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Summary of the Economic Survey of Latin America and the Caribbean 2001

Summary

The severe slowdown in the world economy in 2001 has cut short the recovery that began in 2000 and dashed hopes that Latin America and the Caribbean were about to embark upon a new growth cycle. Regional output grew at a very slow pace (gross domestic product (GDP) growth amounted to a scant 0.4 per cent) and growth prospects for 2002 are not promising (0.5 per cent) due to the crisis in Argentina and the slow growth expected in the other economies. Given the magnitude of the external factors that buffeted the region's economies during the year, however, they did quite well in withstanding a large part of these destabilizing shocks and in averting domestic or external crises. The one exception was Argentina, which has been in the throes of a crisis for the last three years. Inflation continued to abate, and the increase in the external deficit was fairly small. Without detracting from the macroeconomic advances that the countries succeeded in making under such adverse circumstances, however, the fact remains that the succession of stop-go cycles experienced over the past decade have resulted in a low long-term growth rate. Consequently, this rate is far lower than what the region needs in order to reduce its high level of unemployment and improve the substandard conditions under which a large percentage of its population still lives.

The deterioration seen in the region's economic situation was, once again, the result of an adverse international economic environment. The slowdown seen in the industrialized countries was exacerbated by the harder than expected landing of the United States economy. Unlike the crises of the 1990s, which were confined to a limited group of countries, the slowdown of 2001 engulfed the region as a whole.

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In a somewhat unusual turn of events, the recessionary climate in the global economy led to declines in the value of the region’s exports and the value of its imports (the last time that both had fallen at the same time was in 1982). These decreases reflected a steep drop in United States orders for Latin American and Caribbean products. This was compounded by a downward trend in raw materials prices which, in the case of some products, began in 2000 or even as far back as the Asian crisis. The greater uncertainty that arose in international markets in the wake of the 11 September attacks against financial and political targets in the United States accentuated this trend for a time.

Against this grim backdrop, intraregional trade — which is more heavily concentrated in manufactures and less easily influenced by international events — helped to buoy exports. This was particularly true of the Central American and Andean countries, thanks to the consolidation of these subregions’ integration schemes. On the other hand, the Southern Common Market found itself in a difficult economic and political situation, and its trade activity contracted by 10 per cent.

Capital inflows to Latin America and the Caribbean were also down sharply. Autonomous flows were a scant US$ 34 billion, a figure reminiscent of the meagre levels seen in 1999 when the region was suffering from the repercussions of the Russian moratorium. The terms and conditions under which the countries have access to external financing continued to be worse than they had been before the Asian crisis. The most severe constraints in this respect were experienced by Argentina and, to a lesser extent, Brazil and Ecuador, and multilateral lending institutions disbursed unprecedented amounts of standby credit to these countries.

Rather than being confined to export sectors, the impact of the adverse international environment impinged upon all areas of activity; in fact, the consequences of this situation were felt more keenly by the domestic economy than by export activities. While the latter were able to partially offset the downturn in prices by expanding the volume of shipments by 2 per cent, domestic consumption in the region as a whole was flat, and gross investment declined.

The poor performance of domestic demand was the result of a number of different factors. The 4 per cent deterioration of the terms of trade and higher factor payments drove real per capita income down by 2 per cent, and the effect this had on private demand was magnified by pessimistic expectations. In addition, in keeping with a trend that had been in evidence since the second quarter of 2000, macroeconomic policy was tightened. With some exceptions, real variations in interest and exchange rates created less favourable monetary conditions than those seen in 2000. Nor was there any sign of a countercyclical management of fiscal expenditure, and the automatic stabilizing effect of a larger fiscal deficit was quite limited since, as a regional average, the deficit expanded by less than half a point of GDP. This cautious frame of mind was evidenced by public policymakers as well, and the pace of structural and trade reform processes slowed, even though some advances were made.

Latin America and the Caribbean: main economic indicators

	1999	*2000*	*2001[a]*
Economic activity and prices		*Annual growth rates*	
Gross domestic product	0.4	4.1	0.4
Per capita gross domestic product	-1.2	2.5	-1.1
Consumer prices	9.5	8.7	6.8
Terms of trade	0.4	5.9	-4.7
		Percentages	
Urban open unemployment	8.8	8.4	8.4
Fiscal balance/GDP[b]	-3.1	-2.7	-3.1
External sector		*Billions of dollars*	
Exports of goods and services	341.0	405.8	390.9
Imports of goods and services	362.7	419.4	412.0
Balance of goods	-6.2	3.9	-1.6
Balance of services	-15.5	-17.5	-19.5
Balance on income account	-52.2	-52.5	-54.0
Balance on current account	-55.1	-46.2	-52.4
Balance on capital and financial account	43.3	61.5	33.8
Overall balance	-11.8	14.6	-18.6
Net resource transfer	-3.1	1.0	-3.4

Source: Statistical Appendix.
[a] Preliminary estimates.
[b] Simple average.

Despite these widespread difficulties in the domestic and external sectors of the region’s economies, they did not — apart from Argentina — fall victim to outright balance-of-payments or financial crises. Although the Argentine crisis did have a contagion effect on neighbouring economies in the second and third quarters, financial and exchange-rate indicators for the fourth quarter of 2001 backed up the belief that the region’s economies had succeeded in de-linking themselves from the Argentine crisis.

In the fiscal arena, the authorities sought to compensate for the decline in revenues by curtailing their investment programmes and, on average, the Latin American and Caribbean countries’ fiscal deficits expanded somewhat. Primary expenditure contracted and was thus once again slightly procyclical. Inflation continued to subside. This downward trend is attributable both to the countries' success in controlling underlying inflationary factors and to lower fuel prices. In some cases, however, the declines registered in monthly consumer price indices ceased to be good news and were instead seen as a sign that the countries were at risk of lapsing into a recession.

The steep reduction in growth hurt the labour market, and the employment rate fell by over half a percentage point. Since the labour supply also shrank more sharply than it had at any time since 1990, however, the regional unemployment rate held steady at 8.4 per cent of the economically active population. Nonetheless, this figure is still one of the highest to be recorded in the last 10 years. Sluggish production activity in 2001 also hurt wages, which stagnated or fell in real terms. In contrast, wages in the manufacturing sector increased moderately on average, while they rose steeply in Mexico.

