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UNITED NATIONS

ECLAC
Economic Commission for Latin America and the Caribbean

THE ECONOMY OF LATIN AMERICA AND THE CARIBBEAN POSTS MODEST RECOVERY

The Latin American and Caribbean economy will grow 1.5% in 2003, recovering modestly from a 0.6% drop in 2002, while per capita GDP will remain flat this year, 2% lower than in 1997, completing the region's sixth lost year.

So concludes the Economic Commission for Latin America and the Caribbean, **ECLAC**, in its annual ***Economic Survey of Latin America and the Caribbean, 2002-2003***, which reduced the growth estimate made six months ago.

ECLAC estimates that 2003 will be better than 2002 in terms of growth, employment, financial conditions and external accounts, "although the fact remains that 2002 is a poor basis for comparison." In 2004, these variables are expected to continue to progress, depending on the stronger or weaker performance of the world economy.

For this year, **ECLAC** forecasts flattening growth, due "to the lack of either a vigorous international economy or reactivating forces within the region." No "external engine" is available: the United States is not growing as forecast, the European economies are surprisingly weak and Japan remains stagnant.

Argentina Heads Growth Ranking

Argentina will head the growth ranking (5.5%), although its per capita GDP will be 17% lower than in 1997, while Venezuela will post the lowest (-13%) growth, despite a significant recovery in the second quarter.

(continued on page 3)

CHANGES IN LATIN AMERICA AND CARIBBEAN COUNTRIES' ECONOMIC POLICY

ECLAC's Economic Survey of Latin America and the Caribbean 2002-2003, points to three trends as the most significant in terms of economic policy in 2003.

First, fiscal reforms became increasingly structural throughout the region during 2002-2003, which **ECLAC** considers a sign that fiscal problems are not simply the result of temporary conditions "but rather pose challenges that must be addressed from a more institutional perspective."

El Salvador is the only Latin American economy that has neither legislated fiscal reforms nor attempted to do so during these two years, although the issue is the subject of public debate. All the others have either passed tax reforms (Argentina, Brazil, Chile, Colombia, Guatemala, Honduras, Nicaragua, Panama, Peru (partially), Uruguay and Venezuela) or are in the process of doing so (Costa Rica and Ecuador). Others attempted reforms that failed, due to riots in Bolivia, public protests in Mexico, or a deadlock between the executive and the legislature in Paraguay.

A significant number of changes were introduced and attempts made to introduce new laws regarding tax codes, fiscal responsibility, structural changes in public expenditure or other standards, pension system reforms to reduce the structural fiscal deficit and adjustments to public utility rates.

(continued on page 6)

FINANCIAL INNOVATION AND THE MILLENNIUM TARGETS

ALICIA BÁRCENA

With firm support from heads of state and governments, the Millennium Summit established development objectives and targets to focus efforts to correct poverty, hunger, environmental damage and discrimination against women, among other issues. It also proposed creating a world association for development with specific goals in the areas of aid, trade, and debt relief. In 2002, the Monterrey International Conference on Financing for Development identified the need to create an international system to resolve the debt question.

Twenty years after the Mexican debt crisis of 1982, this issue remains unsolved in the region. The hardships involved in servicing debt have grown worse in the past six years due to the accumulation of obligations during the previous decade, the reduction in the absolute amount of loans, and important changes in their composition.

The net transfer of resources (net income from total capital minus net payments of profits and interest) went from 1.4% of GDP in 1998 to -2.4% in 2002. Private debt flows determined this decline. Although official financing has significantly contributed to external financing, it has fluctuated tremendously. Official aid for development, in any case, represents less than one-third of the commitments made at the Earth Summit. Foreign direct investment, for its part, has been positive in these years, but tended to decline.

Far from dropping, the region's vulnerability to swings in capital flows has increased in recent years. The fall in net financing made it difficult for several of the region's economies to honour their commitments. Recently, two countries found it impossible to make external payments. Argentina went into partial default on its obligations, a problem that despite a recent agreement with the IMF, still awaits solution. Uruguay had to resort to a debt swap to avoid default. Both countries had their debts spread out among multiple creditors, which made the coordination necessary for a renegotiation more difficult. The Uruguayan debt swap included Collective Action Clauses (CAC), which had already been included in new issues from Mexico and Brazil.

