]

	1997	1998	1999	2000	2001	2002 [b]
Latin America (270)	25.0	-38.2	57.1	-15.3	-6.1	-15.4
Argentina (23)	17.3	-28.4	33.4	-25.0	-30.9	-67.4
Brazil (86)	20.5	-42.6	67.0	-8.4	-22.3	-22.0
Chile (43)	3.4	-30.0	35.3	-14.0	-5.2	-12.8
Colombia (18)	24.1	-43.6	-20.0	-44.9	25.1	5.1
Mexico (58)	47.6	-39.0	80.4	-20.4	12.2	-7.0
Peru (28)	13.9	-39.7	21.0	-27.8	12.3	3.6
Venezuela (14)	23.2	-51.8	-12.6	26.5	-20.1	-35.5
Asia (1067)	-43.9	-6.8	61.1	-37.8	2.0	6.2

Source: International financial Corporation (IFC).
[a] Figures in parentheses indicate number of firms covered.
[b] Figures to June.

Table II.6

LATIN AMERICA: NUMBER OF FIRMS QUOTED ON STOCK MARKETS

	1991	1996	1999	2000	2001
Argentina	174	147	129	127	111
Brazil	570	551	478	459	428
Chile	221	283	285	258	249
Colombia	83	189	145	126	123
Mexico	209	193	188	179	168
Peru	298	231	242	230	207
Venezuela	87	87	87	85	63

Source: Emerging Stock Markets Factbook, 2001; Emerging Stock Markets Review, January 2002. Standard & Poor's.

Box II.2

CURRENCY AND BANKING CRISES IN MEXICO, BRAZIL AND ARGENTINA: DIFFERENCES AND EXPERIENCES [a]

One of the most prominent characteristics of recent currency disturbances has been their association with crises in the banking sector. In Mexico, in 1994-1995 banks' non-performing portfolios increased steeply in number, and this resulted in a large percentage of banks being declared insolvent. In the case of Argentina, the foreign-exchange crisis ultimately led to the banking system's *de facto* insolvency. This did not happen in Brazil, however.

The basic difference between these crises stems from three factors: (i) the extent of dollarization of bank assets and liabilities; (ii) the degree of financial leverage at the outbreak of the crisis; and (iii) the speed at which interest rates and exchange rates change. These three factors basically point to the vulnerability of the banking system in terms of credit-, liquidity- and exchange-rate risk.

In the Mexican case, the level of dollarization of the banking system at the time of the crisis was very low because of the legal restrictions applying to contracts denominated in foreign currencies. The gearing ratio had risen very sharply in the wake of the country's financial liberalization in the late 1990s, and many analysts believe there was an imprudent expansion of credit portfolios. The currency crisis had the twin effect of provoking a very large rise in domestic interest rates and a significant contraction in GDP. These were the fundamental factors behind the rapid growth of non-performing portfolios.

Brazil was obliged to hike interest rates in response to its severe currency crisis. This, in turn, led to a substantial reduction in growth. In this case the three variables discussed above displayed very different characteristics: the dollarization of bank liabilities was fairly slight, and the banks had large quantities of dollar-indexed government bonds in their portfolios. The gearing ratio was also relatively low, given the banks' preference for government bonds at that time and the contraction of the real economy, which had already factored in much of the effects of the currency crisis. Accordingly, when the crisis broke out, not only did Brazilian banks see little increase in their intermediation risks, but they actually made substantial profits on their investments in public debt paper. Clearly, the counterbalancing factor of those profits was a worsening of the fiscal situation.

In the case of Argentina, a simultaneous effect of the currency crisis was an increase in the demand for deposits (especially in dollars) and, following the crisis, rapid growth in the volume of non-performing portfolios. The Argentine crisis was so deep that in late 2001 the monetary authorities were obliged to freeze deposits (a policy known as the *corralito*), and the banking system remains technically insolvent to this day.

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[a] See Stallings B. and R. Studart, *Financial regulation and supervision in emerging markets: the experience of Latin America since the Tequila Crisis,* Macroeconomía del desarrollo series, No. 9 (LC/L.1670-P/I), ECLAC, Santiago, Chile.

7. Structural reforms lose momentum in a worsening economic climate

The deterioration of the economic climate, both globally and regionally, discouraged implementation of the structural reform projects planned for 2001. As the reform process in Latin America and the Caribbean has matured in recent years, the focus has shifted away from privatizations, trade reform and financial deregulation, and towards fiscal and capital-market reform, State modernization and regional integration processes. The net result of these two trends, one short-term and the other longer, is that the reform process was less dynamic in 2001 than it had been in earlier years, and the forward movement of regional integration processes, in particular, slowed.

Privatizations continued to lose momentum in 2001, despite one large transaction in which the Mexican bank Banamex was sold for US$ 12.5 billion. In countries such as Brazil, Colombia, Ecuador, Nicaragua and Paraguay, several projects were postponed. In contrast, concession projects continued to open up new areas, with one example being the award of contracts to private enterprises to build and operate prisons in Chile.

In addition to the tax and fiscal reforms mentioned earlier in this chapter, two other countries (Costa Rica and Ecuador) opened up or expanded opportunities for private-sector participation in social security. In Uruguay and Bolivia, major steps were taken to break up the telecommunications monopoly, and in Brazil the authorities decided to set up an agency with wide-ranging powers to combat corruption.

Prudential supervision and regulation continued to be strengthened, especially in countries that suffered financial crises during the second half of the 1990s. This process is closely linked to measures taken to tighten up controls and rules against money laundering. The efforts made in this regard by a number of countries and territories, such as Panama, Barbados and the Cayman Islands, led to their being removed from the list of countries not collaborating with the Caribbean Financial Action Task Force on Money Laundering. Guatemala, on the other hand, was added to the list in 2001.

Governments also promoted measures to develop and consolidate capital markets. Uruguay authorized foreign security transactions on its stock exchanges, and the three existing stock markets in Colombia were merged into one. In Brazil a package of measures was adopted to make the stock market more transparent and improve protection for minority investors. In Mexico, greater supervisory power was given to stock market regulators, and in Chile the capital gains tax was eliminated. In El Salvador the Superintendency of Securities was created, and the Superintendency of the Financial System was strengthened.

The lifting of foreign-exchange restrictions in Chile during 2001 marked the culmination of the country's gradual deregulation of its currency market. Meanwhile, in the troubled Argentine and Venezuelan economies, the authorities adopted a range of measures, such as exchange controls, tariff hikes and safeguards, to tackle economic problems that were putting pressure on their currencies (in early 2002 both countries were obliged to adopt more flexible exchange-rate regimes).

Among other changes in labour legislation, Chile introduced reforms that strengthen supervision and raise the cost of dismissing workers. It also passed legislation establishing a new type of unemployment insurance, based on individual accounts managed by private funds. Another project in Guatemala gave greater supervisory powers to the Ministry of Labour.

Regional integration efforts were seriously hindered by the adverse economic climate, and integration processes within the four existing free trade areas either came to a halt or regressed.[5] In contrast, trade negotiations prospered with other countries in the region or with partners elsewhere in the world.

The protracted crisis in Argentina has been very damaging for the Southern Common Market (MERCOSUR). Argentina has deployed an entire battery of trade and non-trade measures to ease its economic problems, and these steps have provoked other members into taking countervailing action. The increase in such disputes, however, has not led to the breakup of MERCOSUR. Member countries continued to participate jointly in negotiations with third countries or trade blocs, with the exception of Uruguay, which decided to embark upon negotiations with the United States on its own account.

In contrast, trade links among members of the Andean Community were maintained, and this resulted in a further expansion of trade despite the adoption of a number of unilateral measures that undermine trade within the bloc. In 2001, concrete steps were also taken with a view to harmonizing macroeconomic policies; within this framework, the first convergence target is to achieve single-digit inflation by the end of 2002.

Like the Andean Community, trade within the Central American Common Market (CACM) grew robustly, thereby partly making up for the widespread downturn in extraregional exports. In terms of negotiations with third countries, the free trade agreement between the Northern Triangle and Mexico came into force in 2001. Another recent initiative is the Puebla-Panama Plan, which aims to strengthen economic integration, especially in the area of infrastructure, in the area running from the south of Mexico to Panama. In 2001, Belize joined the Central American Integration System (SICA), while Costa Rica signed a free trade agreement with Canada and another with Trinidad and Tobago.

The Caribbean Community (CARICOM) continued to work towards its goal of setting up a unified economic area. In 2001, it gave the go-ahead for the creation of the Caribbean Court of Justice, which will act as the supreme judicial body in most CARICOM countries. In addition, the regional legal framework for the implementation of the single market was completed (*CARICOM Single Market and Economy*).

Lastly, the participants in the third Summit of the Americas, held in Quebec, Canada, in April 2001, agreed that negotiations for the Free Trade Area of the Americas (FTAA) would be concluded by early 2005, with the corresponding treaty taking effect in December of that year.

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[5] For a more detailed study of regional integration in 2001 see ECLAC *Latin America and the Caribbean in the international economy* (LC/G.2149-P), Santiago, Chile, March 2002.

B. THE MAIN REAL VARIABLES

In 2001, the economies of Latin America and the Caribbean turned in a poor performance marked by flat GDP growth and a decline in per capita output. The labour market situation also suffered from a drop in the employment rate, although unemployment remained stable thanks to a reduction in participation rates. The trend of inflation was favourable once again in 2001, but towards the end of the year there were clear signs of a rapid rekindling of inflationary processes would soon occur in several countries (notably Argentina, given its imminent abandonment of the convertibility regime).

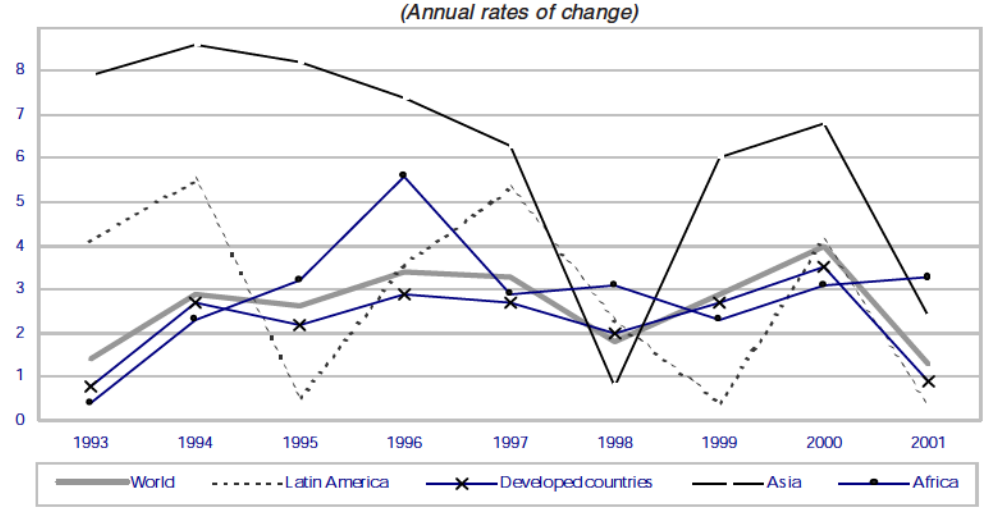
1. The regional economy stagnated

Regional GDP grew by just 0.3% in 2001, far below the 4.1% rate of 2000, and per capita output fell by 1.2%. This setback marks the onset of the third crisis to occur since 1990. The virtual stagnation of production activity stands in contrast to the growth projections announced by ECLAC in early 2001, when an annual expansion of around 4%, which would have been broadly in line with the previous year's figure, was expected. By the middle of the year, however, this prediction had been revised downward to 2% in view of the increasingly gloomy international economic outlook.

Unlike other recent crises which only affected some of the countries in the region, this time the growth slowdown was widespread. Only two countries (Ecuador and Paraguay) managed to improve upon their 2000 growth performance, and in both cases this represented a rebound from declines in output in previous years. The average growth rate for the last 10 years (2.9%, equivalent to 1.2% on a per capita basis) is insufficient to help overcome the problems of unemployment and poverty facing the region.

The world economy clearly underperformed in 2001, posting its lowest growth rate of the last decade. This followed a 4% expansion in 2000, which was the best result since the mid-1980s. Slower growth was seen throughout the world, except in Africa, where growth rates of around 3% have been recorded during the last five years (see figure II.6). In addition, world growth has become more volatile since 1997 and has taken on characteristics similar to those seen in Latin America in recent decades, albeit with smaller fluctuations.

Figure II.6
WORLD ECONOMIC GROWTH
(Annual rates of change)

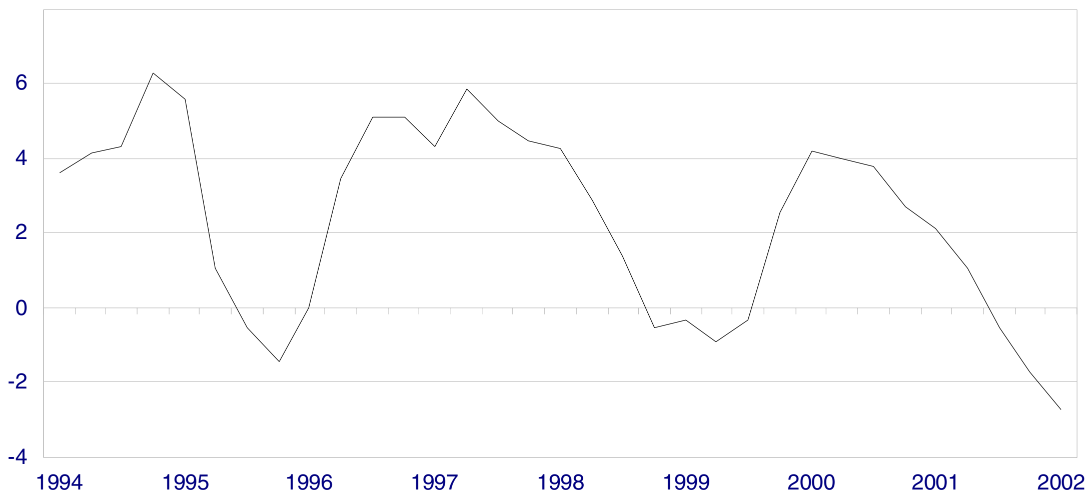


Source: United Nations (2002), *World Economic Situation and Prospects 2002*, Department of Economic and Social Afairs (DESA); and United Nations (2002), Project Link, *Global Economic Outlook*, Department of Economic and Social Afairs (DESA), New York. Latin American data based on ECLAC estimates.

The deterioration in world trade caused by this weak performance, compounded by the uncertainty sparked by the events of September 11 in the United States, was clearly detrimental to the region. Nonetheless, internal factors also had a negative influence. This factors included the financial collapse in Argentina, the energy crisis in Brazil, natural disasters in Central America and the Caribbean, the reappearance of foot-and-mouth disease in the Southern Cone, the fragility of the region's financial systems and the increasing vulnerability of its economies as a result of large fiscal deficits that raised public-sector debt levels still further.

The economic slowdown in Latin America began in the last quarter of 2000 and lasted throughout 2001. Starting in the third quarter, regional output began to shrink in absolute terms, and this situation carried over into 2002 (see figure II.7).

Figure II.7
LATIN AMERICA: QUARTERLY GROSS DOMESTIC PRODUCT
(Percentage change from the same quarter the previous year)

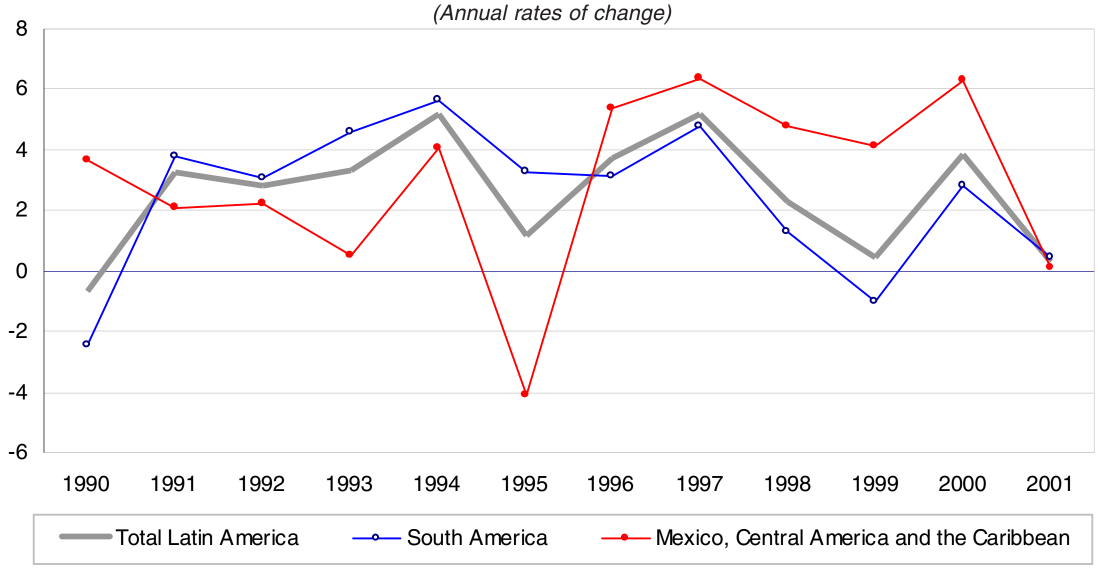


Source: ECLAC, on the basis of official figures.

The regional figures conceal major differences across countries, among which four groups can be distinguished. The first includes economies whose activity levels actually contracted (Argentina, Haiti, Mexico and Uruguay). The second group is made up of countries that posted GDP growth rates of between 0% and 1.5%, implying near-zero or negative output growth in per capita terms (Bolivia, Brazil, Colombia, Costa Rica, Panama and Peru). The third group consists of countries with growth rates of between 1.5% and 3%, namely Chile, Cuba, Dominican Republic, El Salvador, Guatemala, Honduras, Nicaragua, Paraguay, and Venezuela. Ecuador is in a category all of its own, since it was the only country to record a substantially higher growth rate (6%).

The stagnation or slackening pace of growth has a variety of implications, depending on the economy's previous dynamism. As shown in figure II.8, since 1996 the northern part of the region has performed better, while South America has endured a lengthy period of stagnation which is all the more worrisome because of its major economic and social repercussions. All the countries that succeeded in sustaining high growth rates in 1998-2000 (Costa Rica, Cuba, Dominican Republic, Guatemala, Mexico and Nicaragua) saw their growth slow drastically thereafter, and this was especially true of the Dominican Republic and Mexico. The only country to stage a major recovery was Ecuador. Many countries achieved growth near the 2%-3% range, but their rates were nonetheless below the previous year's figures. Meanwhile, Argentina and Uruguay have been in recessions for a number of years, and they were joined by Mexico and Haiti in 2001. In the first quarter of 2002, these four countries, together with Brazil and Venezuela, saw output decline.

Figure II.8
LATIN AMERICA AND THE CARIBBEAN: REGIONAL GROWTH
(Annual rates of change)

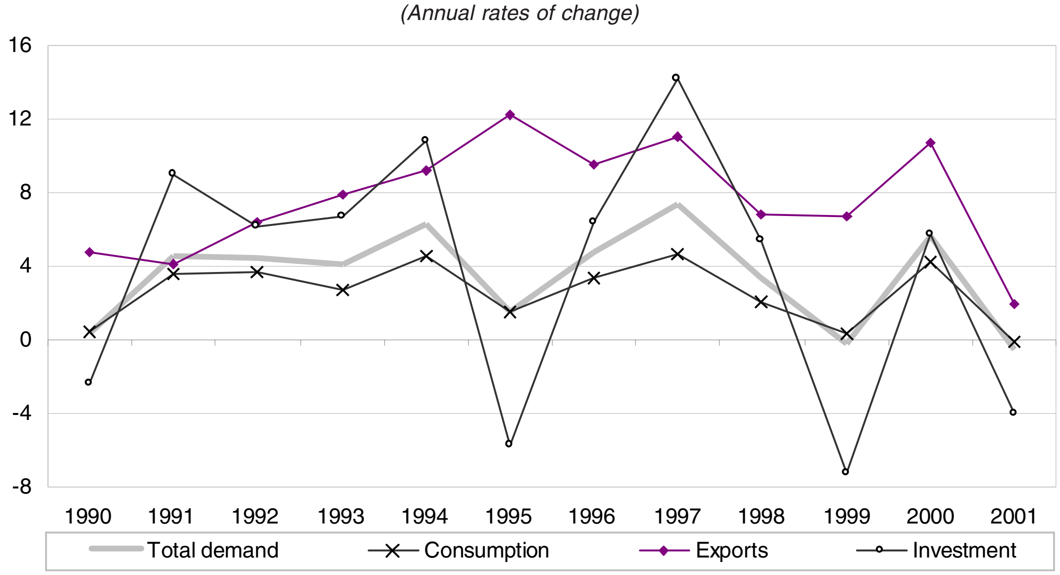


Source: ECLAC, on the basis of official figures.

A large part of the region's adjustment was borne by domestic demand, as investment retreated and consumption stagnated. Investment levels fell in over half of the countries and shrank by about 10% in Argentina, Bolivia, Panama and Paraguay. Consumption was also scaled back in Argentina, Chile, Panama and Uruguay.

Exports of goods and services expanded by just 3.2% in volume –the lowest rate since the end of the 1980s. The countries whose main export market is the United States, such as Mexico and the Central American and Caribbean nations, were hit the hardest. Imports of goods and services stagnated owing to very slack domestic demand (see figure II.9).

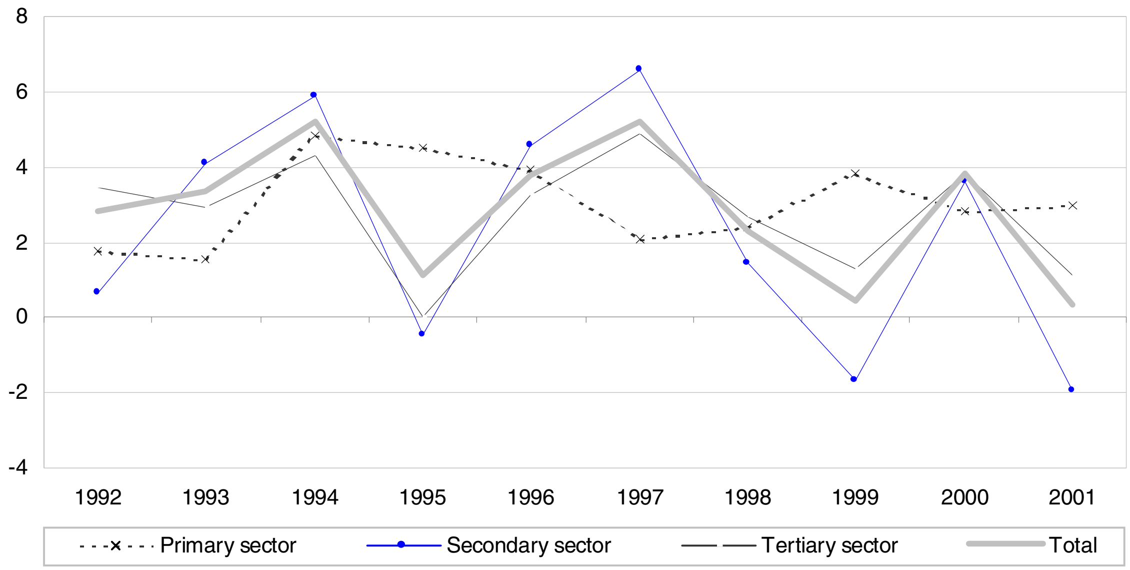
Figure II.9
LATIN AMERICA AND THE CARIBBEAN: COMPONENTS OF TOTAL DEMAND
(Annual rates of change)



Source: ECLAC, on the basis of official figures.