The current account deficit climbed to nearly US$ 52 billion (around 3 per cent of regional GDP) within a context of real exchange rate appreciation. The increases in the deficit remained within the bounds of each country's external financing capacity, however, and in most cases the external shortfall remained below 4 per cent. The merchandise trade account ran a small deficit and net factor service payments rose.

Foreign direct investment diminished for the second year in a row, from US$ 64.8 to US$ 58.3 billion, but was still high compared to historical averages. Official loans filled the gap left by the contraction of private capital flows. Despite the fairly high level of capital inflows, however, net inward transfers were nil. This virtual balance between inflows and outflows of financial resources has been maintained for the last three years and is a development that bears watching. The prospects for inflows of foreign direct investment are not promising in either the short or medium term due to the prevailing level of uncertainty on international markets and the fact that the privatization drive in the region is nearing its end.

Given the prospect that these investments may decline and that net resource transfers may turn negative, it is becoming increasingly urgent for the region to implement the reforms needed to reduce its external vulnerability, build up its internal capacity to finance investment and social expenditure, and smooth out its economic cycles. In the view of the Economic Commission for Latin America and the Caribbean (ECLAC) volatility management in the region requires the following elements: (i) consistent, flexible macroeconomic (fiscal, monetary, credit and exchange-rate) management; (ii) strict prudential regulation and supervision of national financial systems; and (iii) a liability policy that will result in an appropriate public and private (both external and domestic) debt profile.*

* See ECLAC, *Equidad, desarrollo y ciudadania*, vol. 3 "Agenda económica", Bogotá, ECLAC/Alfaomega, 2000. At the same time, better finance for development for the region within the present context of globalization is required. See ECLAC, *Crecer con estabilidad: el financiamiento del desarrollo en el nuevo contexto internacional*, Bogotá, ECLAC/Alfaomega, 2001.

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I. Domestic economic performance

1. In 2001, the Latin American economies were faced with an increasingly hostile external environment as growth in world trade and in the United States economy dropped off sharply and international prices for raw materials fell. Financial turbulence associated with declines in the world's stock markets and uncertainty in the wake of the events of 11 September in the United States generally affected the world's economies. These effects were compounded by a number of regional factors, including the escalation of the financial crisis in Argentina and its repercussions on other economies in the region which tended to weaken during the last months of the year, the energy crisis in Brazil, natural disasters (earthquakes in El Salvador, drought in various countries of Central America, hurricanes in Cuba, Honduras and Jamaica), forcing authorities to undertake unbudgeted public expenditures, and a new outbreak of foot and mouth disease in the southern part of the continent curtailed meat exports.

The regional economy deteriorates

2. Economic activity barely expanded in Latin America and the Caribbean during this year, cutting short the promising recovery that had begun in 2000. This deterioration became more and more evident as the year progressed, with world economic growth slowing and the crisis deepening in Argentina. Output increased by 1.5 per cent in the first semester, but fell by 0.8 per cent in the second. Thus, for the year as a whole, the region's output expanded by 0.4 per cent and per capita output declined by 1.1 per cent. National income was flat, given the worsening terms of trade and an increase in net outward factor payments.

3. Regional consumption stagnated and gross fixed investment was reduced by 1 per cent, exports increased by just over 2 per cent and imports held steady. Both tradables and non-tradables accounted for this poor performance. Among non-tradables, construction was one of the hardest hit sectors, with activity down sharply in a number of countries. The Argentine automotive industry plummeted and maquila activities, which have been very dynamic in recent years, took a turn for the worse in some countries. Tourism suffered a setback after 11 September, especially in the northern part of the region.

4. The adverse trend in economic activity was regionwide, affecting both countries with high growth rates and countries that were in the process of recovering from the crisis of 1999. The first group includes Mexico, whose economy stagnated in 2001 after five years of growing at an average annual rate of 6 per cent, as the long-lasting economic expansion in the United States — which purchases 90 per cent of Mexico's exports — came to an end. The Dominican Republic experienced only moderate growth, in contrast with its performance in recent years when it had recorded the region's highest rates of expansion. The downturn was largely attributable to adjustments implemented the previous year, a weaker performance by maquila industries and the setback experienced by the tourism industry after 11 September. Cuba was battered by Hurricane Michelle and the downturn of tourism and the sugar sector, and its growth rate fell to 3 per cent. The Central American countries also saw their growth rates slacken, as external problems were exacerbated by a widespread drought that caused heavy losses in agriculture and by low prices for these nations' traditional export products. Costa Rica was also hurt by a lower level of activity in the high-technology electronics industry.

5. Most of the South American countries, which were badly hurt by the crisis of 1999, performed poorly again in 2001. Brazil's promising recovery was cut short by its energy crisis, by the adverse international economic climate and by the worsening economic and financial crisis in the region. The Chilean economy also lost momentum, despite its sound economic fundamentals, owing to the difficult external environment. In Colombia, the reactivation was halted by the continued weakness of internal demand and deterioration of the external context, with the exception of strong growth in exports to Ecuador and Venezuela. Peru, which is emerging from a severe political crisis, performed poorly during most of the year. The Bolivian economy stagnated as a consequence of weakness in both domestic and external markets.

6. Given the severe contraction of external financing and capital flight, the recession that Argentina has experienced for the last three years continued during the first semester and worsened during the second. Despite adjustment plans that were put into effect, the fiscal deficit did not recede because tax receipts were down sharply. Uruguay also moved into its third consecutive year of recession, as the problems

generated by the devaluation of the Brazilian real and the worsening of the Argentine crisis were aggravated by the reappearance of foot and mouth disease, which dealt a severe blow to the country's livestock industry.

7. The exception to this gloomy picture was Ecuador, whose economy expanded rapidly in the first semester, although its high growth rate later tailed off as world oil prices dropped. Venezuela turned in moderate growth as booming petroleum prices and a low real exchange rate drove up domestic demand steeply, even though imports also increased considerably. Paraguay recorded a modest upswing in activity, which made up for the slight decline of the previous year.

