Economic competition in Latin America

dr. Adrienn Prieger

Abstract: Latin America's economic systems have often been viewed terribly by its European counterparts, but after the CELAC summit meeting in Santiago de Chile, this opinion has changed.

Latin America's economies are very different as a result of a long colonial past. Latin America economy has shown promise and growth for quite some time. With global demand for commodities, the region was able to grow at an average of 3.8% between 2004 and 2013.

The regional divide extends beyond trade. The region is blessed with geographical location and can use it to its advantage in terms of trade, transport of goods among others. Co-operation in various sectors could help make the regional economies become more competitive.

As part of this paper, I investigate into various economies and try to analyse the future prospects of the region. In this document I would like to highlight the competition between Latin American countries, and focusing especially the economy of Brazil, Chile, Colombia and Peru. This region has various economic groups with different agendas and future prospects.

To my mind, South America is remarkably interesting; it has an intangible, special atmosphere. This document explored Latin America's future and mentioned some possible alternatives. These days cultivating international relationships is really essential, this is another reason why I find it useful to get acquainted with the culture of distant countries.

Keywords: economic comparison, South America, development, financial strategy, Brazil, Colombia, Peru, Chile

Author: dr. Adrienn Prieger, PhD student at University of Miskolc. Contact: +36704287222; dr.prieger.adrienn@gmail.com

Introduction

Latin America's economic systems have often been viewed terribly by its European counterparts, but after the CELAC summit meeting in Santiago de Chile, this opinion has changed. The CELAC was established between the European Union and Latin America. The Chilean head of state told, that Latin America's speed of development is rapid, compared to the other parts of the word. (Klopfstein-László, 2013)

As of this year (2015), Péter Szijjártó, the Hungarian Minister of Foreign Affairs and Trade announced the launch of the "southern door policy". With this program, the Hungarian government would focus their interest to Africa and Latin America. Szijjártó explained that within a year four new embassy will open up, namely Ecuador, Ethiopia, Ghana and Angola. (mandiner.hu, 2015)

Latin America's economies are very different as a result of a long colonial past. Latin American economy has shown promise and growth for quite some time. With global demand for commodities, the region was able to grow at an average of 3.8% between 2004 and 2013. (Pezzini and Melguizo, 2015) But with the slowing global economy, the demand has dwindled and it has exposed the region's over-dependence on the commodities sector.

The region is currently divided among economies, some of which are expected to grow like Colombia, Chile while at the same time some are facing downturn like Brazil, Argentina and Venezuela. The countries contribution to regional growth is limited and this can be understood from the fact that the intraregional trade is dismal accounting to just 18% of the total international trade. (Muñoz, 2015)

The regional divide extends beyond trade. The region is blessed with geographical location and can use it to its advantage in terms of trade, transport of goods among others. Co-operation in various sectors could help make the regional economies become more competitive.

Though over the years region has undergone economic growth but the benefits have been limited to the elite. There is a widespread inequality and cases of land grabs. In Guatemala, 1% of the population holds 40% of the land. (CIDSE press release, 2015) The Latin American people face ironic situations. While their countries are increasing export of commercial agricultural goods, malnutrition is widespread in the region.

The countries must work towards diversifying their exports, investing in infrastructure development, and better connectivity, setting up manufacturing plants to rejuvenate growth. All this should be supported which focus on improving the intra-regional trade.

As part of this paper, I investigate into various economies and try to analyse the future prospects of the region.

In this document I would like to highlight the competition between Latin America, and focusing especially the economy of Brazil, Chile, Colombia and Peru.

Latin American economies

This region has various economic groups with different agendas and future prospects. These economies though regionally close are diverse in the economic policies and industry; each having its own strengths and weaknesses. As part of this document, I attempt to look into few of them namely Brazil, Chile, Colombia and Peru.

Brazil

Brazil in the last 20 years due to economic stabilisation and growth is now touted as a major economic power. Brazil has been a WTO member since 1 January 1995 and a member of GATT since 30 July 1948. Brazil's economy has stagnated from 2011 to 2014 and is contracting further. The currency has fallen by almost 50 percent since 2011. (Biller, 2015) The current economic situation can better be understood by comparing it with Russia. The contraction in Brazilian economy is in line with that of Russia. The concerning part here is that while Russia's economy is hurting because of sanctions against oil and finance companies resulting in weaker oil prices. Brazil is not under any such sanctions and in fact enjoys good relations with other countries. Also Brazil's economy is diverse unlike Russia's economy which is over-dependent on the single commodity. (Rapoza, 2015)

The economy is under pressure due to high inflation and declining consumption. Inflation is running at a more than 11-year high. (MercoPress, 2015) This is being considered as the deepest recession in 25 years. Some of the notable price rise is in the aviation sector where airfare rose by a whopping 29%.