The economic downturn in the region during 2001 made itself felt in a variety of ways in the main production sectors. The secondary sector was the worst off, since the level of manufacturing activity actually declined. Driven by agriculture and livestock production, which expanded by 3.2%, the primary sector behaved countercyclically. Services rose by 1%, with activity being led by basic services (particularly transport and telecommunications), whereas the electricity, gas and water industries and commerce all slipped back (see figure II.10).

Figure II.10
LATIN AMERICA: GROWTH BY PRODUCTION SECTOR
(Annual rates)



Source: ECLAC, on the basis of official figures.

The farming and livestock sector was helped by favourable weather conditions in several countries of the Southern Cone and thus recorded bumper grain and oilseed harvests, especially in Argentina, Brazil, Chile and Paraguay. In contrast, a number of Central American and Caribbean economies suffered from inclement conditions, including a drought in El Salvador, Guatemala and Honduras and Hurricane Michelle, which left a trail of destruction in several Caribbean island States. Coffee-producing and exporting countries were once again hurt by overproduction as international prices remained very low. Lastly, the spread of foot-and-mouth disease since mid-2000 affected livestock herds and meat exports in several countries, especially in the Southern Cone.

Growth in the mining sector was slightly above the average for the economy as a whole (2.2%). Among countries with major mining industries, activity in the sector grew by 11% in Peru, but fell back significantly in Colombia. The upswing in this sector in Peru reflected the fact that the Antamina project (the world's largest joint copper-zinc mine) came on stream, as well as the expansion of other mining operations. As a result, Peru posted record production figures for gold, copper, zinc, silver and lead. By contrast, hydrocarbon production decreased again as oil reserves began to run dry. Nonetheless, in 2001 preparatory work began for the development of Peru's Camisea natural gas field, which is expected to boost output in this subsector starting in 2004. The poor performance of the mining industry in Colombia was primarily due to the depletion of a number of oil wells.

One of the sectors that was hurt the most by the slowdown in regional growth was manufacturing (-1.8%). Weak domestic demand (-0.3%) was the underlying cause of the contraction in most cases, although some sectors were also affected by a slackening of external demand. The maquila industry was especially hard hit, in most cases because of reduced demand from the United States. Manufacturing contracted in two thirds of the region's countries, with the steepest declines occurring in Argentina (-7.5%), Costa Rica (-7.3%), Uruguay (-6.2%), Panama (-5.7%) and the Dominican Republic (-5.4%). Only Ecuador, El Salvador, Honduras and Nicaragua posted growth above 2%. Ecuador was the only country to substantially improve upon its 2000 results, while in Colombia, the Dominican Republic and Mexico growth deteriorated by more than 10 percentage points.

Anaemic external demand, especially in the United States, was the main explanation in the case of the Dominican Republic, since this caused production in duty-free zones to slump. In Mexico, the unprecedented contraction in the maquila industry was entirely due to the economic slowdown in the United States. Other countries in Central America and the Caribbean were also affected by negative trends on international markets. In Costa Rica, the sharp downturn in external demand had a particularly strong effect on the high-technology electronics industry, and this was compounded by weaker demand domestically and in Central America.

Table II.7

LATIN AMERICA AND THE CARIBBEAN: GROSS DOMESTIC PRODUCT BY BRANCH OF ECONOMIC ACTIVITY

(Annual growth rates)

	Agriculture		Mining and quarrying		Manufacturing goods		Construction		Subtotal: services		Basic services		Other	
	2000	2001[a]	2000	2001[a]	2000	2001[a]	2000	2001[a]	2000	2001[a]	2000	2001[a]	2000	2001[a]
Latin America and the Caribbean	2.4	3.3	4.0	2.1	4.4	-1.7	0.9	-3.0	3.3	-0.6	7.0	2.2	3.3	0.8
Argentina	-1.7	1.0	6.7	4.4	-3.8	-7.5	-9.3	-12.1	-4.0	-6.0	2.7	-3.4	0.3	-3.9
Bolivia	3.8	1.1	7.2	2.7	1.7	1.1	-10.5	-8.6	2.2	0.6	2.2	1.3	1.5	0.7
Brazil	3.0	5.1	11.1	3.4	5.4	0.6	3.0	-2.6	4.5	0.9	8.3	2.4	2.4	2.0
Chile	6.7	6.5	5.2	3.6	4.0	-0.3	0.2	3.8	4.0	2.5	9.9	6.3	3.2	2.6
Colombia	5.0	1.5	-10.0	-4.0	9.7	-0.8	-2.8	3.2	3.4	0.1	1.8	3.0	1.3	1.1
Costa Rica	0.6	1.6	6.3	7.6	-4.3	-7.3	3.4	12.2	-2.1	-2.7	11.3	8.4	3.9	2.3
Cuba	11.6	-1.7	14.4	3.1	4.3	0.5	9.7	3.6	5.9	0.6	9.0	3.5	4.5	4.8
Ecuador	-5.3	4.5	6.8	1.8	2.4	7.5	3.7	14.7	1.3	6.5	4.4	3.9	1.6	6.3
El Salvador	-3.1	-2.1	-4.7	12.0	4.1	4.2	-3.4	10.0	0.9	3.0	4.9	3.1	2.5	0.7
Guatemala	2.6	1.2	-8.5	0.4	1.9	1.4	-18.3	-38.0	0.4	-1.3	9.1	5.5	4.1	2.9
Haiti	-3.6	0.6	5.9	-4.9	-0.2	0.2	8.0	0.9	0.2	0.5	7.6	-1.3	3.7	-0.6
Honduras	9.5	-0.1	1.7	-3.3	5.5	5.2	1.5	-7.1	6.6	1.2	8.1	0.6	5.3	5.9
Mexico	0.6	2.5	3.8	-0.6	6.9	-3.9	5.1	-4.5	5.6	-2.9	8.8	2.7	7.1	1.0
Nicaragua	11.4	3.1	-20.0	2.5	2.8	2.6	10.4	5.2	8.2	3.2	3.3	2.9	3.1	2.9
Panama	1.6	0.8	-6.7	-12.8	-5.3	-5.7	2.5	-9.7	-0.9	-4.5	10.4	3.6	1.7	1.1
Paraguay	-4.4	10.5	2.5	-15.2	1.0	1.3	2.0	-22.7	-1.8	2.9	9.1	4.1	-1.5	1.4
Peru	6.4	-0.6	2.4	11.2	6.7	-1.1	-4.3	-6.0	4.0	0.2	4.4	0.4	2.7	0.2
Dominican Republic	5.0	5.1	9.2	-15.2	9.0	-1.3	5.2	0.9	6.8	0.4	13.1	11.7	7.0	2.0
Uruguay	-3.0	-5.1	-8.8	-11.2	-2.1	-6.2	-11.1	-11.2	-4.0	-6.8	2.7	0.7	-0.6	-0.9
Venezuela	2.4	2.6	4.7	1.1	2.1	-0.2	-2.7	13.0	2.6	2.1	7.1	7.3	2.8	2.5

Source: ECLAC, on the basis of official figures converted into dollars at constant 1995 prices.
[a] Preliminary figures.

Sluggish domestic demand accounted for the poor performance of manufacturing in Argentina, Brazil, Colombia and Nicaragua. In Argentina, the recession in this sector was very deep, with the slide in aggregate industrial output intensifying as the year proceeded (a 15% drop was recorded for the fourth quarter of 2001). Results in Brazil's manufacturing sector were very uneven, with an increase in capital goods production (12.8%) that was heavily concentrated in agricultural and electrical equipment contrasting with stagnation or contraction in other major industrial categories (intermediate and consumer goods). The production of consumer durables shrank by 0.6%, as demand reacted to energy rationing.

The drop in investment triggered a 3.3% contraction in construction, which was the sector to post the year's worst performance. This was the third straight year of disappointing results in the construction industry, which is all the more serious in view of its implications for job creation. This situation is largely attributable to slacker lending to the private sector, difficulties in financing public works and delays in obtaining approvals for tenders. There were major declines in Paraguay (-23%), where construction activity fell back to levels last seen in the early 1990s; in Argentina (-12%), which has suffered a cumulative decline of 27% since 1998; and in Uruguay (-11%), where both public- and private-sector construction projects faced financing difficulties.

The construction industry turned in a positive performance in some countries, however. Ecuador saw a 10% expansion thanks to the start-up of work on the new heavy crude oil pipeline, together with public works and private-sector building activity in housing, commercial outlets, restaurants and hotels. The construction boom in Venezuela, which was based on government-funded public works and housing projects, represents a major recovery following three successive years of decline. In Costa Rica, middle-class housing construction benefited from attractive credit conditions, combined with an upturn in hotel and shopping centre construction and in highway refurbishment.

The service sector expanded by a modest 1%, but this was nonetheless above the GDP growth rate. There were also wide variations between the various subsectors. In the basic services category, electricity, gas and water declined for the first time since the 1980s, mainly because of the energy crisis that overtook Brazil, where this subsector shrank by 5.5%. The crisis was brought on by a major drought (in a country where 93% of the energy supply is hydroelectric) and was compounded by the legacy of grossly inadequate investment throughout the 1990s. The transport, storage and communications sector expanded by 3%, its slowest rate since the early 1990s, when it entered a high-growth period driven by privatization and the incorporation of new technologies. This result was also influenced by a steep decrease in this sector in Argentina.

2. Investment performed very poorly[6]

In 2001 there was a sharp reduction in total gross investment (-4.4%) in Latin America and the Caribbean which interrupted the recovery that had begun in 2000. The fact that 2001 is the third time that investment has declined in absolute terms during the last seven years demonstrates the volatility of this variable. The deterioration intensified as the year progressed: an increase in the first quarter was followed by successive quarterly declines that culminated in a 9% contraction in the last three months of the year. This negative result was widespread; only a small group of countries managed to better their 2000 investment figures. The reasons were in large part the same as the reasons for the stagnation of economic activity: a slowdown in the world economy, especially in the United States, which hurt the northern part of the region in particular; and the severe crisis in Argentina, which had negative effects on neighbouring countries and exacerbated the already fragile economic situation in South America. Depressed domestic demand in some of the countries also played a part in the weakness of investment.

Fixed investment, which represents expansion of productive capacity, declined overall by 2.7%, and its share of output fell to the lowest level of the last decade (19.1%). The main burden of the crisis fell on private investment, particularly in machinery and equipment. Public-sector investment held steady thanks to construction projects. The downturn in private investment was steepest in Mexico, Panama and Uruguay; while public-sector investment remained very buoyant in the Dominican Republic, Ecuador, El Salvador and Guatemala, but fell sharply in Nicaragua, Paraguay and Peru.

Just five countries (Brazil, Colombia, Costa Rica, Ecuador and Venezuela) managed to improve upon their 2000 performance. Fixed investment in Ecuador, driven by private-sector projects, grew by a spectacular 37% in 2001 –one of the highest rates in the region during the last decade.

6 This chapter presents the saving-investment series in two forms: at current prices and at constant 1995 prices. The saving-investment balance at current prices is a better indicator of financial flows, whereas investment measured at constant prices more accurately reflects expansion in the economy's productive capacity and potential growth.

Table II.8
LATIN AMERICA AND THE CARIBBEAN: TOTAL GROSS CAPITAL FORMATION
(Annual growth rates)

Country	1993	1994	1995	1996	1997	1998	1999	2000	2001[a]
Latin America and the Caribbean	6.7	10.8	-5.7	6.4	14.2	5.4	-7.3	5.7	-3.4
Argentina	15.1	13.5	-13.0	8.8	17.5	6.7	-12.6	-6.8	-15.9
Bolivia	-0.2	-11.0	12.6	18.9	31.1	27.6	-18.8	-10.2	-20.5
Brazil	11.9	12.9	8.1	2.8	7.4	3.2	-7.5	4.5	1.8
Chile	18.8	4.7	26.7	8.0	9.5	2.1	-19.9	14.3	-7.6
Colombia	34.5	24.9	6.1	-12.0	-0.6	-2.3	-38.6	11.8	9.6
Costa Rica	13.2	1.8	-5.1	-10.9	24.4	25.8	-15.6	-2.2	18.6
Cuba	-39.7	-1.4	39.8	22.2	16.8	15.2	4.3	9.3	1.1
Ecuador	-4.3	5.6	6.3	-11.6	16.9	9.7	-51.9	46.2	57.4
El Salvador	9.6	14.0	14.0	-20.5	6.4	22.3	-4.1	1.4	-4.3
Guatemala	-4.7	1.8	-1.6	-15.8	21.6	38.7	-0.5	4.4	-2.4
Haiti	-26.0	-34.8	123.4	11.8	7.6	-3.2	24.0	18.3	-6.8
Honduras	29.2	7.3	3.0	-6.3	8.5	1.9	8.6	-0.2	-3.1
Mexico	-1.4	10.4	-35.4	26.1	25.8	8.7	4.0	11.6	-7.4
Nicaragua	-18.9	26.1	19.1	9.8	19.3	11.0	37.8	-12.0	-2.5
Panama	14.0	14.2	10.9	6.0	1.1	11.7	13.2	-9.6	...
Paraguay	3.5	4.3	6.9	0.1	-1.9	-4.3	-3.5	-0.5	-17.7
Peru	12.0	32.9	20.0	-4.9	14.8	-1.9	-13.4	-3.6	-8.5
Dominican Republic	6.6	-2.8	-5.6	6.6	19.2	30.5	11.1	7.5	1.8
Uruguay	9.8	12.8	3.9	-2.3	7.3	12.5	-8.0	-11.2	-9.3
Venezuela	-19.0	-30.1	39.0	-12.3	36.8	0.8	-15.1	9.3	3.8

Source: ECLAC, on the basis of official figures converted to dollars at constant 1995 prices.
[a] Preliminary figures.

Table II.9
LATIN AMERICA AND THE CARIBBEAN: COMPOSITION OF FIXED CAPITAL
(Percentages of GDP)

	1993	1994	1995	1996	1997	1998	1999	2000	2001[a]
Gross fixed capital formation	19.4	20.3	18.9	19.2	20.8	21.0	20.0	19.3	18.6
Construction	12.1	12.2	11.7	12.0	12.3	12.5	12.1	12.1	11.8
Machinery and equipment	7.3	8.1	7.2	7.2	8.6	8.6	7.9	7.2	6.8
Public sector	3.5	3.5	3.1	2.8	2.8	3.1	2.6	2.6	3.1
Private sector	15.9	16.8	15.8	16.4	18.0	17.9	17.4	16.6	15.6

Source: ECLAC, on the basis of official figures converted into dollars at constant 1995 prices.
[a] Preliminary figures.

In Brazil, fixed investment rebounded by 1.8%, following a 5.3% drop in 2000, but the behaviour of investment throughout the year has plainly been procyclical. Following an 11% expansion in the first quarter, it stagnated in the middle part of the year and then fell back by 7.5% in the final quarter. Investment in Costa Rica, especially in construction, recovered on the back of domestic demand, which was boosted by lower interest rates, easier credit terms and more favourable input prices, together with the fact that foreign direct investment (FDI) remained stable and high. The large increase in fixed investment in Venezuela was founded upon public-sector projects, especially in construction.

Following the positive growth rates recorded in 2000, the investment situation changed appreciably among countries in the northern part of the region (El Salvador, Guatemala, Haiti, Honduras, Mexico, Nicaragua and Panama). This turnaround reflected the slowdown in the United States economy in large part. A gradual decline in gross fixed investment had begun in Mexico in late 2000, and by mid-2001 this downward trend had strengthened. Honduras and Nicaragua, for their part, experienced sharp decreases, while in Costa Rica, El Salvador and Guatemala there were slight falls. The crisis in Argentina was made worse as fixed investment shrank by over 15%, and this had a contagion effect on a number of neighbouring countries, including Bolivia, Paraguay and Uruguay, where investment retreated by nearly 20%.

Investment financing was hurt by a sharp decrease in domestic saving, measured as a percentage of GDP in current dollars. With lower domestic saving and a factor-income outflow amounting to about 3% of GDP (which was only partly offset by larger transfer inflows), national saving totalled some 17% of GDP. The lowest figures (below 15%) were posted by Argentina, Bolivia, Colombia, Costa Rica, Cuba, Guatemala, Haiti, Nicaragua and Uruguay, although some of these countries managed to make up for this with large volumes of external savings.

Table II.10
LATIN AMERICA AND THE CARIBBEAN: FINANCING OF GROSS CAPITAL FORMATION
(Percentages of GDP)

	1993	1994	1995	1996	1997	1998	1999	2000	2001[a]
1. Domestic saving	19.3	19.9	20.6	20.5	20.7	19.4	19.4	20.2	18.6
2. Factor income	-2.6	-2.4	-2.4	-2.4	-2.4	-2.5	-3.0	-2.8	-2.9
3. Transfers	0.8	0.8	0.9	0.8	0.8	0.9	1.1	1.1	1.3
4. Gross national saving (1+2+3)	17.5	18.4	19.1	19.0	19.1	17.8	17.5	18.6	17.0
5. External saving	3.3	3.3	2.3	2.1	3.3	4.4	3.1	2.4	2.7
6. Gross capital formation (4+5)	20.8	21.7	21.4	21.1	22.4	22.2	20.7	21.0	19.7

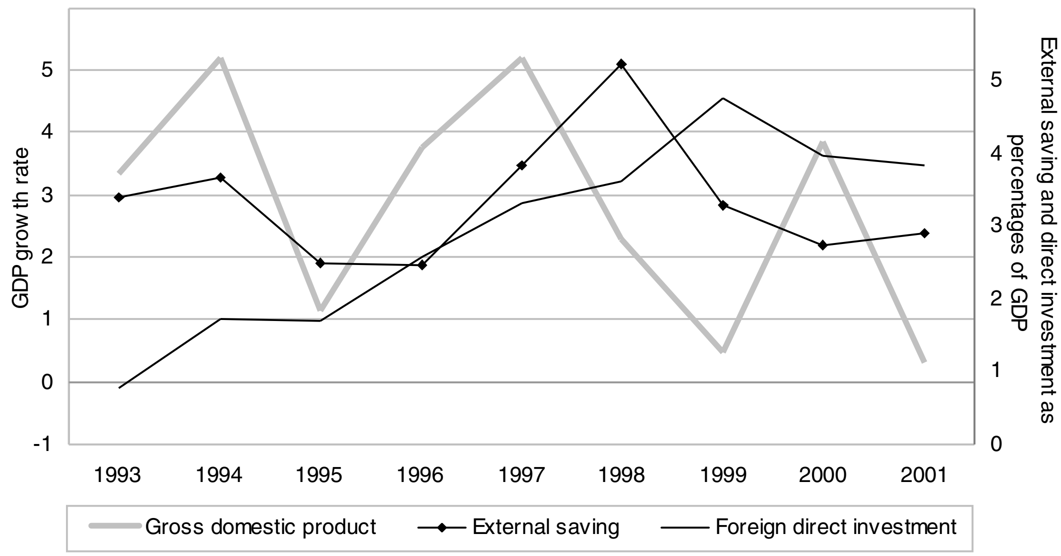
Source: ECLAC, on the basis of official figures converted to dollars at constant prices.
[a] Preliminary figures.

External saving expanded in 2001, rising from 2.4% to 2.7% of GDP regionwide and exceeding 5% in five countries (Costa Rica, Dominican Republic, Honduras, Nicaragua and Panama). The volatility displayed by this variable in the 1990s continued, however, making economic growth highly unstable. In addition, the uptrend of FDI seen during the 1990s gave way to a downward trend from 2000 on (see figure II.11).

Worldwide, FDI followed a similar pattern, with global FDI shrinking by 40% in 2001 compared to its 2000 level. Most of this reduction, however, was in flows between developed countries, which were down by half. Developing countries witnessed a much smaller reduction (6%), and in some cases (e.g., China), FDI flows actually increased (see figure II.12).[7]

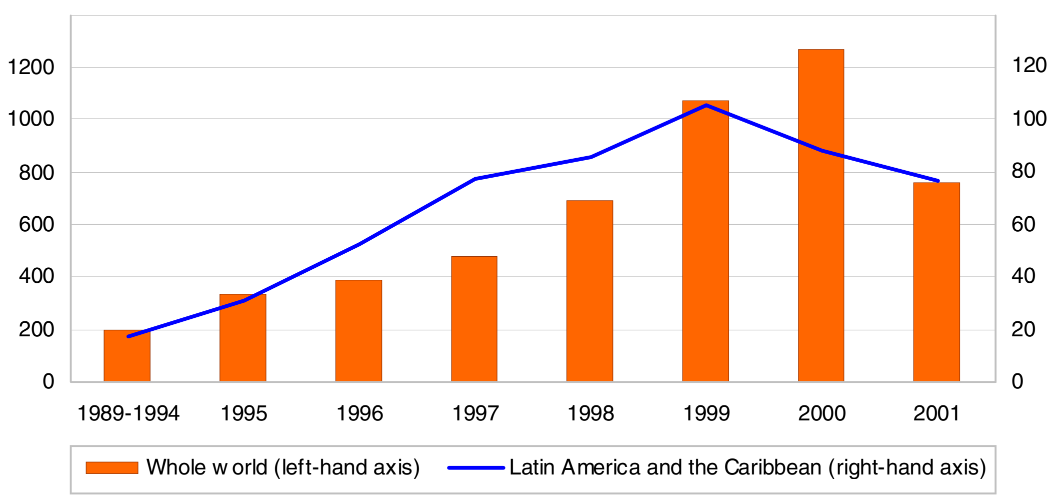
[7] Figure II.12 uses the concept of FDI *in*flows, whereas figure II.11 shows FDI inflows minus outflows. See ECLAC, *Foreign investment in Latin America and the Caribbean, 2001 Report* (LC/G.2178-P), Santiago, Chile, June 2002.

Figure II.11
LATIN AMERICA AND THE CARIBBEAN: EXTERNAL SAVING, FOREIGN DIRECT INVESTMENT AND GDP GROWTH
(Percentages of GDP and growth rates)



Source: ECLAC, on the basis of official figures.

Figure II.12
NET FOREIGN DIRECT INVESTMENT IN LATIN AMERICA AND THE CARIBBEAN, AND WORLWIDE
(Billions of dollars)



Source: ECLAC, on the basis of official figures.

The weakening of foreign investment flows to Latin America and the Caribbean was evident not only in new investments but also in merger-and-acquisition activity and in privatizations. This contraction, following unprecedented growth in the 1990s, is attributable to both circumstantial and structural factors. The former included the economic and political crisis in Argentina, compounded by uncertainty regarding the international economy, especially in the United States. Structural factors had to do with the economic reforms implemented in the 1990s, which had generated a wave of privatizations among large State firms. This process has now practically come to an end, and there has been a consequent decrease in large-scale flows used to purchase privatized assets. In addition, acquisitions of large local firms by transnational corporations –operations that generated copious FDI flows in the late 1990s– have given way to a period during which the emphasis is on the consolidation of the resulting industrial organization, and operations of this sort have therefore declined.

3. Inflation falls further

Inflation, as measured by consumer price indices, decreased again in the region as a whole. Falling to just 6.1% in 2001 (nearly three percentage points lower than in 2000), the region's inflation rates thus continued to converge towards developed-country levels. Wholesale prices rose by slightly less than this figure, in contrast to the sharp increases recorded in the two previous years. This encouraging performance was quite widespread, and in the few countries where inflation remains at high levels, the trend was clearly downward. Nonetheless, turbulence in the Argentine economy, which led to the abandonment of the convertibility regime in early 2002, raised the spectre of a major devaluation that could cause inflation in that country to flare up to heights not seen in the region for several years now (see table I.7 of the statistical appendix contained in the attached CD-ROM).