Investment declined in 2001

8. The upturn in gross fixed investment which had begun in 2000 was reversed in 2001 by a downturn of 1 per cent. Bleak expectations and the steps taken to limit public spending bore part of the blame for this setback. External saving increased for the region as a whole, but this was attributable to a limited number of countries, as the indicator showed no variation or declined in the rest. National saving decreased, especially in the public sector.

9. The northern portion of the region, which had enjoyed a substantial increase in investment in 2000, saw this trend reversed in 2001. This downturn was largely attributable to Mexico, where investment had expanded by almost 9 per cent in 2000 but decreased by around 3.5 per cent in 2001. In the other countries, the results reflected meagre GDP growth and were thus generally quite poor.

10. In South America investment performed no better than in the rest of the region. Chile and Brazil turned in modest growth rates that were far below their first-quarter results, which had generated strong expectations of an upswing in these economies. Investment fell steeply once again in Argentina, Peru and Uruguay, after having dropped sharply in previous years as well. By contrast, the recovery of investment continued in Colombia, after plummeting in 1999, but has yet to regain its 1998 level. Venezuela had little difficulty in continuing to increase investment, in particular public investment, thanks to its hefty tax receipts from petroleum exports in recent years.

Inflation down again

11. In 2001 the rate of inflation in the region declined once again, falling to 6.8 per cent. Wholesale prices climbed by 6 per cent after having risen sharply in 1999-2000. Moderate inflation in 2001 was mainly attributable to stable exchange rates in most countries and to the end of the escalation in oil prices, in combination with the continued implementation of prudent monetary policies and the recessionary conditions existing in the region; in fact, a number of countries experienced deflation, which could be cause for concern.

12. The rate of inflation decreased in 18 of the 22 countries for which information is available and increased in only four. The latter group included Brazil and Guatemala, where inflation was three or four percentage points above the 2000 figures. Ecuador made the greatest improvement, with a drop of almost 70 percentage points in its rate of inflation. In 2001 only three economies had double-digit inflation and the highest rate of all was only around 22 per cent. Four countries, by contrast, recorded near-zero inflation or even deflation.

13. In Ecuador, the inflationary spiral of 1999 and early 2000 came to a halt following the dollarization of the economy. The inflation rate then began to drop steeply, sliding to 22 per cent, while producer prices fell significantly (-3 per cent) in the first 10 months of the year. Mexico also turned in a good performance, clearly signalling the consolidation of its stabilization process, with an annual inflation rate of just 4.4 per cent, the best result since 1971. In Venezuela, inflation continued to subside, although more slowly than before. In Brazil, the outcome for the year was fairly positive, since the rise of around 20 per cent in the exchange rate and the increases in fuel prices and public rates and charges translated into no more than a moderate upturn in inflation. This was attributable to a slower economic growth rate, along with stricter monetary policies.

14. Chile, El Salvador and Uruguay once again posted very low and declining inflation rates. In Chile, this was despite a significant rise — of over 15 per cent — in the exchange rate. Panama continued to display its customarily low rate of inflation, and Bolivia and Peru had virtually zero inflation in 2001. In Argentina consumer prices declined by 1.5 per cent and wholesale

prices by 6 per cent, in a deflationary phenomenon attributable to the recession in the country.

Labour market worsens in 2001

15. The sharp reduction in growth adversely affected the labour situation in the region. The employment rate dropped by more than half a percentage point, but unemployment held steady at 8.4 per cent since the labour supply also shrank. Be that as it may, unemployment was still high in historical terms. The low demand for jobs was only partially reflected in wage trends, as in some countries these were stagnant or fell, and in others real remunerations were favoured by progress in controlling inflation.

16. The employment rate decreased from 53.3 per cent in 2000 to 52.7 per cent in 2001, which meant that the ground gained in 2000 was lost once again. This was partly attributable to a decline in employment in the region's largest economies, Brazil and Mexico. The employment rate was also down in Chile and Argentina, but it remained practically unchanged in Colombia. By contrast, employment was up in Costa Rica, Ecuador, Uruguay and Venezuela. The labour supply shrank from 58.4 per cent in 2000 to 57.6 per cent in 2001, the largest decrease in the last 10 years. The behaviour of this indicator in the individual countries was mixed, however, as the labour force participation rate decreased significantly in the two largest economies, Brazil and Mexico, but increased in another five countries.

17. Although the rate of unemployment remained stable at the regional level, major differences existed across countries. Unemployment increased in 10 of the 16 countries for which information is available and it did so quite sharply — by one percentage point or more — in five of them (Argentina, Colombia, Dominican Republic, Panama and Uruguay). It declined in El Salvador and Venezuela.

18. The recession in the United States economy had a negative impact on job creation in Mexico's export sector, and employment in maquila export activities declined for the first time in 15 years (-17 per cent between December 2000 and December 2001). In manufacturing, employment declined by almost 4 per cent. As a result, in 2001 the rate of open unemployment was 2.5 per cent, up from 2.2 per cent in 2000. The absorption of labour by the informal sector offset the negative trend recorded in export sectors to a large extent.

19. In Brazil, net job creation declined as a result of fairly slack GDP growth. Nevertheless, the urban unemployment rate decreased from 7.1 per cent in 2000 to 6.2 per cent in 2001. This was a reflection of a lower labour force participation rate for the working-age population in major urban centres, probably owing to people's discouragement at the lack of job opportunities. In Argentina, the employment ratio decreased by one percentage point, with the greatest fall in the Buenos Aires metropolitan area. The unemployment rate rose from 15.1 per cent in 2000 to 17.4 per cent in 2001, with the biggest increase being in the second semester.

20. In Chile, job creation in the formal sector had begun to weaken in the fourth quarter of 2000. The deterioration in the labour situation has been partially mitigated by the introduction of direct public employment programmes and subsidies for private employment which benefited about 1.5 per cent of the economically active population. Urban unemployment remained high in Colombia, with an average of 18.2 per cent in the first 10 months of 2001, compared to 17.2 per cent a year earlier. The overall labour force participation rate remained unchanged from its 2000 levels. This rate was still higher than the long-term trend, however, due to increased participation by secondary workers in response to a decline in household income. In Ecuador, the rate of employment began to increase again in the second half of 2000, rising from 48.8 per cent in 2000 to 49.8 per cent in 2001. This, together with a decline in labour supply, made unemployment significantly lower.

