Latin America and the Global Economic Crisis

Duncan Green, Oxfam GB, March 2009

Introduction

An overview of the region up to 30 January 2009 by the UN Economic Commission for Latin America and the Caribbean (cepal)[1] argues that the larger economies have been more directly affected by the global economic crisis (because in general they are more integrated with the global markets, especially finance), but are also better equipped to respond to it. In particular, Cepal sees South America as diverging from Central America and the Caribbean, which seem to be both less resilient in terms of their economies, and more exposed to the slump in the USA. They are being driven back to aid as the last/only resort. Mexico is in a category of its own, the most exposed to the US downturn, but as a large economy and an oil exporter, better placed to withstand the downturn than its Caribbean basin neighbours. Cepal highlights:

- A marked reduction in both international demand and the terms of trade for the region's goods and services.
- Increasing difficulties in accessing international finance.
- Strong pressure on exchange rates due to capital flight.
- A deterioration in labour markets, investment, and consumption.

Growth

By March 2009, growth projections for 2009 were still heading downwards, to 0.3 per cent (World Bank), 0.5 per cent (Cepal), or 1.1 per cent (International Monetary Fund). All three projections show a fall in per capita terms, compared to figures of 5.7 per cent in 2007 and 4.6 per cent in 2008[2]. Cepal's Executive Secretary, Alicia Bárcena, likens the economy to flying a plane in which one by one, the motors are stopping. It is likely that future revisions will be downwards (e.g. in March, it became clear that Brazil's economy had contracted by 3.6 per cent and industrial production by 20 per cent in the last quarter of 2008[3], much higher than expected).

Trade and finance

Over 90 per cent of the region's gross domestic product (GDP) and population reside in net commodity exporting countries[4], so the slump in commodity prices has had a marked impact. Regional exports fell by 17.5 per cent between December 2007 and December 2008. Those economies that are most tightly linked to the USA, such as Mexico, Central America, and the Caribbean, have seen a rapid fall off in demand for manufactured exports, principally autos and maquila (garments and electronics). Mexico's exports fell by 31.5 per cent in 2008, according to government figures.[5] This, along with falling remittances, has undermined the benefits of falling oil and food prices for net commodity importers in the Caribbean basin.

Tourism has also been hard hit. In the Caribbean, visitor numbers are expected to fall by up to a third in 2009, according to the Caribbean Tourism Organisation. This has halted some ambitious construction projects, with a knock-on effect on construction jobs.[6]

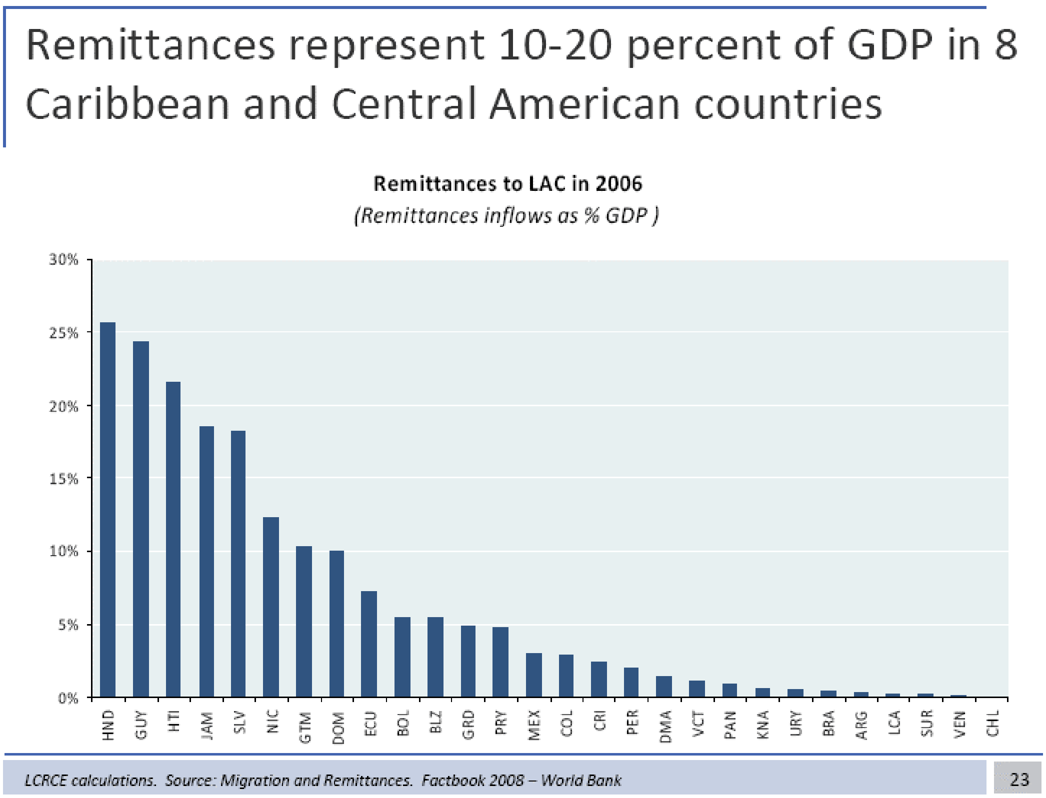
In terms of financial flows, risk perceptions have risen rapidly, increasing the cost of borrowing for Latin American governments, and as in all developing countries, foreign direct investment (FDI) has contracted.