Inflation in 2001 fell to its lowest level in over 50 years, thanks to a combination of structural and circumstantial factors. Structural factors included the openness of the region's economies and greater competition in distribution, both of which stemmed from reform processes carried out by the region's countries during the 1990s. There were also radical changes in monetary policy, with some countries adopting inflation targeting. Short-run circumstantial factors included the ongoing recession in Latin American and Caribbean countries and falling import prices (particularly for oil). In most countries, exchange-rate stability also played a decisive role in bringing inflation down to such low levels. Five countries (Brazil, Chile, Haiti, Paraguay and Uruguay) did see their exchange rates rise significantly (by between 15% and 33%), but inflation remained very low even in these economies. This new situation, in which exchange-rate spikes have little effect on domestic prices, indicates that the practice of indexation, which was pervasive in previous decades, has been steadily on the decline in recent years. Meanwhile, the inertial component, which was an important feature of the inflationary process in the past, is again playing a major role. This time, however, it is working in the opposite direction, as the low-inflation environment is now helping to prevent devaluations from being immediately passed through to prices, or at least to ensure that this happens only partially.

In 18 of the 22 countries that have information available, the pace of price increases slowed, in some cases substantially. The best result in relative terms was achieved by Ecuador, where inflation plummeted by nearly 70 percentage points to just 22%. The pace picked up in four countries (particularly in Brazil and Guatemala, where the rates were about four percentage points higher than those countries' 2000 figures). Aside from Ecuador, only Costa Rica and Venezuela registered double-digit inflation (11% and 12.3% respectively). At the other end of the spectrum, five countries had negligible inflation rates or even deflation.

In Ecuador, the runaway inflation seen during 1999 and early 2000 was reined in following dollarization, and the rate of price increases dropped off sharply. Producer prices slowed even more abruptly, and negative variations were actually recorded. This sharp reduction is a once-only event, however, since it represents a correction of the previous year's rapid rise. In the future, this effect will gradually fade away.

Mexico also turned in a good performance and showed clear signs of consolidating its stabilization process. Annual inflation came in at just over 4% –the country's lowest rate since 1970. In Venezuela, inflation also continued to fall, albeit more slowly since domestic demand was quite robust; in 2002, however, this downward trend has been reversed owing to the devaluation of the bolívar. In Brazil, the rise in the exchange rate (about 20%), together with increases in public utility charges, failed to trigger the inflationary surge that had been feared. On the contrary, prices rose only modestly, and inflation in the wholesale market, which had skyrocketed during the two previous years, actually eased and began to converge towards the rate for consumer prices. This behaviour can be attributed to slower economic growth and a stringent monetary policy that included large interest-rate hikes. Inflation for the year was still above the target figure, however.

The clearest case of deflation was Argentina, where the recession forced consumer prices lower for the third year running, this time by 1.5%, while wholesale prices slipped by 5%. The abandonment of the convertibility regime signals the end of a long period during which the country had a fixed exchange rate and very low inflation. During that entire decade, prices rose at an annual average rate of just 2.5%, which had been unheard of in that country since the Second World War. The devaluation since the regime's discontinuation has been so steep, however, that it will no doubt have a very powerful impact on domestic prices, and Argentina will almost certainly post the region's highest inflation rate in 2002.

Panama, meanwhile, maintained its traditional low rate of inflation during 2001, and price increases were practically non-existent in Bolivia and Peru. Chile, El Salvador and Uruguay again registered declining inflation, although in the latter the downward trend was reversed in 2002 as the pace of devaluation quickened. In Chile, inflation continued to fall despite a substantial (15%) rise in the exchange rate.

In the English-speaking Caribbean countries, inflation was generally very low in 2001. Nonetheless, Jamaica –one of the subregion's key economies– saw prices rise by 9%. This was nearly three percentage points higher than the previous year and was caused mainly by problems relating to the domestic supply of agricultural products. In contrast, inflation in Trinidad and Tobago fell from 5.6% in 2000 to 3.2% in 2001, while Barbados experienced deflation (-1.2%).

4. The cooling down of economic activity is reflected in slack job creation

Slower economic growth was directly reflected in job creation, and the employment rate fell from 53.3% to 52.7% in a resumption of the downward trend of the 1990s. Employment levels were lower in Argentina, Brazil, Chile and Mexico. Elsewhere (in Costa Rica, Ecuador and Venezuela, for example) the employment rate rose, and a simple average of rates for 12 countries remained stable at 51.8%.

Predictably, the weakness of economic activity was primarily manifested in business demand for labour, and wage employment grew by just 1%, while total employment expanded by 1.3%. In many countries, a considerable portion of new wage-based jobs were created in microenterprises, while labour demand in larger firms sagged. In Mexico, for example, the number of workers holding a formal employment contract fell by 0.6% compared to the averages for 2000 and 2001. Wage employment, specifically in the public sector, did receive a temporary boost from the emergency job programmes that were implemented in several countries, however.

In contrast to the sluggish hiring by private-sector firms, self-employment expanded by 1.7%; this trend attested to households' need to generate income, albeit on an unstable basis. Presumably, most of these new jobs are in low-productivity, low-income sectors, thereby consolidating the prevailing trends of the last two decades. The performance of unpaid work by family members also grew at a faster-than-average 6.3%. In contrast, paid domestic employment declined by 0.5%; this result can be attributed to the declining income levels of many households, which are the employers in this case.

A variety of factors combined to reduce employment in all branches of activity in the primary and secondary sectors. Although agriculture posted the highest growth figures regionwide, employment in this sector declined (by 1.5% when measured as a weighted average of the six countries with statistical data available), thereby deepening the prevailing trend of the 1990s. The discrepancy in performance between sectoral output and employment can be explained by two factors. Firstly, the growth in output was based on activities that are relatively more capital- than labour-intensive. This was partly due to weak domestic demand, which had an adverse effect on the production of a number of staple crops, many of which tend to be labour-intensive. Secondly, modernization of the sector has improved production efficiency through greater use of agricultural machinery, but it has not led to a commensurate increase in the demand for labour and has tended to drive out less efficient and more labour-dependent producers. In Brazil, for example, farm and livestock output rose by 5.1%, but the demand for farm labour (there is no information on labour demand in the livestock segment) decreased by 5%.[8] A number of the crops for which substantially larger harvests were reported (soybeans, cotton and sugarcane, among others) make relatively little use of labour, and even this is declining. In contrast, some of the more labour-intensive domestic staple crops, such as rice and beans, have seen both output and employment drop substantially.

Manufacturing employment shrank (by 1.2% as a weighted average for 12 countries), partly because of sagging domestic demand and partly because exports to the United States fell in the wake of the recession. This hit employment in the maquila industry particularly hard, and in Mexico 226,000 jobs were lost in these industries between December 2000 and December 2001; this meant that 17% of the jobs that had existed as of late 2000 were eliminated. Other countries in the region also saw maquila businesses fold, which also hurt wage employment. Employment in construction contracted as well (by 0.8% regionwide). This sector's performance was quite uneven, however, as the regional figure was heavily influenced by job losses in Argentina and Brazil, while in many other countries construction employment posted moderate gains.

Taking the region as a whole, job creation was confined to the tertiary sector, mainly in basic services (3.3%), community, social and personal services (2%), and, to a lesser extent, in the commerce, restaurants and hotels segment (1.5%). In some countries in Central America and the Caribbean, for example, the downturn in tourism that occurred late in the year affected employment in restaurants and hotels. The financial services, insurance, real estate and business services subsector, which was a dynamic job creator in the 1990s, posted its second straight year of job losses (-1.2%). This may partly be the result of a slowdown among new business services and restructuring in the financial sector.

Labour productivity declined in all branches of activity with the exception of the farming and stock-raising sector and the financial services, insurance, real estate and business services industries.

5. But unemployment failed to rise, since labour participation was also lower

The labour force participation rate declined quite sharply, falling from 58.2% to 57.5% (see table II.11). This was essentially a reaction to the sluggish demand for labour, since many people felt it was not worth looking for work, either because they had been unsuccessful in the past or because available information suggested there were no vacancies. Another factor that tended to reduce the participation rate in several countries (especially Ecuador) was the steady emigration of working-age people.

Despite long-standing assumptions to the contrary, it is increasingly erroneous to identify the secondary labour force with female workers. Although there may be opposing trends in this regard –increasing numbers of women entering the labour market on a permanent basis, versus a segment of the secondary labour force consisting of women– in most countries more men than women withdrew from the labour market. In fact, of six countries that reported a drop in the total participation rate, the reduction was greater among men in three (Brazil, Dominican Republic and Mexico), was similar for men and women in two (Chile and Ecuador) and was greater among women in only one (Argentina) (see table II.12).

[8] See *Fundação Sistema Estadual de Análise de Dados* (SEADE), *Sensor Rural*, various editions.

Table II.11

LATIN AMERICA AND THE CARIBBEAN: LABOUR MARKET INDICATORS, 1991-2001

	1991	1995	1997	1998	1999	2000	2001 [a]
Unemployment							
- Weighted average	6.1	7.5	7.5	8.1	8.8	8.4	8.4
- Simple average	9.6	10.1	9.9	9.7	10.3	10.1	10.3
Total participation rate							
- Weighted average	57.8	58.0	58.0	58.3	57.9	58.2	57.5
- Simple average	55.6	56.8	57.1	58.2	58.0	57.7	58.0
Male participation rate [b]	73.3	72.9	73.0	73.4	72.7	71.9	71.7
Female participation rate [b]	36.7	38.9	76.3	41.4	41.8	42.0	42.3
Employment rate [c]							
- Weighted average	54.5	53.7	53.7	53.5	52.6	53.3	52.7
- Simple average	51.2	51.8	52.0	52.7	51.9	51.8	51.8
Real average wage [d]	88.2	100.0	100.8	103.0	104.4	105.7	107.3
Real minimum wage [d]	99.4	100.0	98.8	102.0	103.2	104.1	105.4

Source: ECLAC, on the basis of official figures; see electronic statistical appendix.

[a] Preliminary figures. [b] Simple average. [c] 12 countries. [d] Median. 1995=100.

Table II.12

LATIN AMERICA AND THE CARIBBEAN (10 COUNTRIES): LABOUR MARKET INDICATORS BY COUNTRY, 2000 AND 2001

	Employment rate		Participation rates						Real average wage [a]		Real minimum wage [a]	
			Total		Male		Female					
	2000	2001[b]	2000	2001[b]	2000	2001[b]	2000	2001[b]	2000	2001[b]	2000	2001[b]
Argentina	36.2	35.2	45.2	44.8	55.9	55.8	35.6	34.8	101.6	100.2	100.5	101.6
Bolivia	51.7	...	55.9	...	65.0	...	47.8	...	114.8	119.4	126.8	140.5
Brazil	53.8	52.9	58.0	56.4	72.7	71.0	45.2	43.9	104.8	99.6	116.1	126.6
Chile	48.8	48.1	53.7	52.9	73.3	72.5	34.9	34.0	113.7	115.5	133.2	138.3
Colombia	52.6	52.5	63.5	64.2	73.8	74.3	54.8	55.6	110.0	109.7	104.2	105.4
Costa Rica	50.8	52.4	53.6	55.8	72.8	73.7	35.0	38.6	110.1	112.3	111.1	111.3
Ecuador	48.8	49.8	56.8	55.6	68.3	67.0	46.0	44.7	86.4	97.2	84.6	94.3
El Salvador	48.7	49.6	52.2	53.3	67.7	69.2	38.7	39.5	...	...	95.4	91.9
Guatemala	...	...	...	...	...	...	...	...	128.2	128.9	103.7	121.2
Haiti	...	...	...	...	...	...	...	...	...	...	51.4	45.4
Honduras	...	53.4	...	53.1	...	71.6	...	36.3	...	...	114.7	121.3
Mexico	55.1	54.2	56.3	55.6	74.8	73.8	39.5	38.8	98.0	104.1	88.6	89.0
Nicaragua	...	...	...	...	...	...	...	...	111.3	116.1	...	...
Panama	51.8	51.6	59.9	60.3	78.8	79.4	41.6	41.4	...	...	113.6	121.8
Paraguay	56.5	53.2	62.8	59.6	75.1	71.6	52.6	49.1	99.9	101.3	105.8	109.5
Peru	59.7	62.3	64.4	67.7	77.3	78.3	52.8	58.0	91.8	90.4	215.6	218.2
Dominican Republic	47.5	45.8	55.2	54.3	70.4	69.2	40.6	40.0	...	...	111.4	117.5
Uruguay	51.6	51.4	59.7	60.8	71.9	72.2	49.3	51.0	102.9	102.7	96.9	95.6
Venezuela	55.7	57.6	64.6	66.5	81.9	82.0	47.3	50.9	90.5	96.7	86.1	86.4

Source: ECLAC, on the basis of official figures; see electronic statistical appendix.

[a] Index 1995=100. [b] Preliminary figures.

Moreover, in most countries that reported an increase in labour-force participation, the rate increased more among women than among men; accordingly, as a regional average, the gender gap between male and female labour-force participation rates continued to narrow, as the participation rate for men fell slightly, measured as a simple average, while the corresponding figure for women increased (see table II.11).

The drop in the participation rate was a continuation of the declining trend that had first appeared in 1998. This would be a positive development if it were mainly because young people were spending longer in the education system but, in view of the weak demand for labour, it is more likely that the decrease reflects discouragement at the lack of job opportunities and therefore represents an increase in hidden unemployment.

Since the decline in employment was offset by a withdrawal of workers from the labour market, the regional unemployment rate held steady at 8.4%, which is quite high when compared to historical levels over the long term. This result represented a departure from the prevailing trend of the last 10 years since, if that trend had persisted, the economic growth rate –0.4%– recorded for 2001 could have been expected to push the unemployment rate up by nearly one percentage point.[9]

The regional out-turn was heavily influenced by a downward trend in unemployment in Brazil which lasted through the first three quarters of the year and reduced joblessness by nearly one percentage point. Although this generally occurred within a low-growth context, the largest reduction in unemployment regionwide (Ecuador) partly reflected a recovery in economic activity. Relatively high economic growth rates helped to reduce unemployment in some Caribbean countries as well, especially in Belize and in Trinidad and Tobago. In contrast, unemployment rose by one percentage point or more in Argentina, Colombia, Panama and Uruguay, thereby aggravating an already difficult situation, since unemployment in these countries has stood at double-digit levels for several years.

As discussed above, the stability of the unemployment rate and its consequent divergence from the trend in economic growth were the result of a steep drop in the participation rate. The discussion on labour-force participation and unemployment presented in chapter III shows that this household reaction to reduced job opportunities is nothing new, although it was more marked in 2001 than in the past.

6. Despite weaker labour demand, wages rose moderately

At the regional level, real average wages in the formal sector rose by 1.5% (the median for 14 countries). The two largest economies in the region were at opposite extremes of the wage-trend spectrum. In Brazil, average wages for workers with labour contracts fell by 5% in real terms, in the midst of sluggish economic activity and accelerating inflation. In contrast, real wages in Mexico's manufacturing sector climbed by 6%, despite shrinking demand.

Real wages rose by modest amounts in most other countries, including Bolivia, Chile, Costa Rica, Nicaragua and Paraguay, but they fell in Argentina and Peru and remained flat in Colombia and Uruguay.

The fact that real wages increased, albeit moderately, within a context of sluggish economic activity and weak labour demand, is mainly due to the combination of lower inflation and the relative short-term rigidity of nominal wages. Although GDP growth and labour productivity are decisive in determining the behaviour of real wages in the long run, falling inflation was the only explanation for higher real wages in 2001. Other potential explanatory variables –such as economic growth in the current and previous year, and variations in labour productivity– had no significant impact on real wages during the year.

When wage levels are set by means of collective bargaining processes, they usually take account of inflation (either past inflation or the projected rate for the coming period), along with other variables such as productivity trends. Real wages rise when inflation is falling, especially when their calculation was based on past inflation rates. When wage levels are set on the basis of projected inflation, real wages may also rise if the actual increase in consumer prices undershoots the projected rate, as happened in many countries in 2001 as their economies cooled down.

[9] See ECLAC, *Economic survey of Latin America and the Caribbean, 2000-2001* (LC/G.2139-P), Santiago, Chile, September 2001.

Since labour contracts establish terms and conditions for a fixed period, it is not easy to adjust wages before the contract in question expires. This affects aggregate data, especially in the formal sector, where the terms and conditions of employment in large segments of the labour force are determined through collective bargaining processes. Consequently, the predominance of sluggish economic activity and a resurgence of inflationary processes in some countries make it unlikely that in 2002 real wages will behave as they did in 2001.

Movements in real minimum wages reflected the same factors that influenced average wages. In many countries minimum wages are also adjusted once a year, generally in line with expected inflation. Some countries make irregular adjustments, however, that result in longer periods of real-wage erosion interspersed with years when both nominal and real wages climb. In 2001, real minimum wages rose by 1.2% (the median for 19 countries), thereby maintaining the trend of the last two years; Bolivia, Brazil, Ecuador and Guatemala all posted increases of 9% or more. In the two latter countries, however, these increases only partly made up for the heavy losses incurred in earlier years. In most countries, the upward movement in wages was more modest, and in El Salvador, Haiti, Nicaragua and Uruguay minimum wages actually fell in real terms. In the first three of these countries there were no nominal increases, while in Uruguay the nominal minimum wage was raised by slightly less than inflation.

C. THE EXTERNAL SECTOR

Trade was the main channel through which the sharp slowdown in the world economy was transmitted to Latin America and the Caribbean. Given the abrupt drop in external demand and a widespread deterioration of the terms of trade, export earnings sagged in most countries. The corresponding impact on domestic demand led to cutbacks in import expenditure in many cases. Under these conditions, the merchandise trade balance turned negative again, and the regional trade deficit worsened further.

In addition, there was a slight increase in the regional deficit on the factor income account. This deficit stemmed from a decline in the amount of interest received owing to cuts in international rates and an increase in the interest being paid out due to wider spreads; moreover, the decrease in profit remittances, whose upward trend was interrupted, was not large enough to offset these variations. In contrast, current transfers, consisting mainly of remittances sent by residents in the United States, maintained their upward course, mainly thanks to the increases recorded in Colombia and Mexico. Such inflows continued to be particularly important in the Central American countries and in Bolivia and Ecuador.

These factors conspired to widen the current account deficit on the balance of payments to US$ 51 billion (the equivalent of 2.7% of regional GDP), compared to US$ 46 billion (2.4% of GDP) a year earlier. The bulk of the increase is accounted for by a reduction of over 50% in the current account surplus in Venezuela, which was partly offset by a narrowing of the deficit in Argentina. Most countries recorded deficits of under 4% of GDP, except for Bolivia and a number of Central American and Caribbean countries.

Net autonomous capital inflows shrank by nearly half and proved insufficient to finance the region's current account deficit. For the third year running it was impossible to avoid using gross flows (even including compensatory capital) in their entirety to pay external debt service and earnings on foreign capital, thereby giving rise to a negative net resource transfer (see chapter III). This situation was mainly caused by massive capital outflows from Argentina and Venezuela, which were not offset by the appreciable inflows recorded in Mexico.

Table II.13
LATIN AMERICA AND THE CARIBBEAN: BALANCE OF PAYMENTS INDICATORS

	1993	1994	1995	1996	1997	1998	1999	2000	2001[a]
				Billions of dollars					
Current account balance	-45.3	-51.6	-37.2	-38.5	-64.7	-87.7	-54.9	-46.2	-51.3
Capital and financial account balance [b]	70.4	41.8	28.6	68.2	85.1	69.5	49.2	60.9	32.9
Overall balance	16.9	-15.4	-19.8	29.7	20.5	-18.2	-5.7	14.7	-18.4
Reserves and related items	-16.9	15.4	19.8	-29.7	-20.5	18.2	5.7	-14.7	18.4
Reserve assets [c]	-11.2	10.9	-12.1	-26.8	-16.4	9.5	5.9	-7.0	1.2
IMF loans and exceptional financing	-4.2	4.9	31.4	-2.7	-3.6	8.7	-0.2	-7.7	17.2
				Percentages					
LIBOR (nominal)	3.4	5.1	6.1	5.6	5.8	5.5	5.5	6.6	3.7
LIBOR (real)	0.6	2.7	3.5	3.2	3.7	4.1	4.1	4.1	0.9
Yield on United States government bonds	5.9	7.1	6.6	6.5	6.4	5.3	5.6	6.0	5.0

Source: ECLAC, on the basis of figures from official sources and the International Monetary Fund (IMF).
[a] Preliminary figures. [b] Includes errors and omissions. [c] A minus sign indicates an increase in reserve assets.

Table II.14
LATIN AMERICA AND THE CARIBBEAN: INTRAREGIONAL AND TOTAL EXPORTS
(Millions of dollars and percentage shares)

	1990	1995	1996	1997	1998	1999	2000	2001 [a]
Mercosur								
Within Mercosur	4,127	14,451	17,115	20,478	20,027	15,164	18,078	15,168
World	46,403	70,129	74,407	82,596	80,227	76,305	85,692	89,078
Mercosur / world(%)	8.9	20.6	23.0	24.8	25.0	19.9	21.1	17.0
Andean Community								
Within Andean Community	1,324	4,859	4,698	5,621	5,411	3,940	5,370	5,680
World	31,751	39,134	44,375	47,933	38,896	44,603	60,709	53,543
Andean Community / world (%)	4.2	12.4	10.6	11.7	13.9	8.8	8.8	10.6
LAIA [b]								
Within LAIA	12,302	35,552	38,449	45,484	43,231	34,776	43,195	40,600
World	112,694	204,170	229,164	256,714	251,345	264,235	332,565	320,925
LAIA / world (%)	10.9	17.4	16.8	17.7	17.2	13.2	13.0	12.7
CACM								
Within CACM	624	1,451	1,553	1,863	2,242	2,333	2,545	2,981
World	4,435	9,244	9,928	11,729	11,077	11,633	11,242	9,782
CACM / world (%)	14.1	15.7	15.6	15.9	20.2	20.1	22.6	30.5
CARICOM [c]								
Within CARICOM	469	690	775	785	859	957	1,087	…
World	3,634	4,511	4,595	4,687	4,651	5,182	6,132	5,816
CARICOM / world (%)	12.9	15.3	16.9	16.7	18.5	18.5	17.7	..
Latin America and the Caribbean [d]								
Intraregional	16,802	42,740	46,562	54,756	51,674	42,624	57,858	51,970
World	120,572	216,031	243,687	273,130	267,073	281,050	349,939	336,523
Region / world (%)	13.9	19.8	19.1	20.0	19.3	15.2	16.5	15.4

Source: ECLAC, on the basis of official figures.
[a] Estimates. [b] Includes maquila exports from Mexico as from 1992. [c] Includes Barbados, Guyana, Jamaica, and Trinidad and Tobago. [d] Includes CACM, LAIA, Barbados, Guyana, Jamaica, Panama and Trinidad and Tobago. Trade within each subregion was estimated on the basis of official figures from the respective grouping.

1. The global environment was particularly unfavourable

The slowdown in the world economy, where growth dropped from 4% in 2000 to 1.3% in 2001 (the lowest rate in the last 10 years), drove down the volume of international trade by nearly 1%, following the steep increase of 12% posted the year before. The situation was reflected in a sharp reduction in shipments from Latin America and the Caribbean. The region as a whole was hurt, in particular, by the synchronized pattern of economic growth seen in the main regions of the developed world: United States (1.1%), Japan (-0.3%) and the European Union (1.6%).

Weaker global demand also fed into the prices of the commodities that are most sensitive to variations in economic activity, namely raw materials. Although in 2000 many of these products had begun to approach their pre-Asian crisis levels, in 2001 they lost all or most of the ground they had regained; others, however, had never rebounded from that crisis in the first place. Minerals and metals exported from the region decreased by 9% overall between 2000 and 2001, with double-digit downswings in the cases of zinc, tin, silver, copper and steel products.