21. The sluggishness of the labour market had an impact on wages, and the few countries for which information is available generally recorded no more than minimal variations and decreases in real average wages in formal activities. Thus, a slight increase was recorded in Chile (1.6 per cent), no change in Colombia, and decreases of between 0.4 per cent and 5 per cent in Brazil, Peru and Uruguay. The exceptions were Mexico, where wages were up by 6 per cent thanks to lower than expected inflation, and Nicaragua, which posted a 4 per cent increase.

Weak growth expected in 2002

22. There is still a great deal of uncertainty surrounding the hoped for reactivation of the Latin American and Caribbean economies in 2002. The outlook for the international economy remains fairly unpromising in view of the problems facing the United States, as well as slower growth in the European economies and a worsening of the Japanese crisis. Despite the strong decrease in international interest rates, there is no sign of a return of capital to developing countries, due to the existing high perception of risk. Foreign direct investment, the principal mechanism for the transfer of capital to the developing world in the 1990s, is in a period of retraction.

23. The situation in North America will affect Mexico, Central America and the Caribbean, especially since trade with the United States is likely to remain slack and the situation will be compounded by a crisis in the tourism sector. A modest reactivation is expected in Mexico and Costa Rica, however. In South America, Brazil's performance is likely to pick up somewhat, thanks to exports stimulated by a favourable exchange rate and a revival of internal demand, if exchange rate conditions permit the adoption of a less restrictive monetary policy. The Southern Cone countries as a whole will register a new fall in GDP, but one that is basically due to Argentina, where prospects are not encouraging since it is expected to again register a contraction. Chile, on the other hand, should continue to show modest growth and Uruguay should do better than in 2001. The Andean Community will continue to expand its activity level, although only slightly. Peru's economy should benefit from a mining mega-project and the normalization of its domestic situation, while Venezuela should grow, but very moderately. Colombia should show an improvement in its performance next year, and Ecuador is likely to continue its recovery, although at a slower rate. The region overall is expected to grow at a mere 0.5 per cent in 2002.

II. Macroeconomic policy

24. The sharp decline in economic activity during the course of the year, together with the increasingly gloomy turn taken by economic agents' expectations as domestic and external events slowed the economy, highlighted the need for a rapid reactivation of growth in almost all countries of the region. However, policymakers wishing to embark on countercyclical policies of the sort used by developed countries had very little room for manoeuvre.

25. The slowdown or outright contraction of economic activity had a direct impact on tax receipts, given the close correlation between tax revenues and domestic economic activity in the region. At the same time, expenditure levels were driven up by the rising cost of servicing the domestic and external debt, whose upward trend was attributable to the dual effect of increased borrowing and climbing exchange rates. While many countries resorted to increased external borrowing to cover their widening fiscal deficits, this was in fact a limited option, and they generally had to curtail investment expenditure as well; the result was a procyclical fiscal spending pattern.

26. Monetary policymakers had to be mindful of the repercussions of the adverse external environment, which tended to strengthen external competitiveness, the dollarization of a large part of the public debt and of private contracts in certain countries and the possible impact of exchange-rate trends on domestic prices. Early in the year, monetary policy was aimed at providing sufficient liquidity to underpin the hoped for economic reactivation, but this strategy was of limited usefulness because the expected expansion of aggregate demand never took place. Consequently, monetary policy had to be tightened up more and more as the year moved on.

27. Because of the priority focus on coping with the adverse economic environment and the fact that considerable progress had already been made, the pace of the structural reform process slowed. Privatization operations slackened as this process ran its course, and the emphasis shifted to the award of concessions, to regulatory measures and to the promotion of competition. The main focus throughout 2001 has been on fiscal reforms and on regulations to improve bank supervision and to control illicit capital flows. Regional integration efforts were limited to the tariff reductions already provided for in existing subregional agreements, while within the Southern Common Market, trade disputes arose and discordancies among the different partners' exchange regimes posed a problem.

28. There are therefore a number of lessons to be learned from the beginning of the new millennium.

First, the cyclical character of market economies was strongly evident, for both developing and developed countries. Second, within the framework of an essentially asymmetrical international system, the developed countries have deployed the full arsenal of countercyclical instruments that economic policy has to offer in a bid to counter the contractionary trend of their economies. In contrast, developing countries, among them those in the region, ran into difficulties in their efforts to do so and will therefore need to work towards regaining the ability to wield the entire array of available economic policy instruments if they are to avert sharp cyclical swings.

29. Another important development was that the much feared "contagion effect" of Argentina's financial crisis faded. This crisis erupted midway through the year and had initially caused turbulence in some neighbouring countries, especially Brazil and Chile. By the end of the year, however, Argentina's financial troubles appeared to have been contained within its borders. This also lessened the likelihood that the initial contagion of Brazil would have a "domino effect" on the rest of the region.

Fiscal deficits widen as public revenues contract

30. Public-sector shortfalls had lessened in 2000 thanks to an upswing in revenues, but in 2001 the deficit for Latin America and the Caribbean as a whole widened to 3.1 per cent of GDP. In a region where there is a close correlation between tax revenues and trends in economic activity, fiscal policy was directed towards reducing expenditure, especially on investment, and towards financing the imbalance with domestic and external funds in an effort to avoid threatening the stability of domestic prices.

31. Almost all the countries saw a downturn in government income, and especially in tax revenues; the only exceptions were a few countries, such as Colombia, the Dominican Republic and Ecuador, that had successfully introduced tax reforms. Tumbling international oil prices had a direct impact on the earnings of State-owned oil exporters, with Venezuela being the hardest hit. In Mexico, even though non-oil income increased, the reduction in petroleum-based revenues revived the legislative debate concerning the introduction of a tax reform bill that, among other changes, would apply the value added tax to currently exempt basic consumer items, a proposal that has yet to win acceptance. Colombia was less seriously affected because of its diversified tax structure, while the reduction in Ecuador's earnings from oil exports was offset by domestic revenues from increased economic activity, improvements in tax administration and slackening inflation. In the case of Chile, lower copper prices had both a direct effect on State coffers and an indirect impact in the form of a slowdown in growth driven by the mineral sector.