Financial sector
There is considerable variation in the level of vulnerability of countries' financial sectors. In Brazil, the government controls Banco do Brasil, a huge retail bank, and Caixa Econômica, the largest mortgage lender, plus the BNDES, a large development bank that funds companies. These banks are less vulnerable to capital flight and turbulence in US and in European financial markets, and provide the government with ready-made channels for directing the fiscal stimulus into the economy. Mexico's financial sector, in contrast, is dominated by foreign banks that largely stopped lending once the crisis hit.

In general, however, the region's banking systems seem reasonably solid, at least compared to those of Europe or the USA, and the impact of the slowdown is felt more through the 'real economy' eg collapsing trade, than through financial contagion.

Remittances
Remittances offer a crucial safety net to poor or near-poor families in many Latin American communities and have become an increasingly important contributor to the national accounts (see chart). As a per cent of GDP, Central America and the Caribbean are by far the most vulnerable, with Honduras top – remittances amount to 26 per cent of GDP.

The recession in the USA and Europe has meant a sharp deceleration in remittance flows, especially moving into 2009. Mexico's remittances (the largest in value, though not as a per cent % of GDP) fell by 12 per cent in January 2009 compared to the previous year.[7] Jamaica's remittances fell by 14 per cent in November and December 2008, just as the price of bauxite, its other big earner, halved.[8] Guatemalan remittances were down 8 per cent in January, according to Inforpress.



Social impact
Employment
Although any numbers at this point are highly speculative, Cepal foresees two main impacts on employment, both reversing previous trends (unemployment fell from 11 per cent in 2003 to 7.5 per cent in 2008). Firstly, rising formal sector unemployment; secondly, a shift towards the informal sector as a de facto safety net/source of jobs in a downturn.[9] Inter-American

Development Bank (IDB) fears that most of the job losses will occur in Small and Medium Enterprises (SMEs).[10] In January 2009, Mexico lost 128,000 formal sector jobs in a single month.[11] In Peru 50,000 jobs were lost in the last quarter of 2008, mainly in textiles and mining. Oxford Analytica reports that Brazil lost 700,000 jobs in December and January[12], as key exporters such as Embraer and Vale have cut thousands of jobs in recent weeks as industrial production fell 12 per cent in December 2008, the biggest fall since the government started to keep records.[13] In countries such as Mexico and Bolivia, the return of migrants from the USA and Europe could further increase pressure on the labour market.

The impact of the slowdown on inequality, which had been falling in most Latin American countries, will depend in part on government responses – for example, whether they concentrate on cushioning the impact of job losses in the formal sector, or on wider social protection mechanisms, and on the number of jobs created as part of fiscal stimuli programmes.