The region's two most important export products were especially hard-hit. Crude oil prices fell by a quarter from the previous year's highs, while coffee prices plummeted once more, this time by 30%. This further decrease came on the heels of four consecutive years during which coffee prices have spiraled downward due to excess production and a build-up of stocks on the world market.

Foodstuffs were the only category in which prices continued to recover. In this category, the rise in average prices for the year was at least sufficient for them to regain their level of five years earlier. Bananas (on the free market) marked up the largest increase, followed by beef, wheat (although it was still trading well below its pre-Asian crisis prices) and sugar (a very important product for many Caribbean countries). The prices of agricultural raw materials, which are subject to supply forces that vary from product to product, followed an erratic trend that attested to the extreme volatility of commodity prices. Steep falls, especially in the case of wood pulp, coexisted with significant upturns, for such products as cowhides and fishmeal.

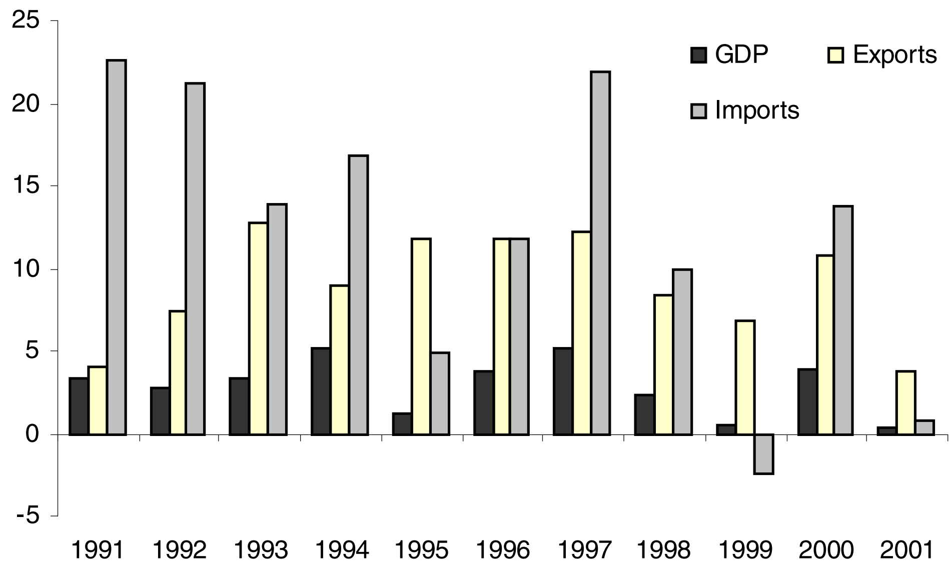
Average prices of developed countries' exports of manufactures also declined by 2.3%, which, among other things, helped to lower the cost of the region's imports. These lower prices, which were associated with a lack of inflationary pressures in those countries, made it possible for them to apply expansionary monetary policies with countercyclical aims. A particularly aggressive policy stance of this sort was adopted in the United States, where interest rates were lowered by a total of 4.75 percentage points in 2001; this move clearly had a knock-on effect on Latin America's floating-rate debt service.

2. The region's external trade generally contracted

In this recessionary global climate, most of the region's countries saw either slower growth or an outright reduction in their export volumes, and none escaped the trend towards lower average prices for their international sales, which fell by an average of over 7%. As a result, export earnings (from both goods and services) were less than US$ 392 billion for the region as a whole, or nearly 4% below the 2000 figure.

The Central American countries and the main hydrocarbon exporters suffered the most. In addition to tumbling coffee and oil prices, Mexico and the countries of the Caribbean basin were also hurt by sagging demand in the United States, on which they rely as a market for their exports of manufactured goods and tourism services. Tourism-based economies also suffered, in particular, from the effects of the September 11 terrorist attacks in the United States. During that month, many countries saw visitor arrivals drop by between 20% and 60%, and several national airlines were forced to suspend flights because of a lack of passengers. Income from travel fell sharply during 2001 in most of the Caribbean basin countries, including Venezuela, as well as in the member countries of MERCOSUR.

Figure II.13
LATIN AMERICA AND THE CARIBBEAN: INCREASE IN VOLUME OF MERCHANDISE TRADE AND GDP GROWTH
(Percentages)



Source: ECLAC, on the basis of official figures.

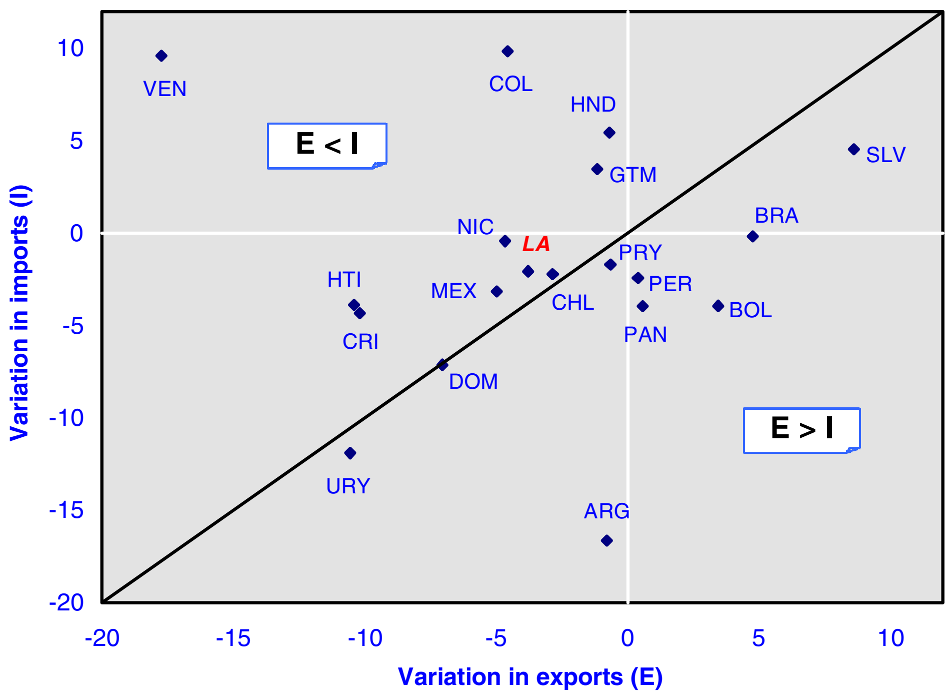
Brazil was one of the few economies to increase its earnings from merchandise exports, although by much less than it had the previous year. Its gains were based on a substantial increase in shipments (up by 9%), and were matched only by the increases recorded in Bolivia and Peru. These results were influenced by the adjustment in the Brazilian economy, which was accomplished chiefly through a depreciation of the *real*, and the expansion of mining activities in Bolivia and Peru.

The sluggishness of economic activity in most countries was accompanied by a reduction in import volumes everywhere except in Colombia and Honduras, which recorded double-digit growth. Imports in Ecuador climbed even more sharply (by nearly 50%), but this occurred against the backdrop of a strong expansion in demand and output, strengthened by a real appreciation of the local currency. In the region as a whole, the volume of merchandise imports was virtually flat, a far cry from the 14% increase recorded in 2000. Because of the price decreases that affected all the countries (the average price decline for the region as a whole amounted to 3%), the value of their imports of goods and services dropped below US$ 412 billion, 2% less than the preceding year's figure.

In the countries of the Andean Community and the Central American Common Market (CACM), intraregional trade served to mitigate the slowdown in trade with countries outside the region, as trade among the member countries expanded in both groups (by 10% and 17%, respectively). As their total export values also fell, the share of total exports represented by intraregional transactions rose to 11% in the Andean Community and to over 30% in CACM. The latter thus consolidated its position as the scheme with the largest percentage of intra-group trade; this trend was also strengthened by the steep drop in its member countries' exports to the United States.

The situation was just the opposite in MERCOSUR, where intra-group trade shrank by 16% while exports to countries outside the region grew. Trade among MERCOSUR members thus fell to 17% of the total in 2001.

Figure II.14
LATIN AMERICA AND THE CARIBBEAN: VALUE OF TRADE IN GOODS AND SERVICES, VARIATION 2000-2001
(Percentages)

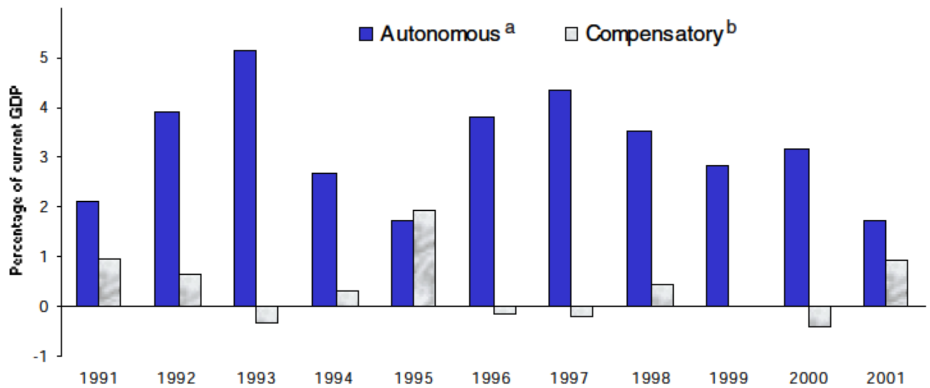


Source: ECLAC, on the basis of official figures.

3. External capital inflows were smaller and more volatile

Latin America's autonomous capital inflows in 2001 heightened this variable's instability in the region and continued to be associated with episodes of volatility. Capital inflows amounted to just US$ 32 billion –a drastic retrenchment compared to the US$ 61 billion that entered the region in 2000. The 2001 inflow was equivalent to 1.7% of GDP, which was similar to the rate in 1995 (a year marked by the Mexican financial crisis), but far below the 1999 figure of 2.8%, when the region was suffering from the effects of the Russian moratorium (see figure II.15). Nonetheless, two countries –Argentina and Brazil– had an overwhelming impact on this outcome; in fact, if they were to be factored out of the calculations, then the figures for capital inflows into the region would actually have increased.

Figure II.15
LATIN AMERICA AND THE CARIBBEAN: NET CAPITAL INFLOW



Source: ECLAC, on the basis of figures from official sources and the International Monetary Fund (IMF).
[a] Autonomous: Balance of financial and capital account; includes errors and omissions. [b] Compensatory: IMF loans and exceptional financing.

The main source of capital inflows was FDI, which maintained its trend of the last few years. In the case of portfolio investment, the previous year's slide was halted, but flows of bonds and bank loans diminished sharply. This was mainly caused by a striking US$ 25 billion turnaround in Argentina, together with a massive capital outflow from Venezuela and significantly smaller flows into Brazil. To compensate for these reductions, the International Monetary Fund (IMF) made an unprecedented US$ 16 billion in disbursements, almost all of which went to Argentina and Brazil. Meanwhile, large volumes of capital continued to flow into Mexico, thanks to high domestic interest rates and cuts in United States rates during 2001; in Colombia, foreign inflows rebounded, while Ecuador reversed the resource outflow of 2000. In most other countries, capital inflows were much the same as they had been in 2000.

At US$ 67 billion, net FDI flowing into the region remained in the same range as in 2000. This result was made possible by the one-off flow of capital entering Mexico in connection with the privatization of Banamex (US$ 12.5 billion) and by the fact that outward foreign investment was practically non-existent in 2001. If the above operation is factored out of the calculations, then FDI flows into the region fell by 10%. The decline in investment flows to other countries, which was , compounded by the repercussions of the global slowdown, was due, among other things, to the fact that most of the State assets which were suitable for privatization have already been sold. The slackening of FDI flows was most notable in Argentina, Brazil and Venezuela. In contrast, Ecuador and Mexico received an unprecedented volume of investment, Chile more than made up for the previous year's negative result and the Dominican Republic maintained the high levels it has posted in recent years.

Equity capital flows were highly erratic, but the downward trend of 2000 was halted late in the year. The regional total was very modest, although, encouraged by the appreciation of the peso, substantial sums flowed into Mexico. On average, stock markets elsewhere in the region registered a small net outflow of equity capital. This trend was reflected in stock market indices, and, despite ups and downs, by late 2001 the regional index of share prices was around 15% lower than it had been the year before.

Argentina's sovereign debt placements amounted to US$ 1.5 billion in the first quarter alone. Unable to obtain financing on voluntary debt markets, in June the Argentine Government carried out a US$ 30 billion swap operation to alleviate the burden of public-debt service in 2002-2003. This transaction involved onerous interest rates, however, and in the following months the country found that it had no access to voluntary debt markets. In November, the Government proposed a global public-debt restructuring plan at a maximum annual interest rate of 7%, but this proved unviable because its sovereign debt had been trading at a steep discount since June. In December the Government finally declared a unilateral moratorium on its external public debt.

Table II.15

LATIN AMERICA AND THE CARIBBEAN: NET FOREIGN DIRECT INVESTMENT [a b]

(Millions of dollars)

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Latin America and the Caribbean	**12,546**	**10,378**	**24,185**	**25,299**	**40,032**	**55,876**	**60,799**	**79,757**	**66,763**	**67,234**
Argentina [c]	3,265	2,089	2,622	4,111	5,349	5,508	4,968	22,633	10,654	3,304
Bolivia	91	125	147	391	472	728	952	983	693	647
Brazil [d]	1,924	801	2,035	3,475	11,666	17,877	26,002	26,888	30,498	24,894
Chile [e]	538	600	1,672	2,205	3,681	3,809	3,144	6,203	-348	3,045
Colombia	679	719	1,298	712	2,784	4,753	2,033	1,352	2,051	2,074
Costa Rica	222	243	292	331	421	402	607	614	404	441
Ecuador	178	469	531	452	500	724	870	648	720	1,330
El Salvador [f]	15	16	-	-	-	59	1,103	162	178	277
Guatemala	94	143	65	75	77	85	673	155	230	456
Haiti	-2	-2	-3	-2	4	4	11	30	13	4
Honduras	48	52	42	69	90	128	99	237	262	195
Mexico [g]	4,393	4,389	10,973	9,526	9,185	12,830	11,602	12,476	14,190	24,730
Nicaragua	42	40	40	75	97	173	184	300	265	132
Panama	139	156	411	267	410	1,300	1,219	652	603	250
Paraguay	118	75	138	98	144	230	336	89	74	152
Peru	150	687	3,108	2,048	3,242	1,697	1,880	1,969	681	1,100
Dominican Republic	180	189	207	414	97	421	700	1,338	953	1,198
Uruguay	-	102	155	157	137	113	155	238	284	319
Venezuela	473	- 514	455	894	1,676	5,036	4,262	2,789	4,357	2,684

Source: ECLAC, on the basis of figures from official sources and the International Monetary Fund (IMF).

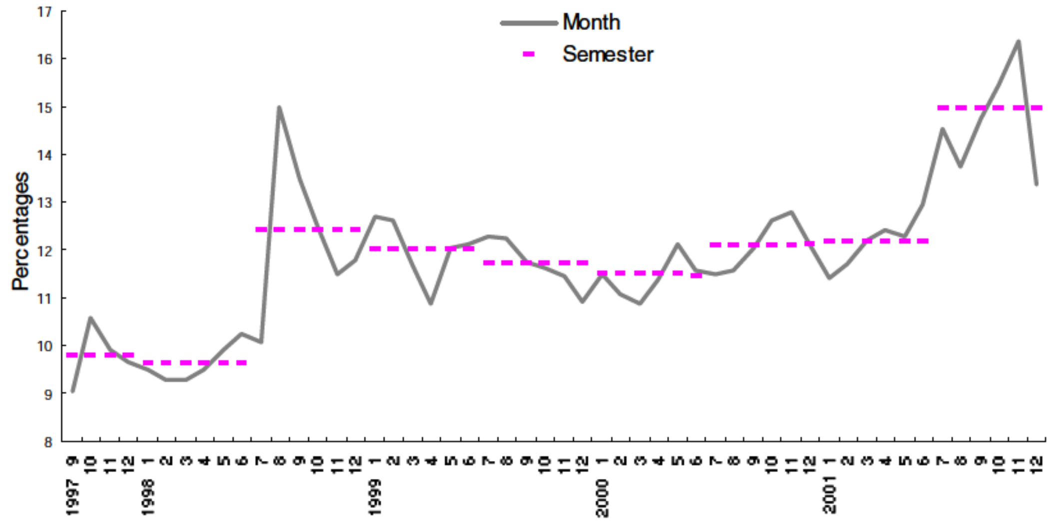
[a] Refers to direct investment in the reporting country minus direct investment abroad by its residents. This information is not available for some countries. Includes reinvestment of profits. [b] According to the fifth edition of the IMF Balance of Payments Manual, all transactions between non-financial direct investment enterprises and their parent companies and subsidiaries are included as direct investment. [c] Net FDI in Argentina included substantial portfolio investment swap operations in 1999 and 2000; excluding these, net FDI was US$ 13.3 billion and US$ 6.3 billion in those years, respectively. [d] In 2001, this includes US$ 3.1 billion repatriated by Banco do Brasil from abroad in respect of gains arising from Brady bond swap operations. It also includes US$ 1 billion corresponding to a credit granted by a subsidiary to its parent company abroad (c.f. note b/ to this table). [e] Includes almost US$ 5 billion of FDI abroad in 1999 and 2000. [f] The Central Reserve Bank of El Salvador has maintained systematic records on FDI since 1998. [g] In 2001 this includes a US$ 12.5 billion investment in BANAMEX by Citigroup.

In contrast, by the middle of the year most other governments in the region had met their targets for public debt placements on international markets. The largest borrowers were Brazil, Colombia and Mexico, although Costa Rica and El Salvador also floated issues. Following the events of 11 September, the Governments of Chile, Mexico and Uruguay took advantage of their investment-grade rating and issued bonds in anticipation of external financing for 2002. The Governments of Colombia, the Dominican Republic and Guatemala also issued debt paper, but at higher interest rates. Placements by private enterprises in the region were few and far between, as risk-averse investors preferred sovereign debt securities.

4. Foreign borrowing terms and relative debt levels changed very little

The foreign borrowing terms that were on offer before the outbreak of the Asian crisis were not reinstated; average maturities hovered around seven years, and the cost of external financing fluctuated around 15% per year in late 2001 (see figure II.16). This partly reflected the deep discount at which Latin American external debt was trading on the secondary market, particularly in the case of Argentine securities and, to a lesser extent, those from Brazil. For all the countries except these two borrowers, the average cost varied little, generally

Figure II.16
LATIN AMERICA: BOND YIELDS ON THE SECONDARY MARKET [a]



Source: ECLAC, on the basis of figures provided by J.P.Morgan.
[a] Weighted average of eurobonds issued by Argentina, Brazil, Chile, Colombia, Mexico, Panama, Uruguay and Venezuela.

holding steady at 11% per year; this was nonetheless quite high, since wider spreads offset the substantial cuts made in United States Treasury bond rates in 2001. In December, the countries witnessing the most serious deterioration in borrowing terms were Argentina (where borrowing costs were triple their late-2000 level of 12%) and Brazil (where they rose by 100 basis points from 12.5% to 13.5%). In contrast, borrowing terms for Colombia improved from 13% to 10% and were additionally favoured by narrower spreads. The countries with the lowest external financing costs in late 2002 continued to include Chile, Mexico and Uruguay.

Latin America's gross disbursed external debt decreased to US$ 730 billion in 2001 from US$ 745 billion the year before. Argentina and Brazil achieved nominal reductions of around 4.5%, whereas Colombia, the Dominican Republic, El Salvador and Panama saw their external liabilities grow by over 10% in the course of the year. The remaining countries saw only small variations in external debt levels.

Since the level of debt declined by the same proportion as exports, the external debt burden (as measured by the ratio between these two variables) remained constant at 180% for the region as a whole. In 2001, this indicator worsened for Colombia, Ecuador, Uruguay and Venezuela. Among the most heavily indebted countries, the debt/export ratio fell to 330% in Brazil and Peru and to 450% from an average of 500% during 1999-2000 for Argentina; in Nicaragua the figure held steady at 700%.

The external debt/GDP ratio rose from 37.5% to 39% for the region as a whole, despite a nominal fall in external liabilities. This occurred because current regional output shrank as a result of a reduction in GDP (measured in dollars) in several countries following steep devaluations. Ecuador, Honduras and Nicaragua were among the countries that succeeded in maintaining high debt/GDP ratios.

Table II-16
LATIN AMERICA: INTERNATIONAL BOND ISSUES

	1996	1997	1998	1999	2000	2001
	A. Maturity of new issues (years)					
	7.8	**15.4**	**8.5**	**6.9**	**9.9**	**7.9**
Argentina [a]	8.2	13.5	10.6	7.6	11.8	9.8
Brazil [b]	6.5	16.5	7.9	5.3	10.9	5.3
Chile	7.3	35.6	11.0	9.7	6.1	10.4
Colombia	6.9	15.0	7.9	7.5	11.2	8.4
Costa Rica	-	-	…	10.0	20.0	-
Ecuador	-	5.0	-	-	-	-
Mexico	7.4	9.4	9.1	10.0	7.4	10.5
Panama	-	19.6	-	30.0	-	10.0
Uruguay	-	30.0	5.0	10.0	7.7	8.9
Venezuela	7.0	30.0	20.0	…	5.0	8.0
	B. Spread (Differential between the yield on the bonds issued and the yield on United States Treasury bonds of similar maturities, 100 basis points = 1%)					
Region	**370**	**285**	**500**	**585**	**503**	**834**
Argentina	383	298	441	594	536	973 [c]
Brazil [b]	358	327	541	646	562	855
Chile	86	96	235	269	250	270
Colombia	188	140	409	563	626	579
Costa Rica	-	-	…	409	…	-
Ecuador	-	470	-	-	-	-
Mexico	393	263	329	413	275	406
Panama	-	219	-	420	-	430
Uruguay	-	135	345	309	-	291
Venezuela	440	325	780	770	-	84

Source: ECLAC, on the basis of figures from official sources and the World Bank, J.P.Morgan and Merrill Lynch.
[a] In 2001 this corresponds to the average maturity of public-debt securities after the June swap. [b] Until 2000, includes operations authorized, even if not carried out. [c] June.

Chapter III

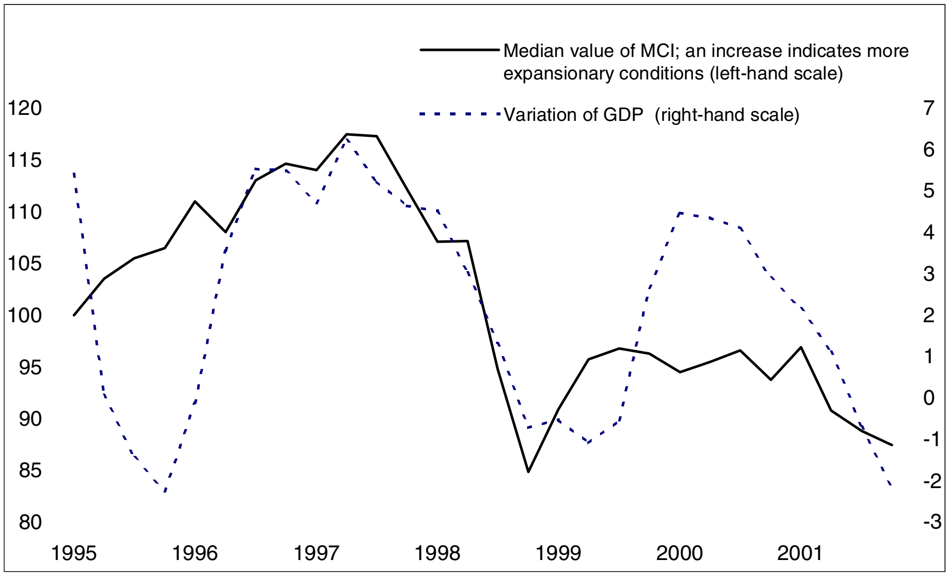
THE MACROECONOMICS OF DEVELOPMENT: SELECTED ISSUES

This chapter reviews a number of specific issues that are particularly germane to the ongoing crisis in the region. These issues range from the crisis' effect on unemployment to the constraints facing exchange-rate, monetary and fiscal policies, and their response potential. An introductory section on macroeconomic policy limitations is followed by others which address the following issues: external constraints (sections on broad macroeconomic equilibria and net external resource transfers); the new orientation of monetary and exchange-rate policies (sections on inflation targeting, the convertibility regime in Argentina and the effect of exchange-rate depreciation on inflation); and the influence of the business cycle on unemployment rates (a section on labour-market participation and unemployment). These sections are not arranged in any particular order and are not linked to one another apart from the fact that they all relate to the same broad subject.