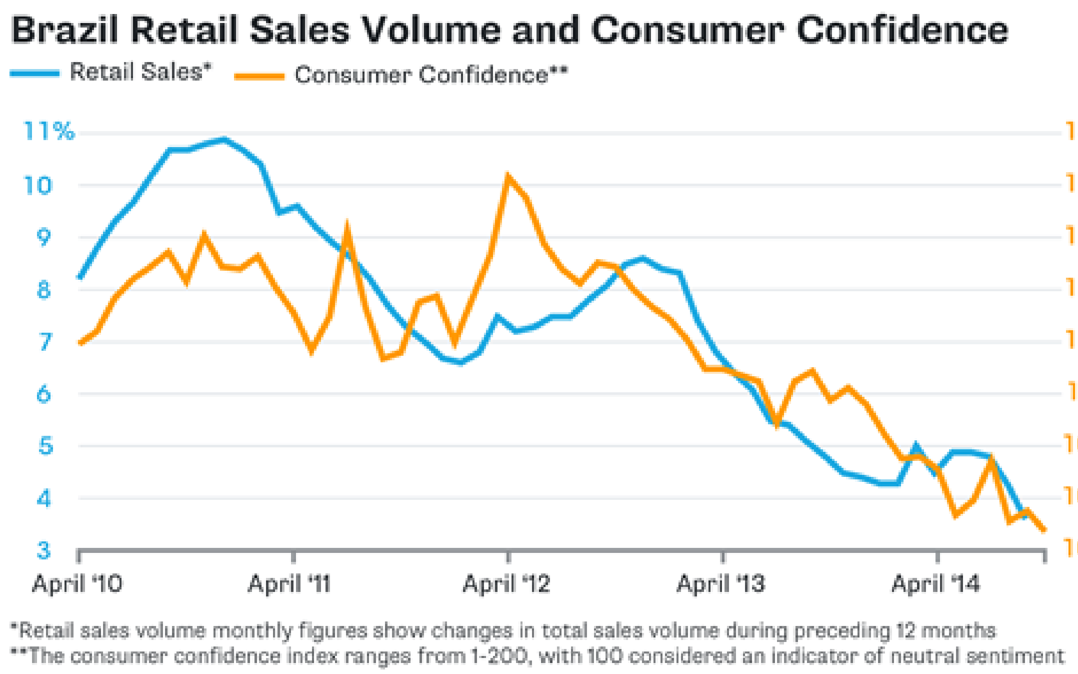

Figure 1. Brazil retail sales volume and consumer confidence (Source: Biller, 2015)

We can see in figure 1 that how the consumption has dwindled in recent years owing to high inflation. The decrease in consumption is attributed to the decline in commodity prices, the profits from which had earlier beefed up the Bolsa Familia social welfare program. Bolsa Familia social welfare program is known as an international model for poverty eradication and had generated the new middle class. With the Bolsa Familia program, which is a social program in Brazil they could prevent child mortality. The people, who registered in this program, got special vaccinations which fight against very dangerous illnesses, for instance measles and poliomyelitis. (Latin-Amerika Társaság, 2013)

In October 2014, Dilma Rousseff was victorious in Brazil's General Election and was sworn in to continue her presidency. She stated that in her second term in office, she would like to continue with the work on the social welfare program that she setup. It will be especially important for the president to develop the health care system, education and the public safety. (Gumhert, 2015)

Brazil continues to lose jobs. In May, the figure stood at 115,599 payroll jobs which was an increase from 97,828 jobs in April. (Cascione, 2015) The unemployment rate rose to 6.7% in

May 2015, which was the highest since 2010 (7.5%) and is accompanied by declining wages. (IBGE, 2015)

The Brazilian government is working to bring the economy back on track. Part of the strategy is to raise taxes and to cut government spending. It has also crimped some pension and government benefits. Critics say that Brazil needs to reduce tax burden, bureaucracy, steep tariffs and introduce flexible labor laws. These steps would help boost investment and productivity. Also they have raised concerns regarding the country's over-reliance on consumption which along with government spending accounts for 8% of the GDP.

Colombia

This country has been ridden with various problems for a long time namely- drugs, violence and kidnappings. But things have changed over the last decade. The business atmosphere has improved and campaigns have been carried out to promote the country as a tourist destination. Colombia's economy grew by 4.8% in 2014 and is expected to grow by above 4% in 2015, despite a near 50% fall in oil prices.