Government responses to the crisis

The larger economies in particular enter the crisis better able to cope than during previous economic shocks. In the words of one World Bank official, the region is 'a better-built boat facing a nastier storm.' [14] The grounds for limited optimism include:

- A major reduction in debt, especially denominated in foreign currencies (which reduces the dangers posed by depreciation).
- Some commodity-exporting countries (Chile, Peru, Mexico, Brazil) have built up 'rainy day' stabilization funds during the commodity boom years. Brazil's $207bn of reserves, for example, are enough to cover 14 months of imports.[15]
- Governments have reduced their deficits, or run surpluses.

However, Latin America is paying for its failure to deal with some of its other long term economic weak spots, notably neglecting to put in place good systems to raise domestic resources. The region's low level of taxation (an average of just 18 per cent of GDP) and regressive taxation systems (the region has the lowest level of direct taxation of any world region) has left it particularly dependent on foreign capital flows, a major source of economic vulnerability in a downturn.[16]

Healthy finances, even allowing for falling tax revenues, provide governments with the 'fiscal space' to fund counter-cyclical policies (i.e. increase spending in a downturn). That breathing space is likely to be temporary, however, with commodity exporters seeing falls in revenues from mining royalties, and the general slowdown hitting government tax takes. Peru's tax take was down 9 per cent in January 2009. Indeed most countries in the region were already moving from surplus into deficit on both fiscal balance and current account in 2008, with a further slide predicted for 2009. While this is what a counter-cyclical response would dictate, the ability to maintain this position is limited by access to finance.

Moreover, some commodity importers, particularly in Central America, were already running large current account deficits before the crisis, led by Nicaragua with a substantial 16 per cent deficit in 2007. Although their commodity import bills will have eased, falling exports and remittances mean that they will have little fiscal space to respond to the crisis in anything other than the traditional countercyclical (and counterproductive) fashion. In January 2009, Nicaragua announced a 20 per cent cut in current spending. These countries will be highly dependent on enhanced aid flows to cushion the shock.

Virtually all governments in the region have responded to the crisis by cutting interest rates, but as elsewhere, mere monetary measures of this kind have not been sufficient to rekindle demand and other measures, such as fiscal stimuli, are being actively considered.

A Cepal[17] overview of government reactions to the crisis suggests that governments have initially chosen to rapidly reduce interest rates and direct fiscal stimuli through the simplest channels – tax breaks and spending on big 'shovel-ready' infrastructure and housing projects. While speed is essential, Cepal points out that, as in the USA, tax breaks are less effective in stimulating demand, because people tend to save, rather than spend, the money. The social impact of infrastructure investment varies enormously, depending on how many jobs they create and how many local inputs they use. The Mexican government has given explicit priority to stimulating SMEs, for example earmarking a minimum of 20 per cent of government procurement for them, but in general Cepal is concerned at the lack of attention to SMEs in most anti-crisis plans.[18]

Chile has been by some distance best placed to run counter-cyclical policies. In January, André Velasco, Chile's finance minister, announced that Government spending would rise in 2009 by 10.7%. On 12 February 2009 the independent Central Bank cut its benchmark interest rate by a massive two-and-a-half percentage points, to 4.75 per cent. These measures mean the economy may suffer only a mild downturn. Much of the money will go on houses for poor people and on road maintenance. The government can afford this because not only is public debt minimal (4 per cent of GDP in December 2008), but the government has also piled up $20.3 billion (about 12 per cent of GDP) in a sovereign wealth fund which it can now spend.[19] That stands in contrast with Colombia, where the government has responded in more traditional countercyclical fashion, or with neighbouring Argentina, whose government has financed an increase in spending by nationalising private pension funds.

Social spending and social protection

Most governments have introduced some kind of countercyclical policies to cushion the impact on poor people and maintain social spending levels. Nicaragua is an exception, opting to cut the budgets for health and education by 12 and 7 per cent, respectively. [20] However, Cepal's overview suggests that the level of increased spending on social programmes is considerably less than that on infrastructure. This may reflect either political preference, or the difficulty of rapidly scaling up social protection programmes.