1. Macroeconomic policy constraints in Latin America and the Caribbean

Given the current economic situation, in which the region is suffering from the recessionary impact of a sharp slowdown in the world economy, there is a clear contrast between the developed countries, which have applied countercyclical macroeconomic policies, and the Latin American countries, where such policies have faced major obstacles. In fact, macroeconomic policies in the region have often turned out to be procyclical (see figure III.1). This observation raises questions about the flexibility of economic policy in the different phases of the business cycle.

Figure III.1
LATIN AMERICA AND THE CARIBBEAN: GDP GROWTH AND VARIATION OF MONETARY CONDITIONS INDICATOR (MCI), LEADING COUNTRIES



Source: ECLAC, on the basis of official figures.

Some of the limitations of macroeconomic policy have been known about for a long time. Monetary policy has well-known asymmetric effects since –as noted by certain schools of thought– although a contraction in the money supply leads to a parallel reduction in nominal gross domestic product (GDP), a monetary expansion does not automatically generate a concomitant increase in nominal GDP. In situations of price deflation and sluggish economic activity, efforts to revive the economy by expanding bank credit may prove fruitless in the face of anaemic demand and a possible crisis in financial institutions struggling to deal with payment arrears on the part of businesses and consumers.

Situations of this kind reverberated throughout Latin America in 2001, as various countries attempted to resuscitate their depressed economies. In Mexico, Peru and Bolivia, the interest-rate cuts that accompanied expansions of the monetary base failed to prevent real domestic credit from shrinking, while economic activity stagnated. Elsewhere, domestic credit grew by less than the monetary base owing to the cautious attitude and vulnerability of banks (reflected in burgeoning non-performing loan portfolios and larger spreads between lending and borrowing rates in most countries), compounded by weak demand for credit.

Fiscal policy, which has been applied successfully since the Great Depression, also has its limitations. This fact became clear in the 1970s, when attempts by industrialized countries to cool down their economies via expenditure cuts and tax hikes ran up against political obstacles that were virtually impossible for democratically elected governments to overcome. These obstacles have also become familiar in Latin America, particularly since the spread of democracy in the region, and have given rise to a "political cycle" of economic activity that often surfaces during electoral periods.

If these constraints on macroeconomic policies in the different phases of the business cycle are relevant in Latin American countries, equally important are those that arise in opposite phases, namely, limitations on the efficacy of monetary policy in cooling the economy and of fiscal policy in reviving it. The European Union's macroeconomic convergence rules are a modern version of restrictions of this type, since they place an upper limit on permissible fiscal deficits for members of the monetary union. More generally, new limitations arise from the openness of today's economies, which has become a focus of analysis within international macroeconomics. These constraints are especially relevant in Latin America today, given the current framework of globalization, financial account liberalization and massive, volatile international capital movements.

The 1990s abound in relevant examples. The widely touted efficacy of monetary policy was called into question when, at the outbreak of the Asian crisis, runaway booms in domestic spending were financed by massive foreign-capital inflows in many countries of the region. The monetary tightening measures deployed to counteract the expansionary effect of such inflows on domestic liquidity were overwhelmed by the sheer volume of external funds available, and the result was a combination of interest-rate hikes and currency appreciation that encouraged capital inflows still further. A number of countries, including Colombia and Chile, imposed restrictions on such inflows, particularly short-term ones, in an attempt to avoid becoming ensnared in a similar vicious circle.

The situation today is just the opposite in a fundamental respect, since capital abundance has given way to shortage. Moreover, exchange-rate regimes have evolved into more or less free-floating systems, with the major exception, until recently, of the currency-board system in Argentina (which, by 2002, had been consigned to history, as outlined later in this chapter) and the dollarization scheme being implemented in Ecuador. The abandonment of fixed exchange rates ought to afford greater flexibility to monetary policy, and this has led several countries to adopt intervention criteria based on explicit inflation targets (also described below). In some cases this has been reinforced by an apparently weak pass-through from exchange-rate variations to domestic prices (the subject of the final section of this chapter).

Nevertheless, the effectiveness of monetary policy has not improved dramatically and remains subject to the vagaries of international capital movements. When monetary policy should have been expansionary, exchange-rate pressures have often forced a tightening to avert the risk of excessive currency devaluation. Recent examples of this familiar scenario can be found in Argentina, Colombia, Paraguay, Uruguay and Venezuela, all of which raised interest rates in 2001 while their economies were in recession.

The effectiveness of fiscal policy has also been limited during the downswings of the business cycle. As is illustrated by the current crisis, the fiscal authorities garner less tax revenue during economic slowdowns, and this is often compounded by lower earnings from commodity exports. Exchange-rate depreciations also result in higher servicing costs for foreign-currency debts. A countercyclical approach would at least allow automatic fiscal mechanisms to operate, so long as the resultant larger fiscal deficit could be financed externally. The use of private domestic credit would serve the same purpose, provided that such government borrowing did not crowd out lending to the private sector (e.g., where there are undesired excess real balances in the economy). In that Keynesian scenario, government borrowing would not put upward pressure on interest rates.[1]

Such a policy is often rendered unfeasible, however, by both domestic and external factors. In the former case, the determination of fiscal targets is burdened by a legacy of dissatisfaction with past fiscal performance and practices, characterized by a lack of discipline and gaping deficits that are particularly inappropriate during economic boom periods. Past episodes of hyperinflation are still remembered in Latin America, as are the four- and five-digit annual price increases experienced during the 1980s and early 1990s in Argentina, Bolivia, Brazil, Peru and Nicaragua due to the monetization of huge fiscal shortfalls. In the 1980s, however, countries had no other means of financing massive resource transfers abroad.

During the past decade, the countries of the region have made significant progress towards fiscal consolidation and have displayed a new spirit of budgetary discipline. This is exemplified by the "fiscal responsibility" laws passed recently in countries such as Argentina, Brazil, Ecuador and Peru, by the fiscal pacts agreed upon in such countries as Guatemala and by the structural deficit rule enacted by Chile. These rules regulate and limit the size of the permissible fiscal deficit. A simple average of fiscal outturns in the countries of the region between 1991 and 1997 yields a deficit of just 1.4% of GDP, and the level of fiscal consolidation achieved should thus put many countries in a strong position to make effective use of fiscal policy for countercyclical purposes.

Nonetheless, the volatility of international capital markets does not ensure a timely, ongoing flow of the necessary external funding,[2] since such flows are subject to the vagaries of the financial crises and panics that are transmitted from country to country and between continents across a highly integrated world market, as demonstrated by the crises that began in Mexico in 1982

[1] Nor would it if there is "Ricardian equivalence" between taxes and borrowing in the financing of expenditure (an early assumption of the application of rational expectations); in this case, however, there would be no effects on the economy.

[2] See Daniel Heymann, "Grandes perturbaciones macroeconómicas y respuestas de política: Algunas notas", a document presented at the eleventh Regional Seminar on Fiscal Policy, Santiago, Chile, 1999.

and 1994, in Russia in 1998, or in Argentina in 2002 (see the section below on net resource transfers from the region). The degree to which each country's access to external financing is restricted depends on variables that play a crucial role in foreign-investor confidence, including the level of public-sector external debt (and its profile) and the current account deficit or surplus on the balance of payments.

The public sector's level of external debt is essentially a function of the accumulation of earlier fiscal deficits, which are in turn a reflection of the factors discussed above. Moreover, the external disturbances that have occurred since 1997 have caused fiscal deficits to widen and, as a result, public debt levels have increased; the consequent deterioration in public-sector solvency restricts the manoeuvring room available for fiscal policy. This phenomenon has been aggravated by the currency depreciation and interest-rate hikes resulting from widening spreads abroad and, in the case of domestic rates, the monetary tightening that is often required in order to defend the exchange rate. As is well known, the ratio of public debt to gross domestic product tends to shoot up when the real interest rate paid on the former exceeds the growth rate of the latter.

The second variable, the current account balance, is affected by the tendency for imports to grow faster than exports (see the section on broad macroeconomic equilibria below), particularly during domestically generated boom periods. This phenomenon was identified long ago by ECLAC, but it has become even more important in the present open-economy context. External trade patterns therefore place an additional constraint on expansionary fiscal policy in times of crisis.

Many countries, such as Brazil in recent months, have had to tighten fiscal policy in order to shore up confidence in their economies on international capital markets. In extreme cases (and in some less extreme cases too, given the idiosyncrasies of those markets) it is becoming necessary to have access to sufficient amounts of compensatory capital under suitable terms and conditions. The strict rules usually imposed on countries by the International Monetary Fund (IMF), a key player in making such capital available, embody the constraints faced by fiscal action, which force governments to undertake severe fiscal tightening even during crises. Such conditions have aroused fierce debate, especially because of the role played by the Fund during the Asian crisis. This controversy continues to rage today as Argentina laboriously negotiates the financial assistance it needs to overcome the problems plaguing that country.

The rest of this chapter summarizes a number of specific issues relating to economic-policy flexibility and the business cycle in the region.

2. Broad macroeconomic equilibria

The broader view of macroeconomic stability proposed by ECLAC[3] looks beyond maintaining low inflation and a sustainable fiscal deficit to embrace key real variables such as growth and employment. Nonetheless, during a time span that began with the 1982 debt crisis and continued into the 1990s, macroeconomic policy in the region was almost exclusively aimed at bringing inflation under control and reducing fiscal deficits. This left the behaviour of real variables almost entirely at the mercy of external factors.

Consequently, macroeconomic policy in the countries of the region has tended to be procyclical, perversely boosting private-sector activity during boom periods and restricting it during downswings. The abundant net inflow of resources in the early 1990s harnessed the financial accelerator (domestic-credit expansion and rising share prices) and wealth effects (arising from financial and real estate assets, or from an overvalued real exchange rate) to generate high growth rates. This process reached its peak in 1997 with a 5.2% growth rate for regional GDP and an external deficit of 3.5%. When the international context took a turn for the worse in 1998 and the net inflow of foreign funds dried up, domestic monetary conditions tightened again, thereby intensifying the recessionary effects of the external situation.

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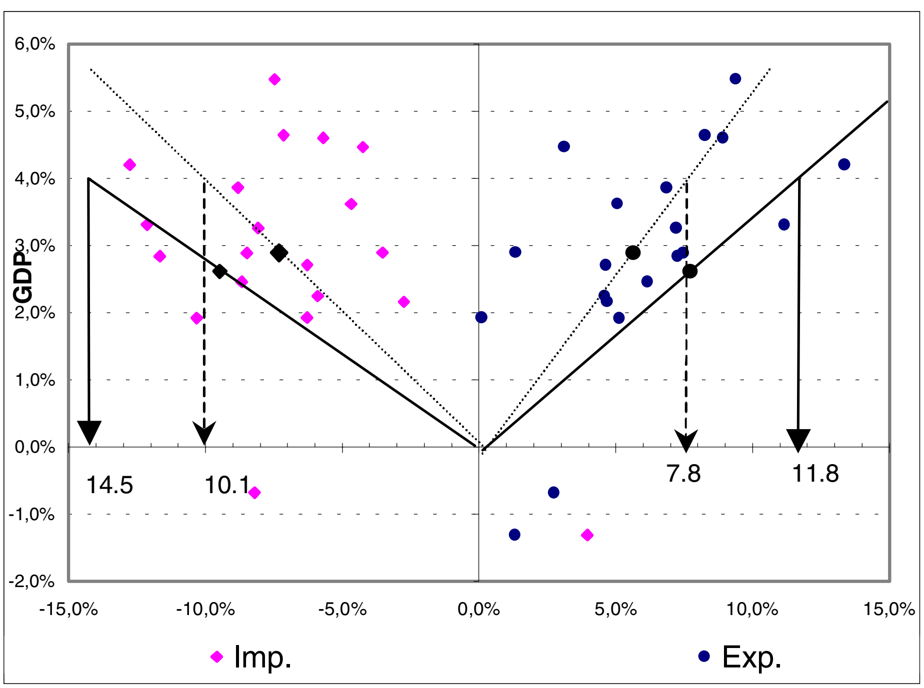
[3] ECLAC, *Globalization and Development* (LC/G.2157(SES.29/3)), document prepared for the twenty-ninth session of ECLAC (Brasilia, Brazil, 6 to 10 May 2002), Santiago, Chile, 2002.

This procyclical bias in macroeconomic policy has made the real economy more volatile, generated a great deal of uncertainty and resulted in less long-term investment and lower growth rates. The latter, in turn, has pushed up unemployment and aggravated social problems throughout the region.

To illustrate the difficulty of reconciling domestic and external macroeconomic equilibria in Latin America under circumstances dominated by external constraints, it may be noted that domestic GDP growth of at least 4% is considered necessary to lower the unemployment rate by one percentage point (see *Economic Survey 2000-2001*, p. 73). Unfortunately the only way that the countries have managed to achieve such growth rates is by incurring an increasingly large trade deficit, since the income-elasticity of imports is higher than the marginal export/GDP ratio.

As shown in figure III.2, this has been the case in Latin America since 1990. The rates of expansion for imports and exports associated with a 4% GDP growth rate during this period have been 14.5% and 11.8%, respectively, for the region as a whole. This 2.7 percentage-point difference has had the effect of widening the trade deficit. When measured in terms of the median for the countries in the region, without weighting the figures by economic size, these values drop to 10.1% and 7.8%, respectively. This smaller gap of 2.1 percentage points probably reflects a behavioural difference between the larger and smaller economies.

Figure III.2
EXTERNAL TRADE AND GROWTH, 1990-2001
(Annual variation)

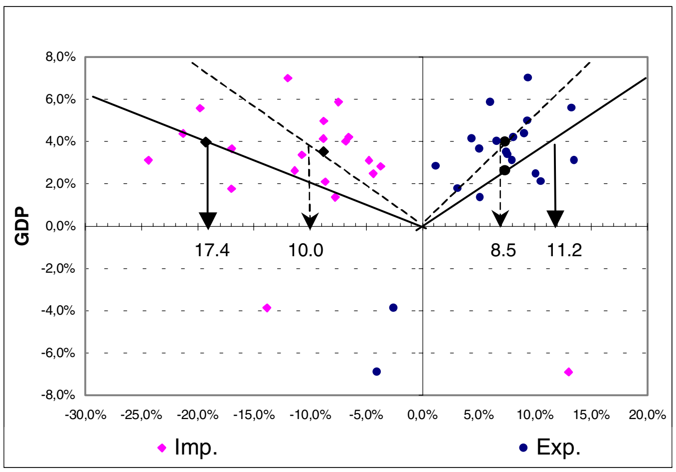


Source: ECLAC, on the basis of official figures.

In addition to having to cover this trade deficit, countries have a contractual obligation to service their external debt regardless of economic circumstances. Thus, in order to reduce the external deficit at times of restricted access to international financing, national authorities have tended to tighten monetary policies to cool the domestic economy down. This has made growth more volatile and pushed up unemployment. Unlike the pattern in developed countries, however, overheating in Latin American economies does not necessarily mean that growth rates are nearing the potential-GDP frontier; instead, overheating depends fundamentally on external conditions and may very well occur in the midst of weak domestic growth.

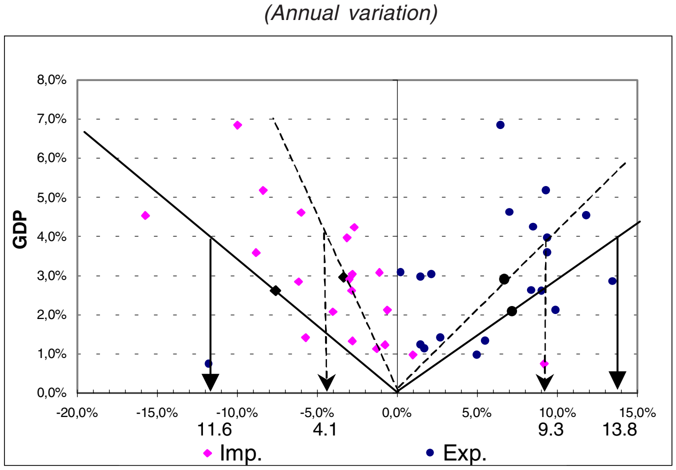
Nonetheless, there are signs that the apparently high income-elasticity of demand for imports (ignoring price and exchange-rate effects) recorded in the early 1990s contained transitory components and has recently exhibited a tendency to decline. Comparing the periods 1990-1995 and 1996-2001 (figures III.3 and III.4), the apparent elasticity of imports has now fallen to a value below the marginal export ratio, both as a regional average and when measured by the median for the countries.

Figure III.3
EXTERNAL TRADE AND GROWTH, 1990-1995
(Annual variation)



Source: ECLAC, on the basis of official figures.

Figure III.4
EXTERNAL TRADE AND GROWTH, 1996-2001
(Annual variation)



Source: ECLAC, on the basis of official figures.

These graphs point to a number of structural and circumstantial factors. Firstly, the income-elasticity of imports is not a constant parameter but tends to move in the same direction as the growth rate. In the early 1990s the import coefficient overreacted as import capacity strengthened following several bad years. Imports were also boosted by tariff reductions and trade liberalization, as well as by what were sometimes excessive flows of external capital and an overvalued exchange rate.

By the late 1990s, many of these factors had disappeared from view: reform and liberalization processes are now reaching maturity, net external capital inflows have all but dried up, and the real exchange rate has regained some of the ground that had been lost in several countries. GDP growth rates have fallen steeply along with domestic demand (particularly investment, which has a high import content). As a result, the implicit elasticity of imports has dropped back to a trend value of 2.4 from its 1993 peak of 3.8.

Unfortunately, under present domestic and external circumstances, the region cannot realistically hope to grow at the 4% rate needed to reduce unemployment, let alone at the 6% rate that ECLAC considers necessary in order for the region to make headway in reducing poverty and inequality. The current world situation is discouraging, and neither external nor domestic demand has the momentum needed to sustain such growth rates. Moreover, it is perfectly possible that an upturn in the economy would push net import elasticity back up and cause the trade deficit to widen again.

Two types of measures are needed to prevent this from happening. Firstly, a systematic and proactive export-promotion policy is called for. The corresponding macroeconomic measures would include all those aimed at maintaining a competitive real exchange rate. Microeconomic actions would include steps to diversify export activities and extend production linkages, thereby intensifying the positive effects that domestic and external demand have on economic activity and employment. Secondly, Latin American economies need to become less reliant on external saving in order to ease the burden of external debt and its servicing. Sound public finances, supported by the development of deep, stable domestic financial systems, have positive effects on national saving and the financing of investment, thereby rendering domestic economies less vulnerable to external financing cycles. To achieve these objectives, in the document *Globalization and Development* mentioned above, ECLAC proposes a new agenda for the era of globalization which is founded upon the complementarity of global, regional and national development processes.

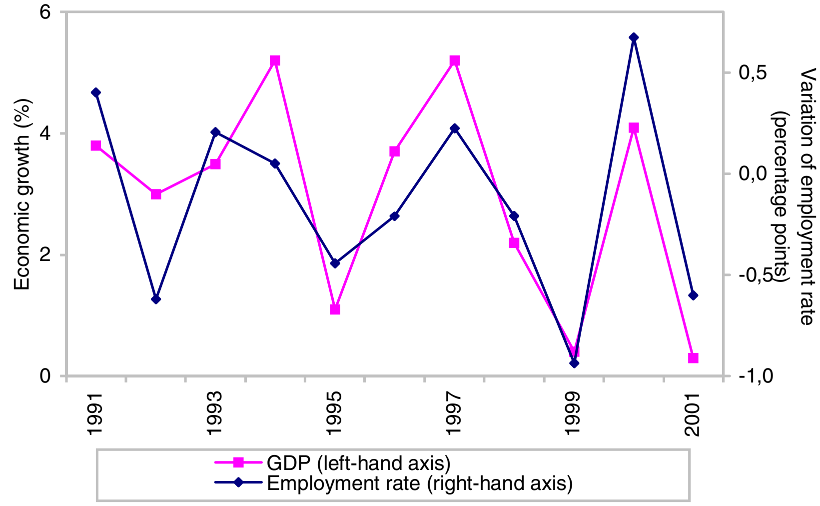
3. Labour-market participation and unemployment

The behaviour of labour-supply is known to respond to both long- and short-term trends. Aside from demographic patterns, the first category includes processes that boost labour-market participation (such as sociocultural changes conducive to an increase in the number of women entering the labour market), together with factors that tend to lower the total participation rate (such as the longer time young people now spend in the education system and the expansion of pension schemes). The relevant short-term trends reflect the economic needs of households and their reaction to changes in economic activity and in perceived opportunities in the labour market.

In this context, a deterioration or an improvement in the economic situation can generate opposing reactions. Higher unemployment or lower real household income levels can either prompt an increase in the number of job seekers (the additional-earner factor) or a reduction (the discouragement factor). Equally, if the employment situation improves, labour-market participation may either grow (the better-opportunities factor) or decline (the income factor). Which of these will prevail at any given point in time is hard to predict and depends on past trends and household expectations. For example, a deterioration in the labour-market situation may initially cause the number of job seekers to rise (the additional-earner factor), but once the idea that the situation is not improving takes hold, the discouragement factor might then set in.

At the regional level, there is a high correlation between economic growth and job creation, as indicated by the variations in the employment rate shown in figure III.5. As can be seen, the level of employment has closely shadowed the trend of economic activity. This comes as no surprise, since most employment takes the form of wage labour, and firms' hiring practices are based on their production levels and corresponding expectations.

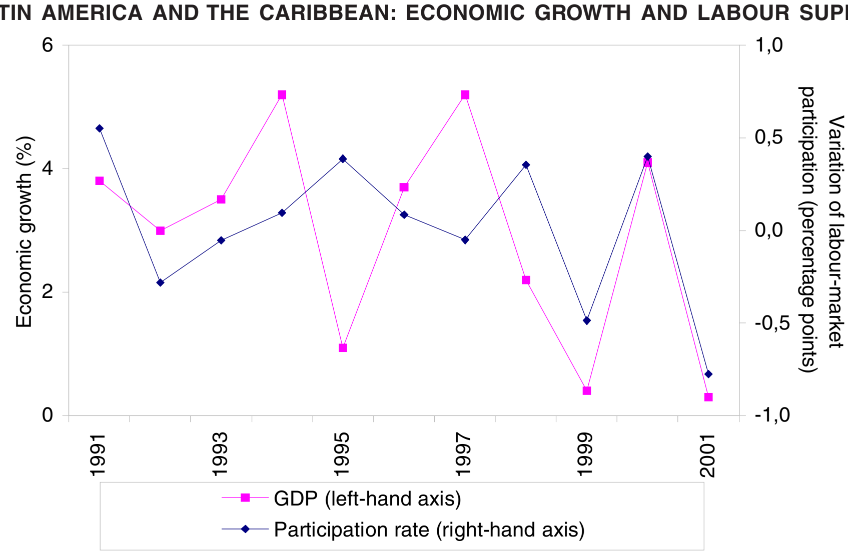
Figure III.5
LATIN AMERICA AND THE CARIBBEAN: ECONOMIC GROWTH AND EMPLOYMENT



Source: ECLAC, on the basis of official figures.