"Twenty years after the Mexican debt crisis of 1982, this issue remains unsolved in the region."

These clauses, permitted on sovereign bonds under English, Japanese and Luxemburg law, are new in bonds covered by New York State legislation, where most emerging countries' sovereign debt issues are placed. Because of this, as the ***Economic Survey of Latin America and the Caribbean, 2002-2003*** notes, the decision by some countries to include them in bonds issued there represented a noteworthy institutional advance.

The market has responded favourably to the use of the CAC. This is apparent in the lower spread posted by the bonds, compared to other issues. Apparently, due to difficulties faced by other securitized debt renegotiations, holders value mechanisms such as the CAC, which constitute a kind of "insurance" in the event of a possible default. Multilateral bodies also supported the CAC. The use of the CAC goes in the direction sought by objectives outlined at the Monterrey summit, of requiring an international system to resolve the debt question. By using them, it is implicitly assumed that the cost of the market alone resolving a debt problem is too high. But despite this progress, the CAC are simply a first step toward emerging countries' achieving the Millennium targets.

The author is **ECLAC's** Deputy Executive Secretary.

Chile's growth will rise more, at 3.5%, led by export sectors and, like Brazil, it is gearing up for faster growth in the medium term, according to **ECLAC**. Brazil will grow for the third year running, at 1.5%.

Colombia is the only Andean economy with better prospects today than some months ago and is forecast to grow 2.5%, while Peru, the country posting the highest growth in 2002 (5.3%) will hold steady at 3.5%. Of the economies of Cuba, Haiti, the Dominican Republic and Central America, Costa Rica will perform the best, at 4.5%. Mexico's reactivation has been delayed but 2003 is expected to move from less to more, permitting growth of 1.5%.

Investment Has Not Turned Around Strongly

Gross investment in fixed capital will rise moderately in 2003 (1%), while the investment rate should reach almost 18% of GDP, measured at constant 1995 prices. This is similar to 1988 levels, the lowest in the 1980s and much lower than the average for the 1990s (19.5%).

The decline in investment reveals that the region's medium-term growth capacity is not improving. According to ***ECLAC's Economic Survey of Latin America and the Caribbean, 2002-2003,*** this is not surprising given that investment, along with imports, is precisely the real variable most affected by economic cycles.

The countries enjoying the highest investment rates will be Argentina, Colombia, Costa Rica and Peru, in the case of the first two after posting all-time lows.

The Terms of Trade Stop Deteriorating

Despite trends in the world economy, the current value of the region's goods exports will rise 4.4% in 2003 (3.5% excluding oil), after stagnating in 2002. The Latin American economies posting the strongest export growth are those with the most competitive exchange rates or those with the most investment in natural, non-renewable resources. Imports, by value, will rise 0.8% in 2003, recovering slightly from their 6.7% fall in 2002.

This will improve the region's balance of trade, with a surplus (US$37 billion) for the second year running, which will almost balance the current account, whose deficit will fall to -US$ 3.7 billion, just -0.2% of GDP, something that had not occurred since 1990.

The decline in the terms of trade, which began in 1997, has stopped, and during the course of this year some marginal improvement is expected, for both oil (1.2%), and non-oil (0.8%) economies.

ECLAC notes the Free Trade Agreement achieved by Chile and the United States and progress in negotiations for the Central American Common Market, also with the United States. It also applauds the renewed commitment that Argentina and Brazil's new authorities have made to Mercosur and integration with the Andean Community, which reflect a new stage in efforts to achieve greater regional trade integration.

International Financial Conditions Improve for the Region

International financial conditions will improve for the region in 2003. Net capital flows will reach US$ 40 billion, but net flows abroad will be negative by about US$ 15 billion, due to sizeable profit remittances and interest payments.

Access to international financial markets has improved, with spreads on sovereign debt declining from all-time peaks in the second half of 2002. Likewise, countries have started to issue sovereign bonds again and, in the cases of Brazil, Mexico and Uruguay include collective action clauses (CAC) which should make any future renegotiations easier.