It is much easier to expand prior social protection networks than to set up new ones from scratch, so El Salvador for example, has doubled to $300 the monthly payments in its Bolsa Familia-style cash transfer programme. In Chile, the government has agreed a one-off 'reactivation bond' to 400,000 poor families. Where social protection systems are more rudimentary, or where trade unions have argued more strongly for jobs, spending has been directed more towards infrastructure and bailouts for ailing companies.

Elsewhere however, social protection has become a casualty of the crisis. In Peru, according to Anamper, a national coalition of local organizations of older people, the government was on the cusp of agreeing a means-tested non-contributory pension, a major victory for the poorest older people. Legislation has been drafted, media work was positive. In February, however, the Ministry of the Economy and Finance told Anamper that a social pension was 'out of the question' and that this 'was not the time for increased social spending of the magnitude required for a social pension'.[21]

Crystal ball

For the last year, every revision of predictions for 2009 and beyond has been downward. The likelihood is that the recession will hit Latin America with a degree of lag – because the region has not shared the US and European banking crisis, the impact is transmitted through the real economy (falling trade and remittances). However, as the real economy slows, and bad loans mount some countries may face a second round banking crisis of their own. Moreover, governments' 'fiscal space' to run counter-cyclical policies is finite. At some point, if the economy does not pick up, they may have to start cutting, rather than increasing, spending. There have been a number of attempts to identify vulnerable countries according to various criteria (see table):

Most at risk countries in LAC

World Bank (decelerating growth)	IMF (Low Income Countries only)	Economist (larger emerging markets only)
Argentina	Haiti	Mexico (12th out of 17)
Brazil	Honduras	Brazil (10th)
Chile	St Vincent	Argentina (8th)

Colombia	St Lucia	Venezuela (7th)
Costa Rica		
Domincan Republic		
Ecuador		
El Salvador		
Guatemala		
Honduras		
Jamaica		
Mexico		
Nicaragua		
Panama		
Paraguay		
Trinidad and Tobago		
Uruguay		
Venezuela		

The longer term political implications of the crisis are hard to discern. Prior to the crisis, the region appeared to be coming to the end of a centre-left cycle, but that may now be reversed. The election of Barack Obama is likely to provide a boost to the centre-left (political contagion?). Certainly, few now dispute the need for effective state regulation of the economy, which may in turn lead to greater efforts to increase Latin America's dismal record on raising domestic revenues – it languishes alongside sub-Saharan Africa in this regard, and its record on direct taxation is the worst in the world.

In the next 18 months there will be 14 electoral processes in the region, including presidential elections in Ecuador, Bolivia, Chile and Honduras; and parliamentary elections in Argentina; In 2010, Brazil, Colombia have presidential elections and there are municipal and regional ballots in Peru. Most of them will be keenly contested processes. And their results could change the political landscape in the region. For "pro-change" governments looking for continuity, their management of the crisis will be a crucial test. During the last few months most of the current governments in the region (especially in the South) have improved their approval rate. This could reflect the widespread feeling in the societies that governments are doing it well. However, as the crisis deepens, voters may well start to blame incumbent governments, and the expected shift to the right may resume.

Finally, the outlook is particularly uncertain for Mexico, with its combination of extreme dependence on the US economy and apparently inexorable rise of narco-related violence, and for Venezuela, the most oil-dependent of Latin America's economies.

Policy implications for governments

Cepal sets out a useful series of short and medium-term recommendations:

Short-term:

- Maintain levels of social spending.
- Increase social assistance for groups that are vulnerable to the crisis (food baskets, emergency benefits, employment programmes.)
- Strengthen programmes to combat child malnourishment.
- Maintain credits for SMEs and micro-enterprises.
- Deal with problems of unemployment and falling income.
- Set up special programmes of public investment in infrastructure.
- Broaden unemployment insurance.
- Strengthen financing, coverage, and institutionality of conditional transfer programmes.

Medium-term

- Forge new socio-political contracts in order to build fiscal covenants with a larger solidarity component (i.e. build consensus for higher levels of progressive taxation.)
- Take advantage of the demographic bonus by increasing investment in secondary education.

- Create regional strategies to support countries that are highly socially vulnerable to the crisis.