32. South America's two largest economies saw their tax revenues plummet. This prompted the Argentine Government to take emergency measures during the third and fourth quarters which included a hike in the financial transactions tax, a reduction in tax exemptions and the postponement of cuts in the gasoline tax. Brazil's efforts to move towards fiscal decentralization and to strengthen its tax system under the Fiscal Responsibility Act were thwarted by the slowdown in domestic economic activity stemming from the unfavourable external climate. The decrease in Paraguay's tax receipts was fully covered by royalty payments from the binational hydroelectric dams. In Uruguay, however, the decline in tax receipts kept the fiscal deficit high.

33. Expenditure, on the other hand, increased. One of the main reasons for the upswing in current expenditure was the additional cost of debt servicing. A generally tighter monetary policy was one of the factors that made it more expensive to service domestic debt, and this effect outweighed the relief provided by lower international interest rates. Current transfers to distressed sectors, such as the coffee industry, and the transitional costs of pension reforms incurred by such countries as Bolivia, El Salvador and Uruguay also fuelled the increase in public expenditure. Most governments resorted to cuts in capital expenditure in order to slow the increase in the deficit. After two earthquakes hit the country, El Salvador had to undertake investments that it had not bargained for in order to repair the damage.

34. The large deficits incurred during the last four years, which were covered with borrowed funds, have significantly raised the level of public debt. In fact, the public debt has risen so steeply that there is now some question as to the viability of resorting to this course of action again in the medium term. The public sectors of Argentina, Brazil, Colombia, Costa Rica and Ecuador,

among others, have built up debt stocks equivalent to more than half or even as much as their total GDP.

Foreign-exchange markets exhibit a response capacity, despite some tensions

35. The massive inflow of foreign capital throughout much of the 1990s caused a downward trend in the real exchange rate in many countries of the region. In an effort to prevent this trend from undermining their external competitiveness, some countries sought to place limits on the revaluation of their currencies by restricting liquidity, but the results of this were just the opposite of what they had expected, as domestic interest rates rose and capital inflows expanded. Other countries additionally opted to restrict the entry of capital.

36. The external environment in 2001 was a far cry from what it had been during the preceding period of abundant capital inflows and burgeoning world trade. The recent trend towards the depreciation of local currencies has not, however, been as strong as the appreciation of those currencies had been during that period. With very few exceptions (Brazil, Chile and Colombia, with flexible exchange regimes, and Uruguay with its crawling peg and flotation band), the currencies of the countries of the region strengthened against the currency basket representing their main trading partners. The end result in terms of the countries' real exchange rates was determined by a variety of factors. The contagion effect of the Argentine crisis that predominated during a good part of the year tended to elevate the dollar's value in Brazil and Chile in the second semester, in the context of greater liquidity. In Colombia's case the value of the dollar rose somewhat more slowly than domestic prices, while the real exchange rate improved as a result of the strong real appreciation of the currencies of Ecuador and, to a lesser degree, Venezuela. The faster pace of devaluation in Uruguay made for an improvement in its real exchange rate in relation to many of its trading partners, but most of this gain was undermined by Brazil's steep devaluation.

37. A total of 13 countries having a variety of foreign-exchange regimes saw their currencies appreciate, even though the international environment was less conducive to such a trend than in previous years. In most of these countries, the appreciation of the local currency coincided with net inflows of foreign capital that covered their fiscal deficits; two countries — Argentina and Venezuela — recorded heavy draw-downs of international reserves, and in Mexico, a copious inflow of private capital exerted downward pressure on the exchange rate. El Salvador embarked upon the dollarization of its economy in 2001 by adopting the dollar as its unit of account, thus becoming the third country in the region to introduce a system of this type.

38. While these developments point to the fragility of the balance of payments, in almost all cases these difficulties remained within the bounds of the national authorities' scope of action. The considerable weakening of productive activity was, however, a negative counterpart to the way in which the external sector weaknesses were handled macroeconomically.

Renewed austerity in monetary policy

39. In early 2001, favourable expectations regarding international and national economic conditions prompted a number of countries to ease their monetary policies in a move aimed at providing sufficient liquidity for the anticipated economic reactivation. When the reactivation failed to materialize, the monetary authorities were left with very little room for manoeuvre.

40. Brazil lowered its interest rates during the first quarter. In a context of growing international uncertainty, particularly due to the effects of the Argentine crisis, the restrictions on supply generated by the energy crisis and the slowing aggregate demand, the dollar's value rose substantially, raising the spectre of possible pressures on domestic prices. In response to these new developments, the benchmark interest rate was raised once again. Steps were also taken to curb the supply of foreign exchange on the market and to tighten liquidity by issuing dollar-indexed securities and increasing the percentage of deposits held in reserve in the banking system. In Chile, spillovers from events in Argentina prompted the central bank to intervene in the foreign-exchange market. These operations resulted in a contraction of liquidity that exerted pressure on the dollar and put the inflation target in jeopardy; nonetheless, the money supply expanded in real terms. Other countries, such as Paraguay and Venezuela, also modified the money

supply's growth rate as the year progressed by conducting open-market operations designed to boost interest rates. Mexico, on the other hand, eased its monetary policy, which had been somewhat restrictive at the beginning of the year, while various Central American countries lowered their interest rates in an effort to boost the liquidity of their economies.

Credit supply and demand remain weak

41. The credit market was influenced by adverse supply and demand factors. The continuing fragility of financial systems in many countries (Colombia, Ecuador, Guatemala, Nicaragua and Peru, some of which had substantial arrears) and pessimistic projections of economic growth tended to restrict credit supply. At the same time, the gradual weakening of the region's economies, coupled with the reduced borrowing capacity of private agents, also dampened the demand for credit, even though interest rates were declining. Where credit supply exceeded private demand, the banking system allocated a portion of its resources to finance public-sector deficits.