If the *demand* for labour has been highly sensitive to production trends, how has labour *supply* behaved in relation to economic activity? Figure III.6 suggests that the recent period can be divided into three distinct phases. Between 1991 and 1994, and again between 1999 and 2001, the trend of labour supply matched economic activity, whereas between 1995 and 1998 it moved in the opposite direction. This means that, during the first and third phases, factors relating to improved opportunities prevailed during years of rapid economic growth (1991, 1993, 1994 and 2000), while the discouragement factor predominated in years when economic activity was slowing down (1992, 1999 and 2001). During the second phase, the income factor predominated in boom years (1996 and 1997), while the additional-earner factor prevailed at times of slow growth (1995 and 1998). In 2001 specifically, labour supply decreased sharply in response to weakening economic activity, and this destabilized the unemployment rate.

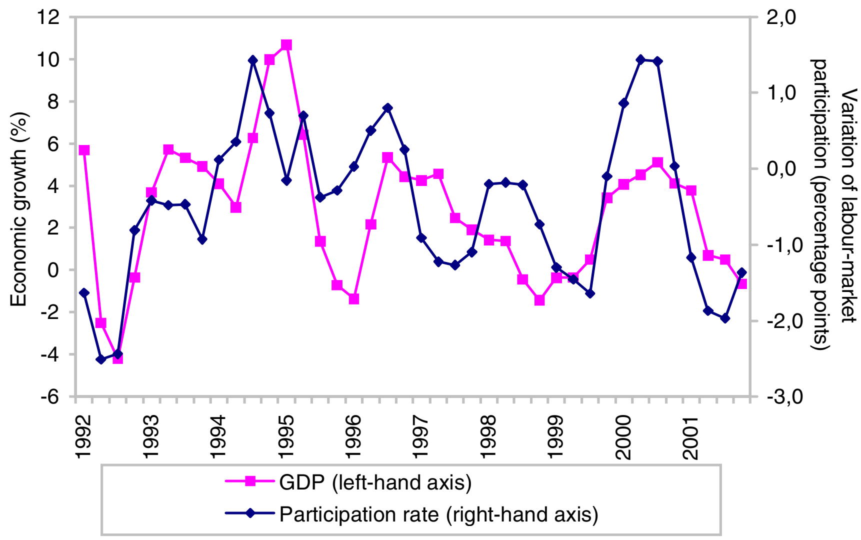
Figure III.6
LATIN AMERICA AND THE CARIBBEAN: ECONOMIC GROWTH AND LABOUR SUPPLY



Source: ECLAC, on the basis of official figures.

In certain countries the reaction of the labour supply to the business cycle can be studied in greater detail, since quarterly data are available for both variables. By way of example, figures III.7 and III.8 show the respective trends for Brazil and Mexico.

Figure III.7
BRAZIL: ECONOMIC GROWTH AND LABOUR SUPPLY



Source: ECLAC, on the basis of official figures.

Figure III.8
MEXICO: ECONOMIC GROWTH AND LABOUR SUPPLY

Source: ECLAC, on the basis of official figures.

In Brazil, labour supply has shadowed trends in economic activity throughout the last 10 years, with improved job-opportunity factors prevailing in expansionary phases, and discouragement predominating during downswings. The correlation coefficient between the two variables is 0.56. The only apparent exception was the period between the fourth quarter of 1997 and the third quarter of 1998; even so, the variation in the total participation rate (TPR) remained negative during this period of slackening activity, so its behaviour cannot be interpreted as being clearly determined by the other two factors.

The situation has been different in Mexico, however, where there is a clear distinction between 1991-1996 and 1997-2001. In the first period, the labour supply largely moved against the trend of output (a correlation coefficient of -0.26), with TPR falling steeply in 1994 and then rebounding in 1995. From 1997 onward, however, labour supply mirrored the behaviour of economic activity, displaying a correlation coefficient of 0.77.

4. Convertibility in Argentina and macroeconomic disequilibria: a historical outline

On 7 January 2002, the Argentine Congress repealed the legislation that had established the convertibility regime in late March 1991. This monetary and exchange-rate scheme had lasted just over 10 years, having been established following several failed attempts to contain the runaway inflation the country had been experiencing for several years, which had quickened its pace dangerously in 1989.

In response to this difficult situation, in March 1991 a “convertibility law” was passed establishing an explicit exchange-rate anchor and laying down strict rules on central bank operations. The currency of the day, the austral, was replaced by the peso at a conversion rate of 10,000 to 1. Restrictions on foreign-currency movements were lifted, and several structural reforms were implemented at the same time. The announcement of the new programme boosted expectations and attracted an abundant foreign-exchange inflow that lasted through the following months. This positive trend in the Argentine economy strengthened over the ensuing years.

Then, in early 1995, the economy was shaken by a major upheaval on financial markets, accompanied by a collapse in asset demand. Conditions on financial-asset markets returned to normal in the second half of the year, but credit was slow to recover as precautionary sentiment persisted. One side-effect of the 1995 episode was a reduction in the number of financial entities operating in Argentina from just over 200 to around 150. Monetary policy was designed to preclude future problems of financial fragility by including provisions on bank liquidity requirements and the capitalization of financial institutions. In addition, the central bank negotiated a contingent credit line abroad to underpin the financial system in the event of further disturbances.

The convertibility regime achieved spectacular results at least until 1998. Between 1991 and 1998, inflation fell abruptly, external funds flowed back into the country, credit reappeared after having practically vanished during the country’s high-inflation years, and, most importantly, the economy began to grow again, posting an average rate of 5.7% per year. Towards the end of the decade, however, the convertibility regime began to be criticized in the light of the deep recession that the country had lapsed into since mid-1998. It was specifically blamed for undermining the economy’s competitiveness following the steep devaluation in Brazil, one of Argentina’s main trading partners, and the strengthening of the dollar against the euro and the yen. In addition, the monetary inflexibility inherent in the exchange-rate scheme was increasingly questioned in view of the country’s burgeoning fiscal deficit. The latter, which was made even worse by the decline in tax revenues associated with the recession, was initially financed using external resources and privatization proceeds; later on, however, it became necessary to obtain financing from the domestic banking system. This led to a surge in public debt, both external and domestic, which became increasingly hard to service.

As a recession took hold in the leading economies, the international outlook darkened and external resources dwindled. The crisis in Turkey in January 2001 complicated the situation still further, and Argentina was thrust into the spotlight on international markets. Meanwhile, domestic financing sources were running low, and the level of country risk began to rise. As a consequence, the interest rates that Argentina had to pay began to skyrocket, thereby worsening the public-sector deficit still further.

In view of the problematic external liquidity situation, the Administration that took office in Argentina in March 2001 modified the convertibility system in June as part of a broader package of economic measures. This included bringing the euro into the currency basket, under conditions of parity, and temporarily establishing a differential exchange-rate system for commercial operations. Financial markets reacted cautiously, however, and there was a steep rise in the country's perceived sovereign risk.

The inability to achieve a credible adjustment in public accounts, compounded by the onset of parliamentary elections that were expected to prove difficult for the incumbent party, engendered a climate of mistrust. Fears were openly expressed that the authorities would be unable to meet their commitments and that the country would default. This triggered a run on bank deposits, both in pesos and in foreign currency, since there were concerns about the solvency of financial institutions that were heavily exposed due to their large holdings of financial assets issued by the Argentine public sector.

In October, voters in the parliamentary elections expressed deep discontent with the course of the economy, and in November there were further bank runs and flight to foreign currencies. In early December, restrictions were imposed on foreign-exchange purchases and capital movements, and limits were set on cash withdrawals from banks. By mid-December, social unrest had forced the President to resign. The provisional head of state who replaced him froze payments on the public debt and announced that a new non-convertible currency would be issued alongside the peso, with the latter maintaining parity with the dollar. This monetary arrangement was never applied, however, because the new President resigned after just three days in office. The Assembly then appointed a new head of government and in January formalized the end of the convertibility system by establishing a dual foreign-exchange market in which the price of the dollar was fixed at 1.40 pesos for commercial operations but was allowed to float freely for other authorized transactions.

5. Exchange-rate depreciation and its effect on inflation

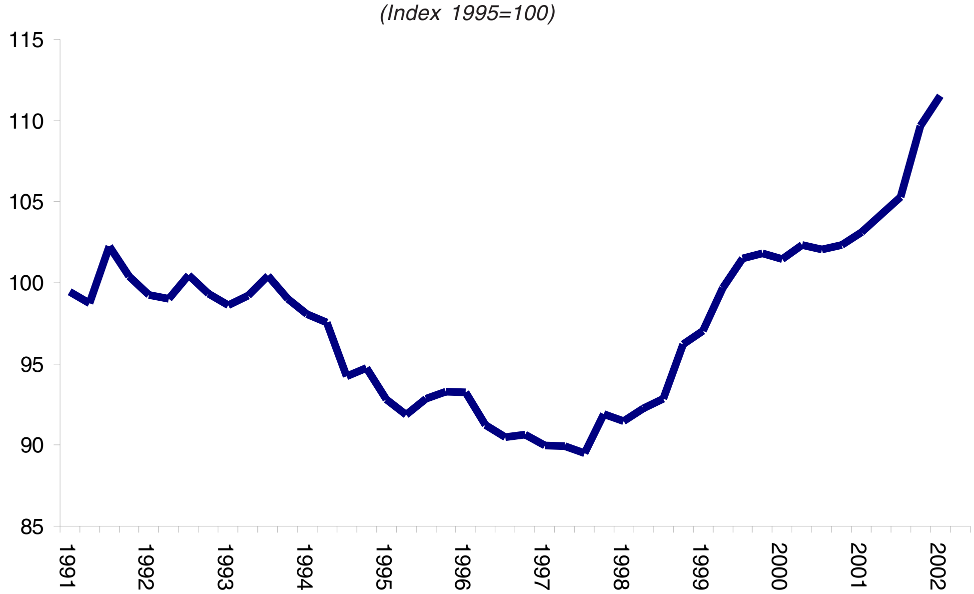
The theory of exchange-rate determination in small open economies postulates that, in the long run and under certain conditions, variations in the exchange rate tend to compensate for differences between domestic and international inflation rates. Nonetheless, experience with periods of high inflation in Latin America and the Caribbean has tended to highlight the opposite relation, whereby variations in the exchange rate *cause* short-run changes in inflation. This empirical relationship can be explained by a number of economic and institutional factors. The economic factors include the weight of imported products in consumer shopping baskets and the effect of imported inputs on production costs; institutional factors include the practice of indexing employment, commercial or financial contracts to the exchange rate.

The inflationary effect of nominal depreciations of the local currency has tended to increase inflationary inertia, not only hindering anti-inflation policies but also drastically restricting the potential for using the exchange rate to correct external imbalances. In these circumstances, the additional inflation caused by devaluation tends to wipe out gains in competitiveness, and the real exchange rate soon returns to its previous value.

For this reason, and taking advantage of the foreign-capital inflows that financed the external deficit and made it possible to sustain an increasingly overvalued real exchange rate, starting in the late 1980s many countries in the region adopted stabilization policies that used the exchange-rate as a nominal anchor (for further details see chapter V of the *Economic Survey of Latin America and the Caribbean, 1996-1997*, published by ECLAC).

Nonetheless, the expectation was that indexation would become less prevalent as inflation was brought down and maintained at low levels. When this happens, the region's economies benefit twice over: firstly, they regain the possibility of using the exchange rate to absorb external shocks; and, secondly, they gain additional autonomy in conducting monetary policy, thanks to greater exchange-rate flexibility. From 1998 onward, an increasing number of countries made their exchange-rate regimes more flexible and adopted monetary policies based on inflation targets (see the next section for a more detailed discussion of this point). The tendency for regional real exchange-rates to appreciate against the dollar was also reversed (see figure III.9).

Figure III.9
LATIN AMERICA AND THE CARIBBEAN: REAL BILATERAL EXCHANGE RATE AGAINST THE DOLLAR
(Index 1995=100)



Source: ECLAC, on the basis of official figures.

Be this as it may, many of the devaluations in Latin America over the last five years have taken place against a backdrop of sluggish growth or recession, combined with high unemployment and low levels of production-capacity utilization, all of which tend to depress domestic prices. This happened in Brazil, and again in Argentina in the first half of 2002, where the pace of devaluation far outstripped inflation or nominal wage growth because of the collapse in domestic demand. Doubt remains, therefore, as to whether the disconnect between domestic prices and exchange-rate movements is persistent or transitory.

In order to determine the extent to which the turning point seen in a number of countries since 1998 is explained by a weaker pass-through from nominal devaluation to domestic prices, lower imported inflation or the deflationary effect of recession, movements in the consumer price index (CPI) were broken down for a selection of 10 Latin American and Caribbean countries using the following model:

$$\Delta pt = c + \alpha_1 \Delta p_{t-1} + \alpha_2 \Delta p^*_t + \alpha_3 \Delta e_t + \alpha_4 (y^*_t - y_t) + \alpha_5 T_t$$

Where:

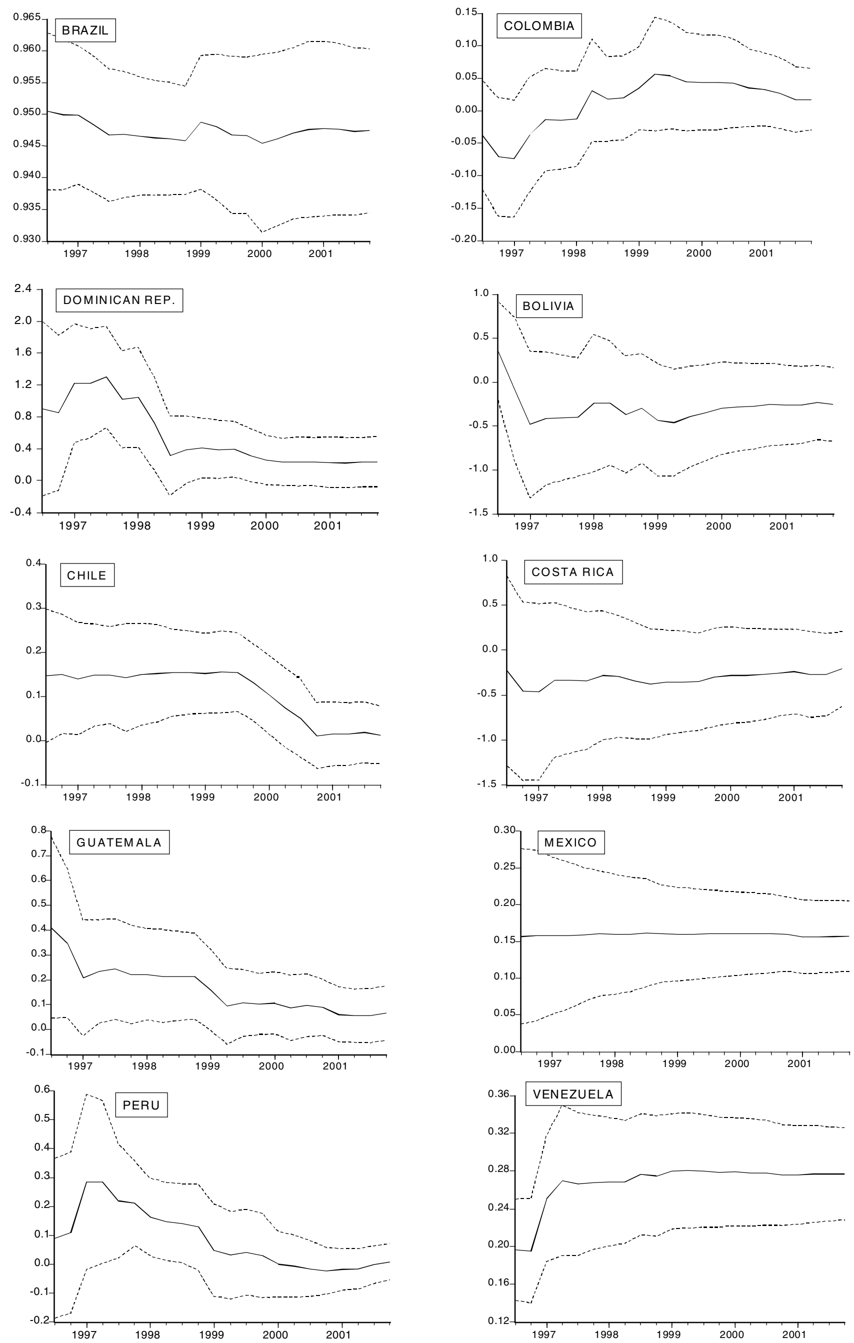
Δpt and Δp_{t-1} are the year-on-year variations in the consumer price index in quarters "t" and "t-1"; c is a constant, Δp^*t is the variation in the dollar prices of imports (imported inflation); Δet is the variation in the nominal exchange rate; $(y^*_t - y_t)$ is the gap between observed (y_t) and trend GDP (y^*_t) (all variables expressed as percentages); and T_t is a time index ($T_t = 0$, 1, 2, 3, ...) that captures the influence of progressive changes in the economy.

Regression results for 1994-2001, covering all countries with data available, show that the trend variable coefficient a_5 is negative and highly significant. This means that there are systemic forces (e.g., structural reforms, macroeconomic policy styles), in addition to the variables explicitly built into the equation, that push inflation lower.

On the other hand, the impact of variables such as the exchange rate, imported inflation and the importance of the business cycle vary widely across countries. This underlines the formal limits of the regression exercise, which is mainly of illustrative value. An exhaustive explanation of inflation in each country would require a far more complex specification of the model.

Recursive regressions were then run to measure the behaviour of the pass-through coefficient (a_3) over the last five years. As can be seen in figure III.10, the pattern varies greatly from one country to another. In two economies (Bolivia and Costa Rica) where the policy has been aimed at sustaining the real exchange rate in order to preserve the economy's external competitiveness, the pass-through coefficient is practically zero. Although the coefficient has fallen in some other countries (Chile, Guatemala, Peru and the Dominican Republic), it has held virtually steady in the two largest economies (Brazil and Mexico), and even trended upwards in two others (Venezuela and Colombia until the change of exchange-rate regime in 1999).

Figure III.10
PASS-THROUGH FROM EXCHANGE RATE TO INFLATION



These results indicate that valid conclusions cannot be drawn based on the disappearance of indexation phenomena and a weaker pass-through from devaluation to prices in all countries of the region. In particular, an inertial trend phenomenon is likely to persist that now helps to keep price rises under control, especially in a context of low inflation and weak domestic demand that raises the opportunity cost of price hikes. After years of falling inflation, markets have grown used to a downward trend in the rate of price increases, and it is only when the pace of devaluation exceeds a certain threshold value that expectations change and consumer prices once again start to follow suit. In such conditions, it is better for the authorities to avoid sharp increases in the nominal exchange rate, since high values could force a domestic price adjustment and make it more difficult for the nominal rate to return to its former level.

6. Inflation targeting

Starting in the early 1980s, inflation slowed sharply throughout the world economy, including Latin America. This occurred under a wide variety of exchange-rate and monetary-policy regimes in individual countries. Nonetheless, the predominant approaches –which involved either the control of a monetary aggregate or, in most cases, an exchange-rate anchor– were based on strict rules, given the uncertainty generated by high inflation and the damage this did to the credibility of the monetary authorities. This strategy, which is easier to implement in situations of high inertial inflation and price indexation, generated exchange-rate appreciations that sometimes became unsustainable and ended in major currency crises. The first of these crises erupted in Mexico in December 1994, and others, starting with the Asian crisis in late 1997, followed.

Unlike what used to happen in the past, the resulting devaluations did not elicit sharp offsetting increases in domestic prices. By making exchange-rate policy more flexible without incurring the cost of higher inflation, countries regained the capacity to pursue more active monetary policies. This also opened up the possibility of establishing more flexible regimes. One of these, which has attracted considerable attention in recent years, involves inflation targeting –a regime that combines a dirty float with specific targets for the inflation rate. Several analyses have judged this regime to have been more successful in lowering inflation; it is impossible to verify its effectiveness in this respect, however, since the policy has only been adopted recently following two decades in which inflation has fallen in all countries, under what have until recently been favourable macroeconomic conditions, with no supply shocks except for the recent oil-price hike.

In any event, it remains true that, as with other monetary and exchange-rate regimes, countries thinking of adopting inflation targeting need to maintain fiscal discipline and avoid an unsustainable exchange-rate appreciation.

Under a strict definition of inflation targeting, the rate of inflation becomes the anchor for the system, with all variables in the economy adapting to its value, rather than the opposite –just as the exchange rate serves as the system's anchor in a currency-board arrangement. Under inflation targeting, the central bank has to announce an explicit quantitative inflation target as its overriding objective; there can be no other nominal anchor, such as a fixed exchange rate. The central bank must operate independently from fiscal requirements in a transparent and open fashion and must be held accountable for its actions. These characteristics nurture credibility in the central bank's actions, and, according to proponents of inflation targeting, are the foundation of this regime's success.

Under this framework, the central bank's sole objective is to achieve the target inflation rate. It is also required to make inflation projections and to establish accountability and transparency standards. In New Zealand, for example, failure to meet the inflation target is the direct responsibility of the Central Bank Governor. The central bank can use its discretion as to which instruments it will use and how it will use them to achieve the target.

As mentioned above, the claim that inflation-targeting makes it possible to reduce inflation is difficult to prove rigorously under current circumstances. Another postulate upon which inflation-targeting is based is that it will provide stronger guidance for private-sector expectations and allow better communication with the public and private sectors. This assumes that central bank credibility is enhanced by this regime and that, as it gains credibility, the announcement of the inflation target will keep the rest of the economy better informed. Again, it is difficult to test this hypothesis when inflation rates are falling regardless of the exchange-rate and monetary-policy regimes in force, when favourable macroeconomic conditions prevail and when the economies in question are free from external shocks.

It can be concluded that the supposed advantages of inflation targeting do not seem to be entirely clear and independent of the lower-inflation setting in which the regime has operated over the last two decades. Its most clear-cut results are to have made central bank actions more transparent in some cases and to have provided an unambiguous definition of central bank responsibilities, such as in New Zealand.

The inflation-targeting regime was first implemented in New Zealand in the early 1990s. An interesting feature of the scheme in this country is that the chief executive of the central bank is held directly accountable for meeting the inflation targets, and failure to do so is subject to specific sanctions. Over the last decade, inflation in New Zealand has been held steady within a very narrow range (between 0% and 2% per year), despite major fluctuations both in the exchange rate and in domestic interest rates. Ten years on, nearly 20 countries have adopted inflation targeting, albeit less rigorous versions in some cases.

In Latin America, countries that announced lower and more stable inflation targets under a less rigorous version of the policy did so starting from high rates. At the present time, some version of inflation targeting is being implemented by five Latin American countries: Brazil, Chile, Colombia, Mexico and Peru.

In 1999, as a result of the recession that hit the country that year, Chile's central bank began to employ a stricter form of inflation targeting. This move entailed replacing the previous currency-band policy with a managed float and enhancing the bank's modelling and projection capacity. It also revamped its system for communicating with the public by publishing minutes of its policy meetings within three months after they take place and issuing periodic inflation and growth projections. The authorities' main concern since then, however, has been the sluggishness of the economy's recovery from this recession, and the central bank has successively lowered its policy interest rates in an effort to fuel its reactivation. Given the continuous upward pressure on the exchange rate generated by the uncertainty associated with the crisis in Argentina and turbulence in Brazil, the central bank has also had to intervene repeatedly in the foreign-exchange market.