Policy implications for donors

As the recession deepens, governments will increasingly have to follow the Caribbean's lead in seeking multilateral and bilateral aid. The IDB and its two affiliates, the Multilateral Investment Fund and the Inter-American Investment Corporation, approved a record $12.2 billion in loans, credit guarantees and grants in 2008. This is 27 per cent higher than the $9.6 billion approved in 2007 and included $900 million from its new fast-disbursing emergency liquidity fund. The $6 billion facility, created in October, provides funding for countries facing transitory difficulties in accessing international credit markets due to the financial turmoil. The funding will go for domestic banks so they can lend to local firms to support their investments and operations.

It is essential that such aid is genuinely fast and free of conditionalities, if it is to serve its purpose[22].

Notes

[1] La reacción de los gobiernos de América Latina, y el Caribe frente a la crisis internacional: una presentación sintética de las medidas de política anunciadas hasta el 20 de febrero de 2009

[2] Cepal figures, Alicia Barcena, presentation, Mexico City, 11 March 2009

[3] Financial Times, 11 March 2009

[4] Latin America and the World Crisis, World Bank, 8 October 2008

[5] El Financiero, 24 February 2009

[6] Economist 29 January

[7] El Financiero, 3 March 2009

[8] Economist 29 January

[9] Cepal Balance Preliminar 2008

[10] Santiago Levy – this claim appears counterintuitive, since the export sector is the most vulnerable to the downturn, and is dominated by large companies, rather than SMEs.

[11] El Financiero, 4 March 2009

[12] Oxford Analytica, 12 February 2009

[13] Economist, 5 March 2009

[14] World Bank Press Brief, October 2008, 'Shockwaves from the North'. http://siteresources.worldbank.org/MEXICOEXTN/Resources/ShockwavesNorth(Pressbrief-8Oct08).pdf

[15] Financial Times, 9 March 2009

[16] Alica Barcena, op cit

[17] La reaccion de los gobiernos de America latina y el Caribe frente a la crisis internacional, February 2009

[18] Cepal, la reaccion, op cit

[19] Economist 19 February 2009

[20] Adolfo Acevedo, Esta Impactando Ya la Crisis Economica Internacional? Mimeo

[21] Claire Kumar, presentation

This paper was written by Duncan Green.

For further information on the issues raised in this paper please e-mail advocacy@oxfaminternational.org.

The information in this publication is correct at the time of going to press.

www.oxfam.org

Disclaimer

Oxfam International is a confederation of thirteen organizations working together in more than 100 countries to find lasting solutions to poverty and injustice: Oxfam America, Oxfam Australia, Oxfam-in-Belgium, Oxfam Canada, Oxfam France - Agir ici, Oxfam Germany, Oxfam GB, Oxfam Hong Kong, Intermón Oxfam (Spain), Oxfam Ireland, Oxfam New Zealand, Oxfam Novib (Netherlands), and Oxfam Québec. Please call or write to any of the agencies for further information, or visit **www.oxfam.org**.