Slower pace of structural reform

42. The privatization process continued to taper off, mainly because of a natural depletion of stock. Many countries are now implementing concession procedures that should give added impetus to cooperation between the public and private sectors. Efforts continued to be made to promote greater domestic competition.

43. The year 2001 saw an abundance of tax reform bills. Reform laws were passed in Argentina, Chile, Colombia, Costa Rica, the Dominican Republic, Ecuador, Guatemala and Peru. Reform bills are still under review in Mexico and Panama.

44. A number of Caribbean countries adopted financial measures designed to curb illegal transactions, some countries tightened up bank supervision, and others introduced measures to broaden their capital markets. Bucking the trend of recent years, both Argentina and Venezuela instituted capital controls.

45. The results of regional integration efforts were mixed. Some groups made progress in the development of a regulatory framework for macroeconomic policy coordination. The Southern Common market members became involved in further trade disputes, however. The marked differences between the exchange regimes of the two largest members, in the absence of mechanisms for providing acceptable means of compensating for disequilibria, severely hampered further progress.

III. External sector

46. Trade was the main channel for the transmission of the global economic crisis to Latin America and the Caribbean. A steep drop in external demand caused the export earnings of most of the countries in the region to shrink. All the countries saw a downturn in the prices brought by their products on world markets, and many were, in addition, unable to ship as large a volume of exports as the year before. The impact on domestic demand of these reductions in earnings and in production led to cuts in spending on imports in many instances. Import prices were also down, but in numerous cases the volume of imports was smaller as well. Under these circumstances, it comes as no surprise that the merchandise trade account ran a deficit and the regional trade balance worsened.

47. The region's deficit on the factor income account also deepened somewhat. This was due to lower interest earned following cuts in international rates and to wider spreads on interest paid, the effects of which could not be offset by declining profit remittances, which were no longer rising. Current transfers (composed primarily of remittances from residents in the United States) on the other hand, continued to climb slowly despite moderate decreases in the Dominican Republic, Haiti and Paraguay. This form of income has traditionally been important for the Central American countries, as well as for Bolivia and Ecuador, but in 2001 it also figured prominently in such medium-sized economies as Colombia and Peru.

48. These factors combined to push the deficit on the balance-of-payments current account up from its 2000 level of US$ 46 billion (2.4 per cent of GDP) to over US$ 52 billion (2.8 per cent of regional GDP) in 2001. The bulk of this increase is attributable to a decrease in Venezuela's surplus to less than half its former level, the expansion of Mexico's deficit and the change of sign in Colombia's current account as it slipped into a deficit position. Most of the countries' deficits were moderate in size (below 4 per cent of their GDP), with

the only exceptions being Bolivia and some Central American countries.

49. Net autonomous capital inflows were too meagre to cover the region's current account deficit; in fact, even when supplemented by compensatory financing, it took the total gross sum of those inflows — for the third year in a row — just to service the external debt and cover the returns on foreign capital. The plentiful inflows received by Mexico were not enough to offset hefty capital outflows from Argentina and Venezuela, which thus played a major role in this situation.

External markets for goods and services reflect the effects of the world crisis

50. The sharp slowdown in global economic activity, whose growth rate slid from 3.8 per cent in 2000 to a decade low of 1.3 per cent in 2001, took a heavy toll on international trade, which registered an even steeper downturn. The volume of international trade was virtually flat in 2001 after having surged by over 12 per cent the year before. This was reflected in a sharp deceleration of the growth of shipments from Latin America and the Caribbean, becoming the main channel for the transmission of the global crisis to the region.

51. Weaker world demand was also reflected in the prices of the commodities most sensitive to swings in economic activity, i.e., raw materials. In 2000, price levels for some products had begun to move back up towards the levels reached before the Asian crisis, but in 2001 all or a good part of the ground they had regained was lost again. Prices for other products had never recovered from the decline experienced during the Asian crisis.

52. The region's two main exports were especially hard hit. The prices of oil and of petroleum products were down by 23 per cent from their high levels of the year before. After having fallen steadily during each of the preceding four years, coffee prices plunged by a further 30 per cent.

53. The average prices of non-fuel minerals and metals for the first 11 months of the year were 9 per cent lower than the average for the whole preceding year. In the case of agricultural raw materials, the drop amounted to somewhat more than 3 per cent, although some products exhibited double-digit declines; wood pulp prices, for example, were down by over 30 per cent, in sharp contrast to cowhides, whose prices rebounded by more than 40 per cent. The prices of numerous metals — including zinc, tin, steel products, silver and copper — fell by over 10 per cent.

54. Food products were the only category that showed an improvement, withstanding the effects of the excess supply which glutted the international market, although the rise in their average annual price was only enough to take it back up to its 1996 level. These results were largely attributable to banana prices, which jumped by nearly 40 per cent, and wheat prices, which climbed 10 per cent (the same as beef prices) but were still far below their pre-Asian crisis levels.

The resulting contraction of trade is felt throughout the entire region

55. Within this recessionary international environment, some countries in the region managed to expand their export volumes, but most saw a slowdown in growth rates or even outright reductions, and not one country escaped the downswing in average export prices. The outcome was a widespread decrease in export earnings, with the regional total for external sales of both goods and services slipping to little more than US$ 390 billion, or 3.7 per cent less than a year earlier.

56. The Central American countries and the main exporters of hydrocarbons fared the worst. The steep drop in the prices of their coffee and oil exports was compounded, in the case of Mexico and the Central American nations, by slackening demand in the United States, on which they are particularly dependent for their exports of manufactures and tourism services. Venezuela also had to cut back on its oil shipments as part of a joint policy agreed upon by the Organization of Petroleum-Exporting Countries.

57. In the specific case of services, the Caribbean Basin countries' earnings from tourism and travel were struck hard by the impact of the 11 September terrorist attacks in the United States. Many countries reported decreases of between 20 per cent and 60 per cent in the number of tourists in September. Several national airlines were operating far below full seating capacity, and in some cases flights had to be cancelled. Tourism revenues are vital for the economies of many countries,

from Mexico to the islands on the eastern fringe of the Caribbean.