Business outlook has improved which can be confirmed by the high end showrooms opened by the likes of Mango, Zara, Louis Vuitton and Armani. This stability and certainty have helped to push Colombia up to the 34th place in the World Bank's "Doing Business" index in 2014, from 53rd place in 2013. This is above larger economies such as Brazil and Mexico – and even above Belgium and Italy. Colombia's middle class is on the rise, climbing from 16% of the population in 2002 to 27% in 2011. Poverty rate (defined by World Bank) has fallen from 50% to 34%.

There has been a surge in entrepreneur spirit and people are readily selling food items, clothes, shoes, etc. on the street. Colombia has negotiated free trade agreements and has been successful in securing a dozen deals around the world, including with the UK through the EU, America and Switzerland.

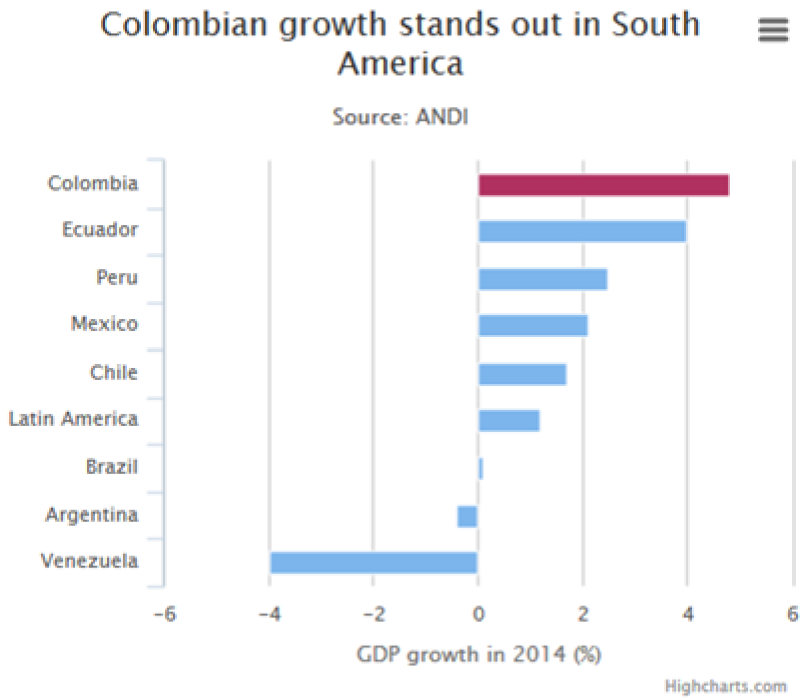

Figure 2. GDP growth of Latin American countries (Source: Szu Ping Chan, 2015)

Colombia's growth has been stable compared to the regional strong economy Brazil. While Colombia's central bank have been successful in controlling inflation to its near target of 3% for more than half a decade, prices have increased in Brazil by nearly 6 to 7% while Venezuela is suffering from hyperinflation of about more than 70%.

Though the growth has been good, it lacks infrastructure. The country lacks motorways or duel carriageways. Transport is a major problem and is a deterrent to businesses. With capital being scarce, Colombia is looking for development using public private partnerships (PPP).

A lot of opportunities remain available for the country. The country must work towards decreasing poverty, improving education system, infrastructure and most importantly maintain peace.

There are many challenges that lay ahead, namely the weakening peso against the dollar. *(The Colombian peso [COP] weakened by 32% against the US dollar [USD] between July 2014 and March 2015).* (Scotiabank Economics, 2015) The decline in oil prices which may require spending cuts, postponement of investment projects, and decrease in national income and thereby impact on growth. Moreover, how domestic demand and exports behave is yet to be seen. Slowdown in global growth especially in key regional trading partners is also expected to impact exports.

As decline in oil prices will decrease revenue, other sources of revenue are required. Tax reforms might help. Substituting personal income tax with VAT, replacing traditional corporate taxation with CREE's simplified exemption structure could help generate revenues and prevent tax evasion.