In this sense, the **ECLAC** report observes that "the market has assigned a higher value to a mechanism that provides for a negotiated solution in cases of insolvency than to issues that lack this mechanism and therefore only offer the extreme option of default."

In short, the international economic context in 2003 will be bumpy.

The tardiness of the expected turnaround in the world's economy has deprived the region of an external engine. In particular, the performance of most of the economies most linked to the United States (Mexico, Central America and the Caribbean) remained unsatisfactory in 2003.

In South America, where the main economies faced critical conditions in 2002, the response to more competitive exchange rates has been evident with regard to several of them, along with a financial context that, while still deficient, has tended to improve.

The special case of Brazil stands out. There, the combination of a growing trade surplus, reduction of sovereign risk and fiscal discipline are giving rise to more relaxed conditions that promise medium-term growth.

In non-oil economies, meanwhile, the decline in the terms of trade that began in 1997 has stopped, bringing some relief. Finally, for some economies international conditions are actually a second order factor when it comes to explaining their performance in 2003, among them Venezuela and the Dominican Republic. www

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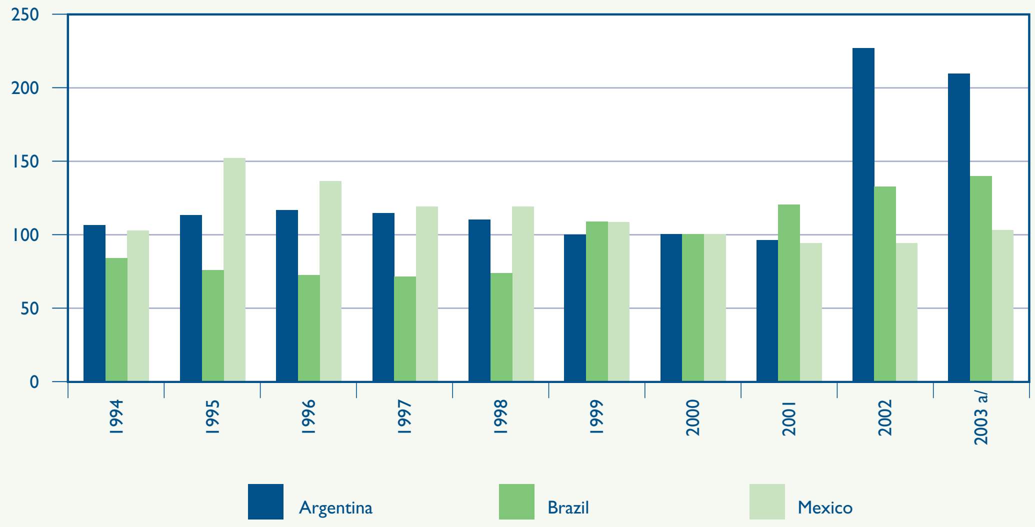
EXPORT COMPETITIVENESS AND THE REAL EXCHANGE RATE

MANUEL MARFÁN

One of the strategic challenges to development in Latin America and the Caribbean is the consolidation of a competitive export sector. Exports should be the main source of the foreign currency available to the region to finance its imports and other external payments without increasing its dependency on foreign flows. A dynamic and diversified export base is an essential condition to overcome external restrictions on economic development. Moreover, in smaller economies, with more limited domestic markets, export growth must serve as a powerful growth engine.

A country's international competitiveness is the result of a range of factors. First, *resource endowment*, which should be understood dynamically, since only in the particular case of natural resources are these of a static nature. In general, the resource stock is a function of investment in certain areas of the economy, particularly those linked to human capital. Essential aspects of resource endowment include the technology and efficiency with which the productive apparatus functions. Second, competitiveness depends on a range of *systemic factors* that involve domestic (infrastructure, institutional regulations, etc.) and external (degree of openness to potential markets) components. Finally, competitiveness depends on the *macroeconomic framework* in which productive activity takes place. The key policy instrument for stimulating exports is a competitive, stable real exchange rate. This macroeconomic price must be the pillar of an ongoing, consistent export development policy, since it offers a signal that makes it possible to organize its competitive resources, and overcome systemic obstacles domestically. External ones can be overcome to the degree that integration agreements lift trade barriers.