58. Argentina and Brazil were two of the very few countries that managed to boost their export revenues, although the gains were smaller than those of the year before. Their earnings were underpinned by sizeable increases in the volume of shipments (up by 9 per cent in the case of Brazil and 5 per cent in that of Argentina). The economic adjustments made by both countries were an important factor in this connection, although these processes took different courses, with Brazil's currency depreciating while, in Argentina, domestic absorption was curtailed.

59. This difference between the two largest South American economies' adjustment processes was also reflected in their imports, whose volume fell by 14 per cent in Argentina but rose by 4 per cent in Brazil. This divergence was also seen in the region as a whole, although the slump in economic activity in most countries of the region was generally accompanied by a slowdown or reduction in both the volume and the value of imports. Against this backdrop, the surge in Ecuador's imports, which climbed by two thirds, and the double-digit increase in Colombia's were particularly striking developments.

60. For the region as a whole, the net effect of these differing trends was that merchandise import volume levelled off, in sharp contrast to the 14 per cent increase posted the year before. Given the decline in prices, which affected all the countries, the total value of their imports of goods and services slipped to around US$ 412 billion, down 1.8 per cent from the previous year.

61. While trade with the rest of the world languished, intraregional trade, which primarily involves manufactures, expanded within the Andean community and the Central American Common Market. The same was not true of the Southern Common Market, where intraregional trade shrank by nearly 10 per cent in the first three quarters, while extraregional exports rose. The share of intraregional trade in the total trade of the Southern Common Market thus dropped to 17.5 per cent.

62. Trade among the member countries of the Andean Community, on the other hand, increased at an annual rate of 11 per cent, whereas their total exports shrank by 8 per cent. Among the countries of the Central American Common Market, sales to the United States fell sharply, while reciprocal trade expanded, consolidating their position as the group of countries with the highest percentage of reciprocal trade (approaching 27 per cent of the total).

Plummeting autonomous capital inflows

63. Autonomous capital inflows to Latin America plunged from US$ 61.5 billion in 2000 to US$ 34 billion in 2001, with Argentina witnessing a sharp turnaround that left it with outflows of over US$ 20 billion, followed by a contraction in flows to Brazil. As a result, capital inflows were lower than they had been even in 1999 (2.5 per cent of GDP), when the region was being buffeted by the repercussions of the Russian moratorium.

64. Argentina and Venezuela both registered large capital outflows, and Brazil's inflows thinned due to the decrease in inward foreign direct investment (FDI). To compensate for this reduction, the International Monetary Fund disbursed a record sum of over US$ 16 billion to Argentina and Brazil. Meanwhile, Mexico's plentiful inflows of 2000 carried over into 2001 thanks to high domestic interest rates and steadily declining rates in the United States. Most of the other countries' capital inflows remained at levels close to those recorded in 2000.

65. As in the preceding year, capital movements mainly took the form of FDI, even though these investment flows slowed for the second year in a row. Net equity investment was negative and all the proceeds from bonds and bank loans had to be used to amortize maturing debts.

External financing for 2002 is received ahead of time, despite the Argentine crisis

66. Sovereign bonds issued by Argentina in the first quarter amounted to US$ 1.5 billion, as compared to the US$ 13 billion taken in during 2000. Since it was unable to obtain financing on voluntary debt markets, in June the Government swapped US$ 30 billion in securities in order to lighten its public debt service burden in 2002-2003. This operation was conducted at extremely high interest rates. The country's difficulties in securing financing persisted in the ensuing months. Late in the year, the Government attempted to

implement a new, comprehensive plan for restructuring the public debt at an annual interest rate of no more than 7 per cent. By the end of November it had completed a swap involving over US$ 50 billion in domestic obligations.

67. Most of the other governments in the region had met their targets for public bond issues on international markets by mid-year, with the biggest borrowers being Brazil, Colombia and Mexico. Costa Rica and El Salvador undertook issues as well. After the events of 11 September, the Governments of Chile, Mexico and Uruguay took advantage of their investment-grade ratings to offer issues that would bring in external financing for 2002. The Governments of Colombia, the Dominican Republic and Guatemala also floated issues, but at higher interest rates. Placements by private firms in the region were few and far between, as risk-averse investors showed a preference for sovereign debt securities. External financing for the region remained unstable and continued to suffer from bouts of volatility.

68. External borrowing conditions have yet to return to where they were prior to the Asian crisis. Average terms hovered around five years, and at the end of the year the cost of external finance was holding at around 16 per cent per annum. This rate was partly accounted for by deep discounts on Latin American external debt on secondary markets, on Argentine securities and, to a lesser extent, on Brazilian securities.

69. If these securities are factored out of the calculations, the average annual cost was around 11 per cent, which was still quite high considering the sizeable reductions in international rates seen in 2001. The cost fluctuated very little because the increase in spreads was offset by reductions in the rates on United States Treasury bonds. As of November, the countries whose position had deteriorated the most were Argentina (from 12.5 per cent to 23.5 per cent) and Brazil (12.5 per cent to 14.5 per cent). Colombia, on the other hand, saw an improvement in borrowing costs (from 13 per cent to 10 per cent) together with a reduction in its spreads. Chile, Uruguay and Mexico continued to enjoy some of the lowest external borrowing costs in the region.

70. Latin America’s gross external debt declined by a moderate amount (from US$ 740 billion in 2000 to US$ 726 billion in 2001). Small variations were observed in most of the countries’ external liabilities. Since the external debt burden decreased by a smaller proportion than exports did, the indicator provided by the ratio between these two variables worsened in most of the countries. Among the most heavily indebted nations, Bolivia, Brazil and Peru continued, as in previous years, to report debt/exports ratios of around 350 per cent; Argentina’s ratio fell to 450 per cent from its 1999-2000 average of 500 per cent, while Nicaragua’s held at around 700 per cent.

Foreign direct investment weakens

71. Net FDI in the region shrank for the second consecutive year, falling from US$ 64.8 billion in 2000 to US$ 58.3 billion in 2001. Factors helping to account for the decline included the repercussions of the worldwide slowdown and the fact that privatization programmes are nearing completion in most Latin American economies. This downswing was quite widespread but was particularly sharp in Argentina, Brazil and Venezuela. Chile, on the other hand, turned its negative inflow of the year before into a positive balance. Ecuador received a record volume of investment and Mexico was able to maintain the significant levels posted over the past few years, even if the proceeds from the sale of BANAMEX to Citigroup (US$ 12.5 billion) are not included in the figures.