Following a relatively lengthy transition period, Mexico has applied most of the above-mentioned components of an inflation-targeting regime, with the difference that, rather than using the interest rate as a policy tool, it continues to use quantitative monetary instruments.

Unlike Chile and Mexico, where the features of inflation targeting were phased in gradually, Brazil introduced most of them in the space of a single year, modelling its system on the experience of Sweden and the United Kingdom. Brazil's central bank has begun to publish regular reports containing inflation and output projections. In addition, if a target is not met, the central bank is required to write an open letter to the Minister of Finance explaining the reasons why and setting out measures to rectify the situation. Even so, inflation targets were not met in 2001, and prospects for 2002 are not very encouraging.

As the above discussion shows, there is no consensus on the details of how to conduct inflation targeting; there is only agreement on its basic characteristics. The details, which are nonetheless crucial, have been implemented in different ways from one country to another. The choice of the specific target and the policy horizon to be used, together with the weight given to the output gap and other variables in the central bank's reaction function, have been decided in the light of the particular characteristics of each economy.

In the lower-inflation setting seen under all kinds of regimes during recent decades, inflation targeting has not proven to have clear advantages over regimes that use cautious monetary policies aimed at averting inflationary surges or lowering inflation rates, at least in Latin America. Moreover, given the difficulties the region is currently experiencing, maintaining such regimes in the near future is likely to be very difficult.

7. Trends in net external resource transfers and their components in Latin America and the Caribbean

In the early years of this new decade, the region is no longer receiving a net inflow of resources from abroad. This situation, which is significant enough in itself, conceals a fundamental change in the composition of resource transfers: since the 1990s, funds entering the region have consisted predominately of foreign direct investment, as financial flows have turned increasingly negative. The scale of this phenomenon and the possibility that it will continue in the short and medium terms can be assessed by comparing it to the behaviour of net resource transfers in earlier decades.

In general terms, the net resource transfer (NRT) can be defined as the total net capital inflow into the region, after deducting counterpart dividend and interest payments which are included in the balance of investment income. The net resource transfer thus consists of two basic components: the first is the resource transfer that originates in foreign direct investment (referred to here as the net transfer of investment resources, or NRT^I). The second component consists of the resource flows that stem mainly from loans which give rise to foreign indebtedness, together with portfolio investments and other miscellaneous capital items recorded as errors and omissions in the balance of payments (referred to here as the net transfer of financial resources or NRT^F). An operational definition is provided below in box III.1.

Box III.1
THE CONCEPT OF NET EXTERNAL RESOURCE TRANSFERS

Note: The categories identified below correspond to those used in the *Balance of Payments Manual* of the International Monetary Fund (5th edition, 1993).

1) Net external resource transfer: NRT = TCI - PFSI

a. Total net capital inflow, TCI

Sum of:
Capital account, financial account, net errors and omissions
Use of IMF credits and loans, and exceptional financing

b. Net payment of factor services on investment, PFSI

Investment income: debit entry (interest, profits and dividends paid), less
Investment income: credit entry (interest, profits and dividends received)

2) Net transfer of direct investment resources: NRT^I = FDI - PFSDI

a. Net foreign direct investment inflow, FDI

Direct investment in the reporting country,a less
Direct investment abroad

b. Net payment of factor services on direct investment, PFSDI

Direct investment income, debit entry (profits and dividends paid), less
Direct investment income, credit entry (profits and dividends received)

3) Net transfer of financial resources: NRT^F = FI - PFFS

a. Net financial inflow, FI

Total net capital inflow, less
Net inflow of foreign direct investment (FDI)

b. Net payment of financial factor services, PFFS

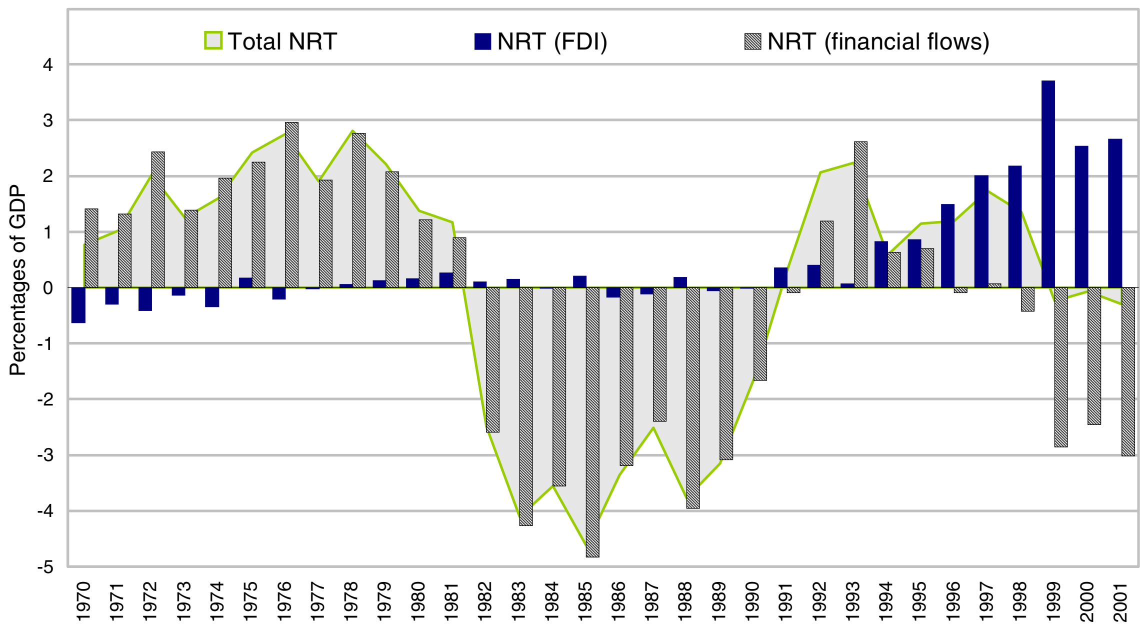
Net payment of factor services on investment, less
Net payment of factor services on direct investment

[a] This item, along with debit items in general, is conventionally recorded with a negative sign in the balance of payments.

The NRT began to assume major proportions around 1970, following two post-war decades of mildly negative figures.[4] Since then, differences in the size, direction and composition of the NRT have marked each decade in Latin America.

Between 1970 and 1981, the overall transfer was large, positive and clearly dominated by NRT^F. Unlike previous decades, in which funds mainly came from official sources, resource transfers in this period consisted overwhelmingly of commercial bank loans, driven in the early 1970s by international interest rates that were negative in real terms, and afterwards by the process of recycling the massive surpluses generated by the unprecedented rise in oil prices. On average, NRT^I was virtually non-existent. During that period, the region was able to meet its burgeoning external debt service by taking out new loans, but clearly this could not continue indefinitely. From 1979 onward, the NRT began to shrink, as increases in net capital inflows were more than offset by even larger increases in debt-service payments, especially now that international interest rates had begun to rise sharply (see figure III.11).

Figure III.11
LATIN AMERICA: NET EXTERNAL RESOURCE TRANSFER



Source: ECLAC, on the basis of figures provided by the International Monetary Fund (IMF).

4 See ECLAC, *Una década de luces y sombras: América Latina y el Caribe en los años noventa*, Bogotá, Colombia, Alfaomega, 2001.

Against this backdrop, the moratorium declared by Mexico in August 1982 inaugurated a decade marked by large negative net resource transfers, also dominated by NRT^F. This has been called the region's "lost decade", since per capita output declined significantly. Amortization and interest payments could no longer be funded by new loans, which had suddenly dried up. Thus, in order to make the negative transfer possible, the region's countries had to generate trade surpluses through a drastic contraction of domestic absorption and steep devaluations. Even so, with few exceptions (such as Colombia and Uruguay), countries still had to negotiate a restructuring of their external debt and interest arrears –a process that concluded with Peru's rescheduling in 1996.

The 1990s saw a major qualitative change in net resource transfers, with NRT^F ceding its dominant role to NRT^I, and net transfers turned positive once again. Starting in 1991, in response to the return to solvency in borrowing countries and the abundance of resources on international financial markets, private capital began to flow into the region again, just as it had in the 1970s. The level of payments associated with this borrowing quickly surpassed the amount of the loans, however, and NRT^F turned negative in the wake of the financial crisis that overwhelmed Mexico in December 1994. Nevertheless, increasing and historically unprecedented amounts of foreign direct investment (FDI) were flowing into the region at the same time. This positive NRT^I was so large that it easily offset the negative NRT^F, and overall NRT therefore rose to very high levels and remained positive until 1998. It should be noted that FDI has been the only private countercyclical flow.[5]

As a result of the Russian moratorium in August 1998, following on the heels of the Asian crisis of the previous year, the negative NRT^F grew to huge proportions, even though international interest rates had been lowered. These outflows of financial capital, which were heavily concentrated in Argentina, Brazil and Venezuela, more than offset an NRT^I that remained positive and continued to rise; consequently, between 1999 and 2001 the overall NRT figures were slightly negative. During this period, official capital flows regained a momentum they had not displayed since before the 1970s, and emergency loans, IMF credits and exceptional financing thus prevented the overall NRT from becoming clearly negative.

Is this pattern likely to continue during the remainder of the decade? Given the massive FDI flows that entered the region from the mid-1990s onward, the region's leading economies will have to set aside increasing sums to finance profit remittances, unless foreign investors can be persuaded to reinvest in the region. Moreover, the continuity of FDI inflows will depend on investor confidence within a different context than before: in the 1990s, nearly one third of all investments were used to purchase existing assets, most of which became available through privatization; but now that this type of opportunity has largely been exhausted, future investments will have to be aimed at creating new production capacity.[6] With regard to transfers from financial sources, larger negative figures are likely to persist, unless access to international financial markets improves for some countries and unless, in extreme cases (such as Argentina), there is a suitable and rapid restructuring of external debt. The role played by multilateral lenders, IMF in particular, will be crucial in this regard.

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5 See ECLAC, *Una década de luces y sombras: América Latina y el Caribe en los años noventa*, Bogotá, Colombia, Alfaomega, 2001.

6 ECLAC, Foreign investment in Latin America and the Caribbean, 2001 report (LC/G.2178-P), Santiago, Chile, 2002. United Nations publication, Sales No. S.02.II.G.47.

Statistical appendix

Table A - 1

LATIN AMERICA AND THE CARIBBEAN: MAIN ECONOMIC INDICATORS

	1993	1994	1995	1996	1997	1998	1999	2000	2001 [a]
				Annual growth rates					
Economic activity and prices									
Gross domestic product	3.3	5.2	1.1	3.7	5.2	2.3	0.5	3.9	0.4
Per capita gross domestic product	1.6	3.4	-0.5	2.1	3.5	0.7	-1.1	2.3	-1.1
Consumer prices [b]	872.4	328.7	26.0	18.6	10.7	10.0	9.7	9.0	6.1
				Percentages					
Urban open unemployment	6.6	6.6	7.5	8.0	7.6	8.1	8.9	8.4	8.4
Fiscal balance / GDP [c]	-1.7	-2.0	-1.7	-1.6	-1.3	-2.2	-3.0	-2.8	-3.3
Total disbursed external debt / GDP [c]	37.5	35.0	36.4	34.8	33.1	37.0	43.0	37.6	39.0
External debt / exports of goods and services	263.5	245.3	226.1	211.8	198.5	223.6	218.3	177.7	178.0
				Billions of dollars					
External sector									
Exports of goods and services	194	223	266	295	328	327	342	407	392
Imports of goods and services	215	251	278	305	361	381	364	420	412
Trade balance (goods and services)	-21	-27	-12	-10	-33	-54	-22	-13	-20
Balance on current account	-45	-52	-37	-38	-65	-88	-55	-46	-51
Balance on capital and financial account [d]	70	42	29	68	85	69	49	61	33
Overall balance	17	-15	-20	30	20	-18	-6	15	-18

Source: ECLAC, on the basis of official figures.

[a] Preliminary estimates. [b] December-to-December variation. [c] Estimates based on figures expressed in dollars at current prices. [d] Includes errors and omissions.

Table A - 2

LATIN AMERICA AND THE CARIBBEAN: GROSS DOMESTIC PRODUCT

(Annual growth rates)

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001[a]	1992 - 2001
Latin America and the Caribbean [b]	**2.8**	**3.3**	**5.2**	**1.1**	**3.7**	**5.2**	**2.3**	**0.5**	**3.9**	**0.4**	**2.8**
Subtotal (20 countries)	**2.8**	**3.4**	**5.2**	**1.1**	**3.8**	**5.2**	**2.3**	**0.5**	**3.8**	**0.3**	**2.8**
Argentina	9.6	5.9	5.8	-2.9	5.5	8.0	3.8	-3.4	-0.8	-4.5	2.6
Bolivia	1.7	4.3	4.8	4.7	4.5	4.9	5.0	0.3	2.3	1.3	3.4
Brazil	-0.3	4.5	6.2	4.2	2.5	3.1	0.3	0.9	4.2	1.5	2.7
Chile	10.8	6.9	5.0	9.0	6.9	6.8	3.3	-0.7	4.4	2.8	5.5
Colombia	3.6	4.4	5.9	4.9	1.9	3.3	0.8	-3.8	2.2	1.5	2.5
Costa Rica	8.8	7.1	4.6	3.9	0.8	5.4	8.3	8.0	2.2	1.0	5.0
Cuba	-13.8	-16.0	2.0	3.4	8.7	3.3	1.3	6.8	5.3	2.5	0.0
Ecuador	3.0	2.2	4.4	3.0	2.3	3.9	1.0	-7.9	2.3	6.0	1.9
El Salvador	7.3	6.4	6.0	6.2	1.8	4.2	3.8	3.4	2.1	1.9	4.3
Guatemala	4.9	4.0	4.1	5.0	3.0	4.4	5.1	3.9	3.4	1.8	4.0
Haiti	-5.5	-8.0	-17.6	9.5	5.6	3.2	2.9	2.9	1.9	-0.7	-0.9
Honduras	5.8	7.1	-1.9	3.7	3.7	4.9	3.3	-1.5	4.8	2.7	3.2
Mexico	3.7	1.8	4.5	-6.2	5.4	6.8	5.0	3.7	6.8	-0.4	3.0
Nicaragua	0.8	-0.4	4.0	4.4	5.1	5.4	4.1	7.4	6.0	3.1	4.0
Panama	8.2	5.3	3.1	1.9	2.7	4.7	4.6	3.5	2.6	0.4	3.7
Paraguay	1.7	4.0	3.0	4.5	1.1	2.4	-0.6	-0.1	-0.6	2.4	1.8
Peru	-0.4	4.8	12.7	8.6	2.5	6.8	-0.5	0.9	3.0	0.2	3.8
Dominican Republic	8.0	3.0	4.3	4.7	7.2	8.3	7.3	8.0	7.8	2.7	6.1
Uruguay	8.3	3.5	7.0	-2.3	5.0	5.4	4.4	-2.9	-1.8	-2.9	2.3
Venezuela	7.0	-0.4	-3.7	5.9	-0.4	7.4	0.7	-5.8	3.8	2.8	1.6
Subtotal - Caribbean [b]	**0.7**	**0.9**	**3.0**	**2.7**	**2.6**	**2.0**	**2.7**	**4.1**	**4.7**	**2.3**	**2.1**
Antigua and Barbuda	0.9	5.0	6.2	-4.8	6.0	5.5	5.0	4.9	2.6	4.3	3.5
Barbados	-5.6	1.1	3.1	1.9	2.5	2.6	4.0	3.0	3.1	-2.2	1.3
Belize	9.0	4.3	1.5	3.7	1.3	4.4	2.0	6.0	10.5	4.7	4.7
Dominica	2.3	1.9	1.9	1.2	2.9	2.2	3.1	1.3	0.7	-5.2	1.2
Grenada	1.0	-1.1	3.4	3.1	3.0	4.3	7.6	7.5	6.5	-3.3	3.1
Guyana	9.1	11.4	9.4	3.8	7.4	6.8	-2.2	5.0	-2.3	2.3	5.0
Jamaica	2.7	2.2	1.6	2.2	-0.1	-1.8	-0.8	0.6	1.0	1.8	0.9
Saint Kitts and Nevis	3.2	5.2	5.5	3.2	5.8	7.2	1.1	3.5	5.0	2.0	4.2
Saint Vincent and the Grenadines	6.9	2.0	-2.3	7.8	1.2	3.5	5.8	3.6	1.8	...	3.3 [c]
Saint Lucia	7.5	-1.3	4.6	2.1	0.8	-0.3	3.0	2.8	0.3	-5.0	1.4
Suriname	-2.0	-4.1	-0.1	0.0	5.3	3.3	2.9	-3.5	-1.2	...	0.0 [c]
Trinidad and Tobago	-1.0	-1.2	4.2	4.2	4.4	4.0	5.3	7.8	9.2	4.3	4.1

Source: ECLAC, based on official figures converted into dollars at constant 1995 prices.

[a] Preliminary figures. [b] Refers only to those countries that provide data. [c] The last column refers to the period 1991-2000.

Table A - 3
LATIN AMERICA AND THE CARIBBEAN: PER CAPITA GROSS DOMESTIC PRODUCT
(Annual growth rates)

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001[a]	1992-2001
Latin America and the Caribbean [b]	**1.0**	**1.6**	**3.4**	**-0.5**	**2.1**	**3.5**	**0.7**	**-1.1**	**2.3**	**-1.1**	**1.2**
Subtotal (20 countries) [b]	**1.0**	**1.6**	**3.4**	**-0.6**	**2.0**	**3.5**	**0.7**	**-1.1**	**2.3**	**-1.2**	**1.2**
Argentina	8.2	4.5	4.4	-4.1	4.1	6.6	2.5	-4.6	-2.0	-5.6	1.3
Bolivia	-0.7	1.7	2.3	2.2	2.0	2.4	2.6	-2.0	0.1	-0.9	1.0
Brazil	-1.8	3.0	4.7	2.7	1.1	1.7	-1.0	-0.4	2.8	0.2	1.3
Chile	9.0	5.1	3.3	7.3	5.4	5.3	1.9	-2.0	3.1	1.6	4.0
Colombia	1.6	2.4	3.8	2.9	0.0	1.4	-1.1	-5.5	0.4	-0.2	0.5
Costa Rica	5.4	3.8	1.5	1.0	-1.9	2.7	5.6	5.4	0.0	-1.2	2.2
Cuba [c]	-14.4	-16.5	1.4	2.8	8.1	2.9	0.8	6.4	4.9	2.1	-0.5
Ecuador	0.7	-0.1	2.1	0.8	0.2	1.8	-0.9	-9.7	0.4	4.1	-0.1
El Salvador	5.1	4.2	3.7	4.0	-0.3	2.1	1.6	1.3	0.1	0.0	2.2
Guatemala	2.2	1.3	1.4	2.2	0.3	1.7	2.4	1.2	0.7	-0.8	1.3
Haiti	-7.2	-9.6	-19.0	7.5	3.7	1.3	1.0	1.1	0.1	-2.5	-2.7
Honduras	2.7	4.0	-4.7	0.7	0.8	2.1	0.5	-4.1	2.1	0.1	0.4
Mexico	1.8	-0.1	2.6	-7.8	3.6	5.1	3.3	2.1	5.2	-1.9	1.3
Nicaragua	-2.1	-3.4	0.9	1.5	2.1	2.6	1.4	4.5	3.2	0.4	1.1
Panama	6.2	3.4	1.2	0.1	0.9	3.0	2.9	1.9	1.0	-1.1	1.9
Paraguay	-1.1	1.3	0.3	1.8	-1.6	-0.2	-3.2	-2.6	-3.1	-0.1	-0.9
Peru	-2.2	2.9	10.8	6.7	0.7	4.9	-2.2	-0.8	1.4	-1.4	2.0
Dominican Republic	6.1	1.2	2.6	2.9	5.3	6.4	5.4	6.1	6.0	1.1	4.3
Uruguay	7.5	2.8	6.2	-3.0	4.2	4.6	3.6	-3.6	-2.5	-3.6	1.6
Venezuela	4.6	-2.7	-5.8	3.7	-2.5	5.2	-1.3	-7.7	1.8	0.9	-0.5
Subtotal - Caribbean [b]	**0.0**	**0.2**	**2.2**	**2.0**	**1.9**	**1.2**	**2.0**	**3.4**	**4.0**	**1.5**	**2.3**
Antigua and Barbuda	0.9	5.0	4.5	-4.8	6.0	5.5	5.0	3.2	2.6	3.7	3.1
Barbados	-5.9	0.7	2.3	1.5	2.2	2.2	3.7	2.6	3.1	-2.6	0.9
Belize	6.8	2.7	0.0	1.7	-0.6	1.9	-0.3	3.6	8.5	2.5	2.6
Dominica	2.5	2.0	2.0	1.3	3.0	2.3	3.2	1.4	0.8	-5.2	1.3
Grenada	0.7	-1.4	3.0	2.8	2.7	4.0	7.2	7.2	6.2	-3.7	2.8
Guyana	8.8	11.1	8.8	3.3	7.0	6.2	-2.8	4.6	-2.8	1.8	4.5
Jamaica	1.8	1.3	0.7	1.2	-0.9	-2.5	-1.6	-0.2	0.2	1.0	0.1
Saint Kitts and Nevis	4.1	6.2	6.4	4.1	6.7	8.1	1.9	4.3	5.8	2.0	4.9
Saint Vincent and the Grenadines	6.2	1.3	-3.0	7.1	0.5	2.8	5.1	2.9	1.2	...	2.6 [c]
Saint Lucia	5.9	-2.8	3.9	0.6	0.1	-1.7	2.3	1.4	-1.1	-6.4	0.2
Suriname	-2.2	-4.6	-0.4	-0.3	5.0	2.8	2.4	-3.8	-1.7	...	-0.3 [c]
Trinidad and Tobago	-1.8	-2.1	3.3	3.5	3.8	3.4	4.8	7.3	8.8	3.8	3.4

Source: ECLAC, based on official figures converted into dollars at constant 1995 prices.
[a] Preliminary figures. [b] Refers only to those countries that provide data. [c] The last column refers to the period 1991-2000.

Table A - 4

LATIN AMERICA AND THE CARIBBEAN: FINANCING OF GROSS FIXED CAPITAL FORMATION

(As percentages of GDP)

	1993	1994	1995	1996	1997	1998	1999	2000	2001 [a]
1. Domestic saving	19.3	19.9	20.6	20.5	20.7	19.4	19.4	20.2	18.6
2. Factor income	-2.6	-2.4	-2.4	-2.4	-2.4	-2.5	-3.0	-2.8	-2.9
3. Transfers	0.8	0.8	0.9	0.8	0.8	0.9	1.1	1.1	1.3
4. Gross national saving (1+2+3)	17.5	18.4	19.1	19.0	19.1	17.8	17.5	18.6	17.0
5. External saving	3.3	3.3	2.3	2.1	3.3	4.4	3.1	2.4	2.7
6. Gross fixed capital formation (4+5)	20.8	21.7	21.4	21.1	22.4	22.2	20.7	21.0	19.7

Source: ECLAC, based on official figures converted into dollars at current prices.
[a] Preliminary figures.