Latin America and the Caribbean: Actual Real Exchange Rate
(Base index: 2000=100)



Source: **ECLAC**, based on official figures.
a/ Average for January to June.

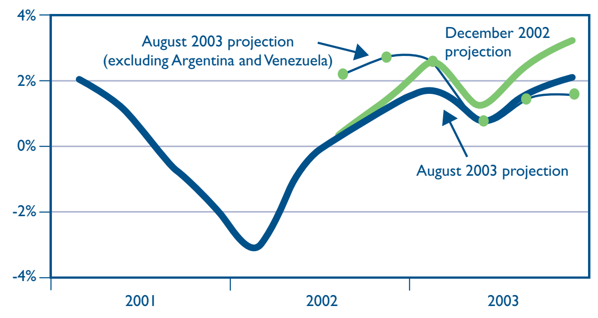
Recent trends affecting some Latin American economies illustrate the importance of a competitive real exchange rate to export sector growth. Brazil, since its foreign exchange correction in 1999 has kept its real foreign exchange rate competitive, encouraging significant export growth despite the difficult moment facing the world's economy at the moment. In fact, its exports rose 15% in 2003 to reach US$ 70 billion. This result would not have been possible without a high real exchange rate like the one Brazil has had for almost four years. Several sectors have positioned themselves competitively in the international market and the country has improved its current account balance. Argentina is beginning to enjoy a similar situation after abandoning a foreign exchange regime that generated significant backwardness in this area. In 2003, Argentine exports will rise 10%. Most of this growth is due to a rise in some agribusiness activities whose profitability has improved thanks to real peso devaluation. Manufactured exports, traditionally sent to Brazil, have not taken off as well. However, many have started to find non-traditional markets and are expected to consolidate in the near future. The Argentine government has reaffirmed its goal of maintaining a competitive, stable real exchange rate. This would be part of avoiding the errors of the past that caused the country's international competitiveness to plummet. Mexico, meanwhile, has become the other side of the Brazilian and Argentine coin in terms of export performance. In 2003, exports (including oil) will rise barely 1%. After the recession in the United States in 2001, its non-oil exports to that country have fallen, although the United States' imports from other countries started to recover. Apparently Mexican exports have lost their competitiveness and the foreign exchange rate, which is lagging behind despite a recent tendency to devaluate, is playing a significant role. How the country will deal with this obstacle to export growth remains unknown to date. However, undoubtedly the example of some South American countries regarding the link between the real exchange rate and export development could offer some food for thought at the moment.

The author is Director of **ECLAC's** Economic Development Division.

INDICATORS

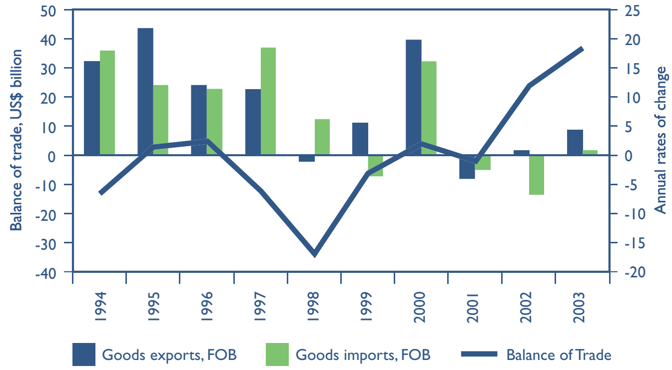
Latin America and the Caribbean: Quarterly GDP, 2001-2003

(Percentage change over the same quarter of the previous year)



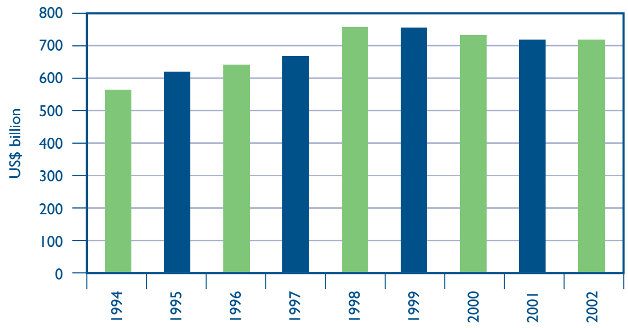
Latin America and the Caribbean: Changes in the Balance of Trade

(1995=100)



Latin America and the Caribbean: Total Gross External Debt

(US$ billion)



Source: **ECLAC**, based on official figures.