72. During 2001, equity capital was highly volatile and the only country recording a net inflow was Mexico, thanks to the appreciation of the peso. Brazil and Chile, whose currencies depreciated quite steeply during the year, registered net outflows of equity capital. This was reflected in stock market quotations, with the regional stock index fluctuating around a mark 15 per cent lower in November than the level posted a year previously.

Annex

Latin America and the Caribbean: total gross domestic product

(Percentages based on values at 1995 prices)

	Annual growth rates										
	1991	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*	*2000*	*2001*[a]
Latin America and the Caribbean	**3.5**	**3.0**	**3.6**	**5.2**	**1.1**	**3.7**	**5.2**	**2.3**	**0.4**	**3.9**	**0.4**
Latin America and the Caribbean (excluding Brazil)	5.2	5.1	3.0	4.6	-0.8	4.5	6.5	3.5	0.1	3.8	-0.3
Subtotal (20 countries)	**3.6**	**3.0**	**3.6**	**5.3**	**1.1**	**3.7**	**5.2**	**2.3**	**0.4**	**3.9**	**0.4**
Subtotal (20 countries, excluding Brazil)	5.3	5.2	3.1	4.7	-0.8	4.5	6.6	3.6	0.1	3.8	-0.3
Argentina	10.6	9.6	5.9	5.8	-2.9	5.5	8.0	3.8	-3.4	-0.5	-3.8
Bolivia	5.4	1.7	4.3	4.8	4.7	4.5	4.9	5.2	0.4	2.4	0.0
Brazil	1.0	-0.3	4.5	6.2	4.2	2.5	3.1	0.3	0.9	4.1	1.5
Chile	7.3	10.9	6.6	5.1	9.0	6.9	6.8	3.6	-0.1	5.4	2.9
Colombia	1.8	3.7	4.6	6.1	5.2	2.1	3.4	0.5	-4.1	2.8	1.5
Costa Rica	1.6	8.8	7.1	4.6	3.9	0.8	5.4	8.3	8.1	2.2	0.3
Cuba	-12.1	-13.8	-16.0	2.0	3.4	8.7	3.3	1.3	6.8	5.5	3.0
Dominican Republic	0.9	8.0	3.0	4.3	4.7	7.2	8.3	7.3	8.0	7.7	3.0
Ecuador	5.0	3.0	2.2	4.4	3.0	2.3	3.9	1.0	-9.5	2.8	5.0
El Salvador	2.8	7.3	6.4	6.0	6.2	1.8	4.2	3.8	3.3	2.0	1.5
Guatemala	3.7	4.9	4.0	4.1	5.0	3.0	4.4	5.1	3.9	3.3	2.0
Haiti	0.1	-13.8	-2.2	-8.3	5.0	2.8	5.9	-1.1	2.3	1.3	-0.9
Honduras	2.7	5.8	7.1	-1.9	3.7	3.7	4.9	3.3	-1.9	4.9	2.6
Mexico	4.2	3.7	1.8	4.4	-6.1	5.4	6.8	5.1	3.6	6.9	-0.3
Nicaragua	-0.4	0.8	-0.4	4.0	4.4	5.1	5.4	4.1	7.4	4.7	2.0
Panama	9.0	8.2	5.3	3.1	1.9	2.7	4.7	4.6	3.5	2.7	0.5
Paraguay	2.5	1.7	4.0	3.0	4.5	1.1	2.4	-0.6	-0.1	-0.3	1.5
Peru	2.7	-0.4	4.8	12.8	8.6	2.5	6.8	-0.5	0.9	3.1	0.2
Uruguay	3.7	8.3	3.5	7.0	-2.3	5.0	5.4	4.4	-2.9	-1.5	-2.5
Venezuela	10.5	7.0	-0.4	-3.7	5.9	-0.4	7.4	0.7	-5.8	3.2	2.8
Subtotal Caribbean	**1.5**	**0.7**	**0.5**	**3.1**	**2.8**	**2.9**	**1.9**	**2.7**	**4.2**	**3.1**	**0.8**
Antigua and Barbuda	2.7	0.9	5.0	6.2	-4.8	6.0	5.5	5.0	4.9	2.6	-
Barbados	-3.7	-5.6	1.0	2.9	2.4	3.3	2.8	5.3	3.1	3.0	-1.5
Belize	3.2	9.0	4.3	1.5	3.7	1.3	4.4	2.0	5.9	10.1	-2.0
Dominica	2.1	2.3	1.9	1.9	1.2	2.9	2.2	3.1	1.3	0.7	-
Grenada	3.7	1.0	-1.1	3.4	3.1	3.0	4.3	7.6	7.5	6.5	2.5
Guyana	8.9	9.1	11.5	9.4	3.8	8.6	6.7	-2.2	3.9	3.0	1.0

	Annual growth rates										
	1991	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*	*2000*	*2001*[a]
Jamaica	0.3	2.5	1.8	1.9	1.8	-0.3	-2.2	-1.0	0.7	0.5	1.5
Saint Kitts and Nevis	2.5	3.2	5.2	5.5	3.2	5.8	7.2	1.1	3.5	7.1	-
Saint Vincent and the Grenadines	1.5	6.9	2.0	-2.3	7.8	1.2	3.5	5.8	4.2	2.0	-
Saint Lucia	-0.4	7.5	-1.3	4.6	2.1	0.8	-0.3	3.0	3.4	0.6	-
Suriname	4.0	-1.8	-10.8	-0.9	4.1	13.2	6.1	1.9	-2.4	-1.0	-
Trinidad and Tobago	3.5	-1.0	-1.2	4.2	4.2	4.4	4.0	5.3	7.8	5.0	1.0

Source: Economic Commission for Latin America and the Caribbean, on the basis of official figures converted into dollars at constant 1995 prices.

Note: Totals and subtotals do not include those countries for which no information is given.

[a] Preliminary estimate.