Oxfam America 226 Causeway Street, 5th Floor Boston, MA 02114-2206, USA +1 617 482 1211 (Toll-free 1 800 77 OXFAM) E-mail: info@oxfamamerica.org www.oxfamamerica.org	**Oxfam Hong Kong** 17/F., China United Centre, 28 Marble Road, North Point, Hong Kong Tel: +852 2520 2525 E-mail: info@oxfam.org.hk www.oxfam.org.hk
Oxfam Australia 132 Leicester Street, Carlton, Victoria 3053, Australia Tel: +61 3 9289 9444 E-mail: enquire@oxfam.org.au www.oxfam.org.au	**Intermón Oxfam (Spain)** Roger de Llúria 15, 08010, Barcelona, Spain Tel: +34 902 330 331 E-mail: info@intermonoxfam.org www.intermonoxfam.org
Oxfam-in-Belgium Rue des Quatre Vents 60, 1080 Brussels, Belgium Tel: +32 2 501 6700 E-mail: oxfamsol@oxfamsol.be www.oxfamsol.be	**Oxfam Ireland** Dublin Office, 9 Burgh Quay, Dublin 2, Ireland Tel: +353 1 635 0422 Belfast Office, 115 North St, Belfast BT1 1ND, UK Tel: +44 28 9023 0220 E-mail: info@oxfamireland.org www.oxfamireland.org
Oxfam Canada 250 City Centre Ave, Suite 400, Ottawa, Ontario, K1R 6K7, Canada Tel: +1 613 237 5236 E-mail: info@oxfam.ca www.oxfam.ca	**Oxfam New Zealand** PO Box 68357, Auckland 1145, New Zealand Tel: +64 9 355 6500 (Toll-free 0800 400 666) E-mail: oxfam@oxfam.org.nz www.oxfam.org.nz
Oxfam France - Agir ici 104 rue Oberkampf, 75011 Paris, France Tel: + 33 1 56 98 24 40. E-mail: info@oxfamfrance.org www.oxfamfrance.org	**Oxfam Novib (Netherlands)** Mauritskade 9, Postbus 30919, 2500 GX, The Hague, The Netherlands Tel: +31 70 342 1621 E-mail: info@oxfamnovib.nl www.oxfamnovib.nl
Oxfam Germany Greifswalder Str. 33a, 10405 Berlin, Germany Tel: +49 30 428 50621 E-mail: info@oxfam.de www.oxfam.de	**Oxfam Québec** 2330 rue Notre Dame Ouest, bureau 200, Montreal, Quebec, H3J 2Y2, Canada Tel: +1 514 937 1614 E-mail: info@oxfam.qc.ca www.oxfam.qc.ca
Oxfam GB Oxfam House, John Smith Drive, Cowley, Oxford, OX4 2JY, UK Tel: +44 1865 473727 E-mail: enquiries@oxfam.org.uk www.oxfam.org.uk	

Oxfam International Secretariat: Suite 20, 266 Banbury Road, Oxford, OX2 7DL, UK
Tel: +44 1865 339100 Email: information@oxfaminternational.org. Web site: www.oxfam.org

Oxfam International advocacy offices:
E-mail: advocacy@oxfaminternational.org
Washington: 1100 15th St., NW, Ste. 600, Washington, DC 20005-1759, USA
Tel: +1 202 496 1170.
Brussels: Rue Philippe le Bon 15, 1000 Brussels, Belgium
Tel: +322 502 1941
Geneva: 15 rue des Savoises, 1205 Geneva, Switzerland
Tel: +41 22 321 2371.
New York: 355 Lexington Avenue, 3rd Floor, New York, NY 10017, USA
Tel: +1 212 687 2091.
Brazil: SCS Quadra 08 Bloco B-50, Sala 401 Edifício Venâncio 2000, Brasília DF 70333-970 , Brazil Tel: +55 61 3321 4044

Linked Oxfam organizations. The following organizations are linked to Oxfam International:
Oxfam Japan Maruko bldg. 2F, 1-20-6, Higashi-Ueno, Taito-ku, Tokyo 110-0015, Japan
Tel: + 81 3 3834 1556. E-mail: info@oxfam.jp Web site: www.oxfam.jp

Oxfam India - 2nd floor, 1 Community Centre, New Friends Colony, New Delhi, India 110 065 tel: +91 (0) 11 4653 8000, fax: +91 (0) 11 4653 8099, email: delhi@oxfamindia.org, website: www.oxfamindia.org
Oxfam International and Ucodep Campaign Office (Italy), Via Fogliano 10, 00199 Rome, Italy
Tel +39 0645 432939, Fax +39 0645 438046 email: ucodep-oi@oxfaminternational.org website: http://www.ucodep.org
Oxfam observer member. The following organization is currently an observer member of Oxfam International, working towards possible full affiliation:
Fundación Rostros y Voces (México) Alabama 105, Colonia Napoles, Delegacion Benito Juarez, C.P. 03810 Mexico, D.F.
Tel: + 52 55 5687 3002 / 5687 3203 Fax: +52 55 5687 3002 ext. 103
E-mail: comunicación@rostrosyvoces.org
Web site: www.rostrosyvoces.org