(from page 1) **Changes in Latin...**

ECLAC notes that these trends clearly reveal "a transition process from short-run fiscal adjustment towards more structural fiscal reforms" from 2002-2003. "There are still numerous challenges to be met in this respect, but the region is headed in the right direction."

The short-term corollary is that during 2003 fiscal policy will not serve to spur domestic spending to rise from its 2002 levels, except in countries where fiscal revenues dropped due to cyclical rather than policy reasons. "The absence of an external engine of growth is thus compounded by the absence of a fiscal engine capable of providing the driving force for a reactivation," states the report.

Monetary Policy Recovers Some Degree of Freedom

Secondly, monetary policy has gained greater freedom to manoeuvre. To defend against foreign exchange pressures last year, many economies shifted toward a more restrictive monetary policy stance. But in the first six months of 2003, more countries are implementing more expansionary monetary policies.

This reactivating effort not only reflects the recovery of monetary management's greater freedom to manoeuvre, but also the weakness of private domestic expenditure, particularly by private investment, which is associated with the adjustment to the balance of trade occurring in several of the region's economies. "A low-growth year (as 2003 is projected to be) in which a trade adjustment is made (as is also expected) is also a sign of a slump in domestic spending. This is, in part, why monetary policy is taking a more expansionary line in most of the region," states the **ECLAC** report.

Exchange-Rate Competitiveness

Thirdly, exchange rate policy is experiencing a calmer year, especially in the Mercosur economies. During the first half of 2003, 12 countries posted currency appreciations against the dollar, headed by the four Mercosur economies. This was to be expected after over-adjustments to foreign exchange last year, the turnaround in the case of the most critical capital outflows, stronger trade balances and, to a lesser degree, dollar depreciation against the euro.

Two main features stand out from an analysis of the region's changing exchange rates, according to **ECLAC**.

The first is that despite recent currency appreciations affecting some South American economies, almost all are ending up with more competitive real exchange rates, that are boosting their exports and sectors that compete with imports. "In the absence of external and/or fiscal engines of growth, the forward momentum being conveyed to the real sector by this increased competitiveness is opening up areas of opportunity more rapidly than in the past," the report notes, adding that in all South American economies whose currencies have depreciated substantially, the agricultural sector (and especially annual and semi-annual crops) are booming.

The second is that exchange-rate variations in South America are having spillover effects on trading partners within the region. For example, Bolivia devalued its currency against the dollar in 2002, but the steep depreciation of its trading partners' currencies, above all Argentina and Brazil, translated into real effective appreciation. However, the appreciation of the Argentine peso and Brazilian real during the year have caused the Bolivian peso to depreciate at a real rate of over 11%.

The ***Economic Survey*** concludes that there is an "interdependence of exchange-rate policies at the subregional level, which is increasing further as trade integration processes progress. The corollary of this is that, in order to carry those processes forward, the countries will need to take steps to strengthen their policy coordination and to forestall the adverse effects of the unilateral devaluations carried out in 2002." WWW

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The symbols used in this newsletter represent the various indigenous cultures of the Americas and some of the milestones in the region's history. The symbols are engraved on the outside of the conference rooms at ECLAC headquarters in Santiago, Chile.

Irrigation systems | Stele of St. Agustine | Brasilia | God or priest with hoes | Nahua Glyphs

INFLATION DECLINES AND EMPLOYMENT RISES

ECLAC estimates that Latin America's inflation will rise on average 8.6% for the period from December 2002 to December 2003, a significant drop from the 12.1% it reached last year. It is important to note that in most of the region, inflation's upward spiral in 2002 and its current decline are mainly associated with fluctuating foreign exchange rates. In several countries, the size of foreign exchange swings has been greater than inflation, so that a significant part of the swings in the nominal exchange rate has translated into changes in the real exchange rate.