Table A - 5

LATIN AMERICA AND THE CARIBBEAN: GROSS FIXED CAPITAL FORMATION

(As percentages of GDP)

	1993	1994	1995	1996	1997	1998	1999	2000	2001[a]
Latin America and the Caribbean	**19.2**	**20.2**	**19.1**	**19.3**	**20.8**	**21.0**	**19.7**	**19.1**	**18.5**
Argentina	18.6	20.0	17.9	18.5	20.1	20.7	18.7	17.6	15.5
Bolivia	16.3	14.3	15.5	16.6	20.2	24.7	20.9	18.7	14.6
Brazil	18.6	20.0	20.5	20.3	21.5	21.2	19.9	18.1	18.1
Chile	21.9	22.2	25.2	25.6	26.6	26.2	21.5	22.3	22.1
Colombia	20.2	23.3	22.4	21.7	20.5	19.9	12.7	13.9	15.0
Costa Rica	19.6	19.2	19.0	17.3	18.8	21.7	19.3	18.4	18.9
Cuba	10.8	7.5	7.8	9.7	9.7	10.0	9.9	9.6	9.5
Ecuador	18.6	18.5	18.6	18.4	18.4	19.4	13.8	14.8	19.2
El Salvador	16.6	17.6	18.7	16.3	16.9	17.9	17.1	17.5	17.3
Guatemala	15.0	14.1	14.5	13.7	16.2	18.5	18.8	17.0	16.9
Haiti	16.2	12.8	26.1	27.6	28.8	27.1	32.6	37.9	35.6
Honduras	28.5	29.0	24.0	24.6	27.1	29.0	31.5	27.9	25.3
Mexico	20.8	21.6	16.2	17.9	20.5	21.2	22.0	23.0	21.7
Nicaragua	19.9	22.1	23.9	24.7	28.0	30.1	39.0	32.9	30.9
Panama	24.0	24.6	26.0	24.6	24.7	27.3	32.2	29.0	…
Paraguay	22.1	22.4	23.1	22.8	22.0	21.1	20.3	20.3	15.9
Peru	18.1	21.5	24.1	22.8	24.6	24.4	21.5	19.9	18.1
Dominican Republic	25.9	24.1	21.7	21.6	23.9	29.1	30.0	29.9	29.6
Uruguay	14.1	14.0	13.5	14.0	14.5	15.0	14.5	13.1	11.8
Venezuela	20.2	17.1	16.5	15.3	18.0	17.3	15.4	15.0	16.3

Source: ECLAC, based on official figures converted into dollars at constant 1995 prices.
[a] Preliminary figures.

Table A - 6
LATIN AMERICA AND THE CARIBBEAN: URBAN UNEMPLOYMENT
(Average annual rates)

	1980	1985	1990	1993	1994	1995	1996	1997	1998	1999	2000	2001 [a]
Latin America and the Caribbean [b]	**6.1**	**7.3**	**5.8**	**6.6**	**6.6**	**7.5**	**8.0**	**7.6**	**8.1**	**8.9**	**8.4**	**8.4**
Simple average (22 countries)	**...**	**...**	**...**	**10.0**	**9.5**	**10.1**	**10.5**	**9.9**	**9.7**	**10.3** [c]	**10.1** [c]	**10.3** [c]
Argentina												
Urban areas [d]	2.6	6.1	7.4	9.6	11.5	17.5	17.2	14.9	12.9	14.3	15.1	17.4
Barbados												
Nationwide total [e]	...	...	14.7	24.3	21.9	19.7	15.6	14.5	12.3	10.4	9.2	9.9
Bolivia												
Departmental capitals [f]	...	5.8	7.3	5.8	3.1	3.6	3.8	4.4	6.1	8.0	7.5	8.5
Brazil												
Six metropolitan areas	6.3	5.3	4.3	5.4	5.1	4.6	5.4	5.7	7.6	7.6	7.1	6.2
Chile												
Nationwide total [g]	10.4	15.3	7.8	6.5	7.8	7.4	6.4	6.1	6.4	9.8	9.2	9.1
Colombia [e]												
Seven metropolitan areas [h]	10.0	13.9	10.5	8.6	8.9	8.8	11.2	12.4	15.3	19.4	17.2	18.2
Costa Rica												
Total urban areas	6.0	6.7	5.4	4.0	4.3	5.7	6.6	5.9	5.4	6.2	5.3	5.8
Cuba												
Nationwide total	...	...	...	6.2	6.7	7.9	7.6	7.0	6.6	6.0	5.5	4.1
Ecuador [e]												
Total urban areas [i]	5.7	10.4	6.1	8.9	7.8	7.7	10.4	9.3	11.5	15.1	14.1	10.4
El Salvador												
Total urban areas	...	...	10.0	8.1	7.0	7.0	7.5	7.5	7.6	6.9	6.5	7.0
Guatemala [j]												
Nationwide total	2.2	12.1	6.3	2.6	3.5	3.9	5.2	5.1	3.8	...	...	...
Honduras												
Total urban areas	8.8	11.7	7.8	7.0	4.0	5.6	6.5	5.8	5.2	5.3	...	6.3
Jamaica [e]												
Nationwide total	...	...	15.3	16.3	15.4	16.2	16.0	16.5	15.5	15.7	15.5	15.0
Mexico												
Urban areas [d]	4.5	4.4	2.7	3.4	3.7	6.2	5.5	3.7	3.2	2.5	2.2	2.5
Nicaragua [j]												
Nationwide total	...	3.2	7.6	17.8	17.1	16.9	16.0	14.3	13.2	10.7	9.8	10.7
Panama [e]												
Metropolitan region [f]	9.9	15.6	20.0	15.6	16.0	16.6	16.9	15.5	15.2	14.0	15.2	16.9
Paraguay												
Total urban areas [k]	4.1	5.2	6.6	5.1	4.4	5.3	8.2	7.1	6.6	9.4	10.0	10.8
Peru												
Lima metropolitan area	7.1	10.1	8.3	9.9	8.8	8.2	8.0	9.2	8.5	9.2	8.5	9.3
Dominican Republic [e]												
Nationwide total	...	...	...	19.9	16.0	15.8	16.5	15.9	14.3	13.8	13.9	15.6
Trinidad and Tobago												
Nationwide total [e]	...	...	20.1	19.8	18.4	17.2	16.2	15.0	14.2	13.1	12.8	11.1
Uruguay												
Total urban areas [l]	7.4	13.1	8.5	8.3	9.2	10.3	11.9	11.5	10.1	11.3	13.6	15.3
Venezuela												
Nationwide total	6.0	13.1	10.4	6.6	8.7	10.3	11.8	11.4	11.3	14.9	14.0	13.4

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Does not include the Caribbean until 1990. [c] Figures adjusted to compensate for lack of data. [d] Represents a large and growing number of urban areas. [e] Includes hidden unemployment. [f] From 2000 on, total urban areas. [g] The figure shown for 1985 actually corresponds to 1984. [h] From 2000 on, 13 cities. [i] From 1999 on, Cuenca, Guayaquil and Quito. [j] Official estimates. [k] Until 1993, the figures given correspond to the Asunción metropolitan area. [l] The figure shown for 1980 and 1985 correspond to Montevideo.

Table A - 7

LATIN AMERICA AND THE CARIBBEAN: CONSUMER PRICES

(December-to-December percentage variations)

	1993	1994	1995	1996	1997	1998	1999	2000	2001
Latin America and the Caribbean	**872.4**	**328.7**	**26.0**	**18.6**	**10.7**	**10.0**	**9.7**	**9.0**	**6.1**
Argentina	7.4	3.9	1.6	0.1	0.3	0.7	- 1.8	- 0.7	- 1.5
Barbados	- 1.0	2.1	2.8	1.8	3.6	1.7	2.9	3.8	- 1.2
Bolivia	9.3	8.5	10.6	9.9	6.7	4.4	3.1	3.4	0.9
Brazil	2 477.2	916.5	22.4	9.6	5.2	1.7	8.9	6.0	7.7
Chile	12.2	8.9	8.2	6.6	6.0	4.7	2.3	4.5	2.6
Colombia	22.6	22.6	19.5	21.6	17.7	16.7	9.1	8.8	7.7
Costa Rica	9.0	19.9	22.6	13.9	11.2	12.4	10.0	10.3	11.0
Ecuador	31.0	25.3	22.8	25.6	30.6	43.4	60.7	91.0	22.4
El Salvador	12.1	8.9	11.4	7.4	1.9	4.2	- 1.0	4.3	1.4
Guatemala	11.6	11.6	8.6	10.9	7.1	7.5	4.9	5.1	9.1
Haiti	44.4	32.2	24.8	14.7	15.6	7.4	9.7	19.0	8.2
Honduras	13.0	28.9	26.8	25.3	12.8	15.7	10.9	10.0	8.8
Jamaica	30.1	26.9	25.5	15.8	9.2	7.9	7.0	6.1	8.7
Mexico	8.0	7.1	52.1	27.7	15.7	18.6	12.3	9.0	4.4
Nicaragua	19.5	12.4	10.9	12.1	7.3	18.5	7.2	9.9	4.7
Panama	0.9	1.4	0.8	2.3	- 0.5	1.4	1.5	0.7	- 0.1
Paraguay	20.4	18.3	10.5	8.2	6.2	14.6	5.4	8.6	8.4
Peru	39.5	15.4	10.2	11.8	6.5	6.0	3.8	3.8	- 0.1
Dominican Republic	2.8	14.3	9.2	4.0	8.4	7.8	5.1	9.1	4.4
Trinidad and Tobago	13.4	5.5	3.8	4.3	3.5	5.6	3.4	5.6	3.2
Uruguay	52.9	44.1	35.4	24.3	15.2	8.7	4.2	5.1	3.6
Venezuela	45.9	70.8	56.6	103.2	37.6	29.9	20.1	13.4	12.3

Source: ECLAC, on the basis of figures provided by public institutions in the respective countries.

Table A - 8

LATIN AMERICA AND THE CARIBBEAN: EXPORTS AND IMPORTS OF GOODS, FOB [a]

(Rate of variation in index, 1995=100)

	Exports [b]			Imports [b]		
	Value	Unit value	Volume	Value	Unit value	Volume
1990	10.2	4.4	5.5	12.9	3.7	9.0
1991	0.7	-3.2	4.0	17.7	-4.0	22.6
1992	8.0	0.6	7.4	22.8	1.3	21.2
1993	10.1	-2.3	12.7	11.8	-1.8	13.9
1994	16.0	6.6	8.9	18.7	1.5	16.9
1995	21.2	8.3	11.8	12.2	7.1	4.8
1996	12.1	0.4	11.7	11.4	-0.4	11.8
1997	11.2	-0.9	12.2	18.4	-2.8	21.9
1998	-1.1	-8.7	8.4	6.2	-3.4	9.9
1999	5.7	-1.1	6.9	-3.8	-1.5	-2.4
2000	19.8	8.1	10.8	16.1	2.1	13.7
2001 [c]	-3.9	-7.3	3.7	-2.5	-3.2	0.8

Source: ECLAC, on the basis of figures from official sources and the International Monetary Fund.

[a] Includes 17 Spanish-speaking countries, plus Brazil and Haiti. [b] The indices shown here for value, unit value and volume do not necessarily coincide with indices for these variables calculated on the basis of national accounts, due to differences in methodologies and coverage. [c] Preliminary figures.

Table A - 9
LATIN AMERICA AND THE CARIBBEAN: EXPORTS OF GOODS, FOB
(Indices 1995 = 100)

	Value			Unit value			Volume		
	1999	2000	2001[a]	1999	2000	2001[a]	1999	2000	2001[a]
Latin America and the Caribbean	**130.3**	**156.1**	**150.0**	**89.8**	**97.1**	**90.0**	**145.1**	**160.7**	**166.6**
Argentina	110.1	124.8	126.0	82.9	91.6	88.4	132.9	136.2	142.5
Bolivia	100.9	119.7	123.4	95.3	99.1	94.5	105.9	120.7	130.6
Brazil	103.2	118.4	125.2	84.0	85.6	83.0	122.9	138.4	150.8
Chile	107.3	120.1	115.5	64.5	71.0	63.5	166.4	169.2	181.9
Colombia	113.6	128.6	120.4	95.6	109.0	99.7	118.9	117.9	120.8
Costa Rica	189.9	166.9	141.7	92.5	87.9	83.4	205.3	189.9	169.9
Ecuador	102.7	114.7	106.6	95.9	115.1	102.8	107.1	99.7	103.7
El Salvador	153.4	179.4	175.6	92.9	92.0	86.5	165.1	195.0	203.0
Guatemala	128.9	142.9	138.1	78.9	79.7	73.3	163.4	179.2	188.4
Haiti	222.1	207.0	192.0	99.0	97.0	94.6	224.4	213.5	203.0
Honduras	120.3	137.0	136.5	96.1	95.1	89.9	125.2	144.1	151.9
Mexico	171.5	209.3	199.3	96.9	101.7	95.0	177.0	205.8	209.8
Nicaragua	125.7	147.5	137.6	84.6	86.3	76.7	148.6	171.0	179.4
Panama	87.1	95.8	97.1	104.8	103.8	100.7	83.1	92.3	96.5
Paraguay	54.8	55.4	55.8	91.8	90.8	87.7	59.7	61.0	63.6
Peru	109.4	125.8	127.0	74.1	75.6	69.6	147.6	166.3	182.5
Dominican Republic	135.9	151.8	141.1	93.9	94.6	92.7	144.7	160.4	152.2
Uruguay	106.7	111.0	99.8	84.5	82.1	79.6	126.2	135.2	125.4
Venezuela	109.1	173.1	141.8	95.9	141.0	114.8	113.8	122.8	123.5

Source: ECLAC, on the basis of figures from the International Monetary Fund and national sources.
[a] Preliminary figures.

Table A - 10
LATIN AMERICA AND THE CARIBBEAN: IMPORTS OF GOODS, FOB
(Indices 1995 = 100)

	Value			Unit value			Volume		
	1999	2000	2000[a]	1999	2000	2000[a]	1999	2000	2001[a]
Latin America and the Caribbean	**134.6**	**156.3**	**152.4**	**92.1**	**94.0**	**91.0**	**146.2**	**166.2**	**167.6**
Argentina	128.2	126.8	101.8	84.2	84.2	81.7	152.2	150.6	124.6
Bolivia	125.8	129.5	122.1	86.8	88.5	85.5	144.9	146.4	142.8
Brazil	99.3	112.4	111.9	89.7	94.2	91.5	110.7	119.3	122.3
Chile	100.6	116.7	112.1	87.7	96.5	92.7	114.7	121.0	120.9
Colombia	78.1	84.4	93.4	93.2	94.1	91.3	83.8	89.7	102.3
Costa Rica	157.6	158.3	149.7	90.0	91.8	88.3	175.1	172.5	169.5
Ecuador	65.6	81.7	117.3	90.3	93.0	90.0	72.7	87.9	130.3
El Salvador	124.9	151.0	154.5	106.9	111.2	107.9	116.8	135.8	143.2
Guatemala	137.9	156.4	160.3	90.5	94.1	90.3	152.3	166.2	177.5
Haiti	143.9	155.8	151.5	103.9	110.1	105.7	138.5	141.5	143.3
Honduras	159.7	169.9	179.1	87.2	91.6	87.2	183.2	185.5	205.4
Mexico	196.0	240.8	232.3	94.7	94.7	91.4	206.9	254.3	254.1
Nicaragua	192.7	186.9	184.8	104.3	111.6	108.2	184.8	167.5	170.8
Panama	100.1	105.2	100.9	99.0	104.0	100.4	101.2	101.1	100.5
Paraguay	61.3	64.7	64.2	104.7	107.8	104.2	58.6	60.0	61.7
Peru	86.8	94.8	92.9	89.0	93.5	89.8	97.5	101.4	103.4
Dominican Republic	155.5	183.3	169.9	90.3	92.7	89.5	172.2	197.8	189.8
Uruguay	117.5	122.2	107.4	89.0	95.2	91.4	132.1	128.3	117.5
Venezuela	109.5	128.4	143.2	89.6	89.6	87.1	122.2	143.3	164.4

Source: ECLAC, on the basis of figures from the International Monetary Fund and national sources.
[a] Preliminary figures.

Table A - 11

LATIN AMERICA AND THE CARIBBEAN: TERMS OF TRADE FOR GOODS, FOB/FOB

(Indices 1995 = 100)

	1993	1994	1995	1996	1997	1998	1999	2000	2001[a]
Latin America and the Caribbean	**94.1**	**98.8**	**100.0**	**100.8**	**102.8**	**97.1**	**97.5**	**103.3**	**99.0**
Argentina	104.8	105.6	100.0	108.5	108.9	103.9	98.5	108.8	108.2
Bolivia	88.3	102.5	100.0	111.7	115.6	109.9	109.8	112.0	110.5
Brazil	79.9	91.5	100.0	98.0	103.8	103.8	93.6	90.9	90.7
Chile	74.2	84.1	100.0	80.7	83.0	73.3	73.5	73.6	68.5
Colombia	91.0	104.9	100.0	103.8	104.4	95.8	102.6	115.8	109.2
Costa Rica	84.5	93.9	100.0	94.9	100.6	103.9	102.8	95.8	94.5
Ecuador	106.4	108.9	100.0	109.6	111.9	99.6	106.2	123.8	114.2
El Salvador	63.7	81.0	100.0	93.6	94.1	91.7	86.9	82.7	80.2
Guatemala	84.3	89.9	100.0	87.7	94.8	94.3	87.2	84.7	81.2
Haiti	94.1	96.8	100.0	90.6	94.8	96.7	95.3	88.1	89.5
Honduras	90.3	92.1	100.0	92.8	115.4	118.0	110.2	103.8	103.1
Mexico	104.9	103.3	100.0	102.8	104.0	100.4	102.3	107.4	103.9
Nicaragua	81.3	95.5	100.0	88.1	83.9	87.4	81.1	77.3	70.9
Panama	106.8	110.1	100.0	101.3	103.4	103.3	105.9	99.8	100.3
Paraguay	87.2	105.1	100.0	100.0	99.9	92.4	87.7	84.2	84.2
Peru	89.1	95.7	100.0	96.5	103.2	89.7	83.3	80.9	77.5
Dominican Republic	90.7	95.6	100.0	97.7	102.0	103.1	104.0	102.0	103.6
Uruguay	94.6	94.7	100.0	96.7	96.4	103.1	94.9	86.2	87.1
Venezuela	100.9	100.0	100.0	115.6	110.8	79.9	107.0	157.4	131.8

Source: ECLAC, on the basis of figures from the International Monetary Fund and national sources.
[a] Preliminary figures.

Table A - 12

LATIN AMERICA AND THE CARIBBEAN: BALANCE OF PAYMENTS

(Percentages of GDP) [a]

	Trade balance (goods and services)		Balance on current account		Balance on capital and financial account [b]		Overall balance	
	2000	2001[c]	2000	2001[c]	2000	2001[c]	2000	2001[c]
Latin America and the Caribbean	**-0.7**	**-1.0**	**-2.4**	**-2.7**	**3.5**	**1.7**	**0.8**	**-1.0**
Argentina	-0.6	1.2	-3.1	-1.6	2.7	-6.0	-0.4	-7.5
Bolivia	-7.3	-5.7	-5.4	-3.5	4.9	3.1	-0.5	-0.4
Brazil	-1.4	-0.9	-4.1	-3.9	6.2	3.7	1.4	-0.6
Chile	1.8	1.6	-1.5	-1.8	2.1	1.0	0.5	-0.8
Colombia	1.5	-1.0	0.4	-2.0	0.6	3.4	1.0	1.5
Costa Rica	2.6	-0.4	-4.8	-4.7	3.8	4.9	-1.0	0.1
Ecuador	7.3	-8.0	6.8	-5.7	-48.5	4.0	-41.9	-1.7
El Salvador	-15.3	-14.8	-3.3	-1.4	3.1	0.0	-0.4	-1.4
Guatemala	-9.0	-10.2	-5.5	-5.8	9.3	8.7	3.4	2.5
Haiti	-20.0	-20.1	-2.1	-1.4	1.0	1.4	-1.2	0.0
Honduras	-14.4	-17.7	-4.3	-5.5	3.5	6.3	-1.1	0.3
Mexico	-1.8	-2.3	-3.1	-3.0	5.2	5.2	1.2	1.3
Nicaragua	-43.2	-44.7	-38.3	-40.9	32.4	32.3	-8.3	-11.1
Panama	-5.0	-1.5	-9.4	-5.0	6.3	2.1	-3.3	-3.0
Paraguay	-5.4	-4.9	-2.5	-2.9	-1.9	2.1	-4.5	-0.8
Peru	-2.0	-1.5	-3.0	-2.0	2.9	2.9	-0.2	0.8
Dominican Republic	-9.5	-8.8	-5.2	-4.2	5.6	7.8	-0.2	2.6
Uruguay	-2.6	-2.0	-2.7	-2.4	3.4	3.7	0.8	1.5
Venezuela	12.1	5.4	10.9	3.6	-7.1	-6.2	4.8	-1.7

Source: ECLAC, on the basis of figures from the International Monetary Fund and official sources.
[a] Estimates based on figures expressed in dollars at current prices. [b] Includes errors and omissions. [c] Preliminary figures.

Table A - 13
LATIN AMERICA AND THE CARIBBEAN: GROSS DISBURSED EXTERNAL DEBT [a]
(Millions of dollars)

	1993	1994	1995	1996	1997	1998	1999	2000	2001[b]
Latin America and the Caribbean	**528 037**	**564 399**	**619 233**	**641 305**	**666 482**	**747 583**	**763 197**	**740 202**	**725 671**
Argentina	72 209	85 656	98 547	110 613	125 052	141 929	145 289	146 338	139 783
Bolivia [c]	3 784	3 777	4 216	4 523	4 366	4 234	4 390	4 327	4 240
Brazil	145 726	148 295	159 256	179 935	199 998	241 644	241 468	236 157	226 036
Chile	19 665	21 768	21 736	22 979	26 701	31 691	34 167	36 849	37 790
Colombia	18 908	21 855	26 341	31 116	34 412	36 606	36 662	36 394	39 885
Costa Rica	4 011	4 133	4 209	3 289	3 086	3 402	3 641	3 748	3 800
Cuba	8 785	9 083	10 504	10 465	10 146	11 209	11 078	10 961	11 100
Ecuador	13 631	14 589	13 934	14 586	15 099	16 400	16 282	13 564	14 411
El Salvador [c]	1 976	2 056	2 168	2 517	2 689	2 632	2 789	2 832	3 148
Guatemala	2 347	2 895	2 947	3 026	3 197	3 618	3 831	3 929	4 100
Guyana	2 062	2 004	2 058	1 537	1 514	1 500	1 196	1 250	1 250
Haiti [c]	866	875	898	914	1 025	1 100	1 166	1 180	1 189
Honduras	3 850	4 040	4 243	4 121	4 073	4 404	4 729	4 721	4 802
Jamaica	3 687	3 652	3 452	3 232	3 278	3 300	3 050	3 200	3 200
Mexico [d]	130 500	139 800	165 600	157 200	149 028	160 258	166 381	148 652	144 534
Nicaragua [c]	10 987	11 695	10 248	6 094	6 001	6 287	6 549	6 660	6 374
Panama [c]	5 264	5 505	5 891	5 070	5 051	5 349	5 568	5 604	6 263
Paraguay	1 254	1 271	1 741	1 801	1 927	2 133	2 697	2 701	2 586
Peru	27 447	30 191	33 378	33 805	28 642	29 477	28 704	28 353	27 653
Dominican Republic	4 562	3 946	3 999	3 807	3 572	3 537	3 636	3 685	4 137
Trinidad and Tobago	2 102	2 064	1 905	1 876	1 541	1 430	1 511	1 550	1 550
Uruguay [c]	3 578	4 251	4 426	4 682	4 754	5 195	5 178	5 492	5 611
Venezuela	40 836	40 998	37 537	34 117	31 328	30 248	33 235	32 056	32 229

Source: ECLAC, on the basis of official figures.
[a] Includes debt owed to the International Monetary Fund. [b] Preliminary figures. [c] External public debt. [d] Public debt does not include investment by non-residents in government securities.