The recently re-elected President Juan Manuel Santos that gained new trading partners and has concluded agreements, plays an important role in growing the economy of Colombia. However, the rapidly modernizing country has a dark secret of vast human rights violations, 4,000 people are behind bars suspected to be political prisoners – although some estimates put their number at 9,500 and little local or international media attention will be given. (Latin-Amerika Társaság, 2014)

The government should focus on infrastructure development like roadways connectivity and social reforms like providing women access to maternity leave which could facilitate their inclusion in the labor force. In addition to that, government should work towards supporting first time job seekers with employment opportunities and try to combat poverty by carrying out pension reforms which would help build social security net. (IMF, 2015)

Peru

Over the last decade, Peru has been one of the best performing Latin American economy with growth being 6% on average. This growth was accompanied by low inflation and poverty reduction. Poverty rate has reduced from about 60% in 2004 to 30% in 2014 which is quite a remarkable achievement. (UNIfeed, 2015)

Growth in recent months can be attributed to domestic and foreign demand for primary products such as cotton, gold and sugar. There is a recovery in mining, manufacturing and the fishing sector. These sectors have contributed to 60% productivity growth. Though, for agriculture and construction the growth was negative.

The investment outlook is positive and there are new projects being undertaken. Backing on new metal mining projects and hydrocarbon production grew by 9.25%. (Andina, 2015a) Spanish firm Enagas has shown interests in the region's potential gas transportation pipeline projects. Recently, it had increased its stakes in Transportadora de Gas del Peru (TgP) who are in charge of the Camisea pipeline, from 20% to 24.34% and also holds a 25% stake of the Peruvian South Pipeline Project. (Andina, 2015b)

Peru's construction sector is getting a boost with public investment projects executed by subnational governments. Their main project includes the building of the Lima Metro Line 2. This will increase demand for raw materials like cement, steel and create jobs for its labor force. (Andina, 2015c)

Peru's government is seeking special powers to tackle the economic slowdown. Last year, the government had increased spending and tax cuts to boost economy. This was accompanied with social and labor reforms. Red-tape was removed and permitting rules were eased. Though these reforms helped but the extent of impact was little. The government's economic proposal comprises of expansion in real estate sector and plans to speed up projects under its infrastructure concession and taxes-for-works programs. They have also proposed administrative measures for industries in various sectors varying from housing to electricity to mining. (Quigley, 2015)

The IMF in its recent report acknowledged that Peru continues to be one of the best performing economies in Latin America and has solid fundamentals and policy frameworks. With successful implementation of the stimulus, the country's growth is expected to recover to 3.75% this year. The growth needs to be backed by proper implementation and withdrawal of stimulus, structural reforms to focus on employment opportunities, investment, and productivity. (IMF, 2015)

Peru is not only interested in the economic system of Hungary, it is also interested in the possibilities of higher education in Hungary. Peruvian students can now take part in the Hungarian University system. (MTI, 2013)

Chile

Chile was the first country in South America who signed up as an OECD member on 11 January 2010. This is a major milestone for Chile with a mission to build a stronger, cleaner and fairer global economy. (OECD, 2010)

Chile's economy is based on the trading of mined ores, it is also the world's largest copper exporter. The Chuquicamata mine is the most prominent open pit mine, which is located in the driest region. Chile is one of the world's top ranking fish exporter. However, the Chilean society is struggling with many problems: overpopulation, drug trafficking, prostitution. (MEOT, n.d.)

Chile's economy has been booming in recent years thanks to its investment friendly approach. The government took various measures like protecting property rights, promoting private sector growth over public spending, low taxes and embracing free markets. The extent of focus on free markets could be understood from the fact that Chile entered into trade agreements with 57 countries including European Union, Mercosur, China, India, South Korea, and Mexico.

A part of this growth could be attributed to higher copper prices and the demand for raw materials from developing economies like China. This co-relation could better be understood by noting that exports account for more than one fourth of the country's GDP, with commodities making up some three-quarters of total exports. Copper alone provides one-third of government revenue. (NationMaster, n.d.)