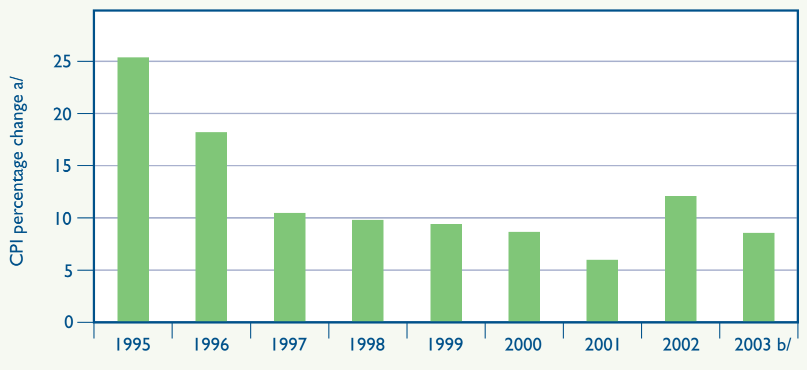
Of the 20 countries included in the ***Economic Survey***, the number of economies with two-digit inflation will fall from seven in 2002 (Argentina, Brazil, Haiti, Paraguay, the Dominican Republic, Uruguay and Venezuela) to just three in 2003 (Haiti, the Dominican Republic and Venezuela).

The four Mercosur economies are posting the greatest decline in inflation in 2003: Argentina's is estimated to reach 5%, down from 41% in 2002, and Brazil, Paraguay and Uruguay will see inflation fall below 10%, after posting two-digit inflation in 2002 (12.5%, 14.6% and 25.9%, respectively).

Slight Rise in Employment Rate

In 2003, labour conditions are expected to improve modestly, after peaking at the highest unemployment rate in history (8.9%) the year before. During the first half of the year, Chile, Colombia, Peru and, above all, Argentina managed to drive up their employment rate and reduce unemployment. In contrast, in Brazil and Mexico it has performed sluggishly.

Average Inflation in Latin America and the Caribbean



Source: **ECLAC**, based on official figures.
a/ December to December b/ Change from June 2002 to June 2003

The rise in the supply of labour - for both demographic reasons and due to higher participation rates - will push urban unemployment up by some 750,000 people to a total of 13.6 million.

In 2002, changes in real wages in the region were to a large extent determined by the sign and size of the change in inflation, which as mentioned reflected changes in the exchange rate. In most countries, lower inflation translated into an increase in the real wage within the formal sector, while in countries with higher increases in the exchange rate and inflation, that is those of Mercosur and Venezuela, wages' purchasing power fell.

In light of sluggish economic activity and flattened mean labour productivity rates, in the first group of countries wages rose slightly in 2003. Because in these cases inflation tends to remain relatively stable and low, real wages posted only minimal changes. In other countries, the year-on-year comparison continues to give negative results, but foreign exchange appreciation and the decline in inflation are helping to stabilize real wages, which have tended to recover: this was the situation at mid-year, above all in Argentina and Uruguay. www

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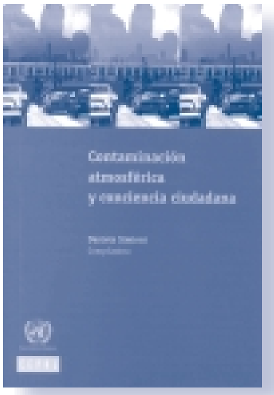
RECENT TITLES

1 ***Contaminación atmosférica y conciencia ciudadana*** (*Air Pollution and Citizens' Awareness*), edited by Daniela Simioni. Libros de la **CEPAL** No. 73, June 2003 (LC/G.2201-P US$15, Spanish). These texts reflect the **ECLAC** project "Strengthening Citizens' Awareness to Formulate Policies for Controlling Air Pollution in Three Latin American Metropolitan Areas," supported by the Japanese government. They aim to correct the lack of empirical studies on citizens' awareness and environmental issues. The cities studied were Mexico City, Sao Paulo and Santiago de Chile. www

2 ***La calidad de la inserción internacional de América Latina y el Caribe en el comercio mundial*** (*The Quality of Latin America and the Caribbean's International Integration*), by Mikio Kuwayama and José E. Durán Lima. Comercio Internacional series No. 26, May 2003 (LC/L.1897-P, Spanish US$10). These countries show two patterns of



export specialization: one involving dynamic product exports (Mexico and several Central American and Caribbean countries); and the other, natural resource-based products whose share of world trade is not very robust (South America). www

3 ***El desarrollo de complejos forestales en América Latina*** (*The Development of Forest Complexes in Latin America*), edited by Néstor Bercovich and Jorge Katz. Co-published by **ECLAC** and Alfaomega, May 2003, available in bookstores). In the past two decades, several countries tried to join the world economy through the renewal of their forestry industry. The study examines forestry complexes in Argentina, Brazil, Chile, Colombia and Mexico to detect sources of strength and growth in new industrial organization models. www

4 ***Evaluación de las reformas a los sistemas de pensiones: cuatro aspectos críticos y sugerencias de políticas*** (*An Evaluation of Pension Reforms: Four Critical Aspects and Policy Suggestions*), by Luis Felipe Jiménez and Jessica Cuadros. Financiamiento del Desarrollo series No. 131, June 2003 (LC/L.1913-P, Spanish, US$10). This study reviews coverage, new systems' administrative costs and efficiency, along with the conditions under which they could raise investment financing, and evaluates the reforms' impact on government coffers. www

5 ***Incertidumbre económica, seguros sociales, solidaridad y responsabilidad fiscal*** (*Economic Uncertainty, Social Insurance, Solidarity and Fiscal Responsibility*), by Daniel Titelman and Andras Uthoff. Financiamiento del Desarrollo series No. 134, June 2003 (LC/L.1919-P, Spanish, US$10). This paper argues that the more the economic environment is plagued by uncertainty and volatility and greater social and economic risk remain without coverage, social security reforms must reconcile insurance and savings ends with those of distribution and solidarity. www

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CALENDAR

MONTH	EVENTS	VENUE
SEPTEMBER		
1 September to 5 December	Regional diploma specialising in human settlements. City and Territorial Management. Ministry of Housing and Urbanism (Chile)/University of Chile /**ECLAC**/Corporación de Promoción Universitaria (Corporation for University Promotion).	**ECLAC** headquarters, Santiago, Chile
1 -12	Fifth course-seminar "Providing and Regulating Infrastructure Services." ILPES.	**ECLAC**
8-12	Course-workshop on international classification, United Nations Statistics Division (UNSD)/**ECLAC**.	**ECLAC**
22	Meeting about issues critical to regulating drinking water and sewage services in the region's countries. Natural Resources and Infrastructure Division, **ECLAC**.	**ECLAC**
23-24	Seminar "Competitiveness and the Environment". Sustainable Development and Human Settlements Division. **ECLAC**/GTZ Montevideo.	**ECLAC**
23-25	Second technical meeting on gender indicators and statistics: Including a Gender Perspective in Poverty Measures. Women's Unit, **ECLAC**.	La Paz, Bolivia
OCTOBER		
1-3	Seminar on new strategies for overcoming poverty in Latin America and the Caribbean. **ECLAC**/FOSIS/Red Social.	**ECLAC**
7-9	Consultation meeting about sustainable development indicators for Latin American and Caribbean countries. Sustainable Development and Human Settlement Division, **ECLAC**.	**ECLAC**
20-21	Plenary meeting of the Macroeconomic Dialogue Network. Economic Development Division, **ECLAC** /European Commission.	**ECLAC**
21-24	Workshop-course, "Implementing Access to Information, Citizens' Participation, and Environmental Justice for Sustainable Development in Latin America and the Caribbean." **ECLAC** /World Bank.	México D.F.
23-24	Workshop on Urban Development Potential in Latin America and the Caribbean: access to land, territorial taxes and local government. **ECLAC** /IDB/Government of France.	**ECLAC**

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