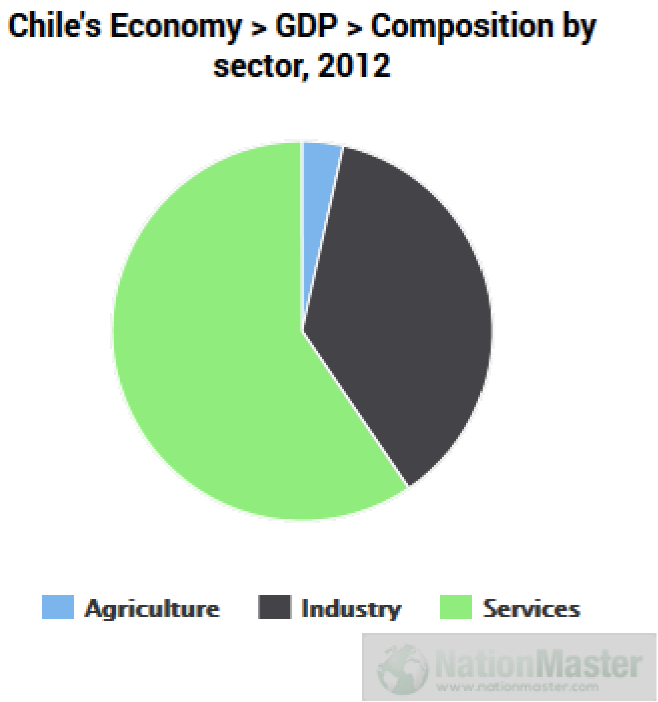

Figure 3. Chile's economic composition 2012 (Source: NationMaster, n.d.)

However in recent years, the country has moved towards diversification. As we can see in the pie chart above, the service sector now forms a major part of the economy.

The growth facilitated wealth generation for the poor and helped reduce income inequality. (Owen, 2015)

The recent slowdown in global demand including that of China has impacted the economy. Depreciating peso, declining commodity prices have all contributed to decrease in investment, inflation, job loss among others. China is a big consumer of Chile's copper, buying nearly 40 percent of it. (Porter, 2014)

The Chilean government is trying to revive the economy but it has been criticised for tempering with the 30 year long growth model. The measures comprise the tax increases, which is expected to lift fiscal revenue by 3 percent of gross domestic product, and are designed to help ensure free education for all and narrow inequality. Inequality in Chile is a matter of grave concern and can be understood from the country's Gini index, a measure of the income gap in which zero represents perfect equality and 1 complete inequality, reached 0.503 in 2011. Chile has the highest income inequality among the 34-nation Organisation for Economic Cooperation and Development.

The Chilean government is also looking into any reforms required in the health care services to meet the needs of the poor. The government has spending plans which is planned to be up by 27%. The economy has responded and copper output surged by 13% and fiscal investment jumped by 60%. Chilean analysts have raised their growth expectations for Chilean economy to 2.8% from earlier 2.7%.

The Chilean government is also working to tackle unemployment and plans to train 300,000 women and 150,000 young people. It is also looking into the country's need to generate sufficient and less expensive energy. Chile's copper production which is third of world's copper is impacted by the energy inflation. (Quiroga and Winkler, 2015)

Comparison of the economies

From all the economies I have considered above, Colombia stands to be strongest. With stable policies and macroeconomic policy management, the country has been able to keep inflation in control and is still attractive to direct foreign investment. The close proximity to its important trading partner, the US and the improvement in US economy does help.

Chile though stable and diversified faces tough political situations. The change in the governmental approach from investment friendly to socialist would be of keen concern to the investors. The increases in taxes may dampen the FDI in the country. In addition to that, the country faces tough climatic changes. The country is facing scarcity of water and it is impacting on power generation, agriculture, mining, among others. However, in the long run, it may lead to innovation in terms of desalinization plants and cleaner energy production. (ThinkAdvisor, 2015)

Peru's economy had performed well in recent years, thanks to its solid fundamentals and policy framework. The economy does face short term issues. The reforms have been slow and almost ineffective. Their governments plan to speed up the reforms and boost infrastructure investment but it may take some time before these reforms make an impact. It is also important that the government properly implements and withdraws the stimulus.

Recently, we can say that Brazil has the weakest economy of the lot. The depreciating currency and rising inflation have impacted demand and productivity. The government is facing serious charges of corruption. Meanwhile, government plans to cut red tape and carry out labor reforms to boost investment. Infrastructure investments are expected to help the region.

Conclusion and future prospects

Future of the region and developing international relations

Having looked into various economies and regional policies, I attempt to analyze the growth prospects of the region.

While the region is trying to diversify exports from commodities and raw materials to other sectors like services, manufactured goods, it is important for the region to engage with developed and emerging economies and work towards trade agreements, resolving tariff disputes and look for exchange of knowledge and technology.

For decades the countries focused on culturally related and regionally closer economies like the US, EU but now they see ample opportunities in Asian countries. The mutual interest between the region and Asia is supported by the fact that trade between the two regions doubled over the past decade and reached as high as $500 billion US dollars in 2014. (Wignaraja, 2015)

Asia houses some of the growing world economies like China, India, and Japan. These growing economies need raw material for manufacturing, food for their growing population which Latin America can help with. In exchange the Latin American economies could benefit from technology transfer and seek investment in infrastructure etc. As an example, experts suggest that in exchange for commodities, Latin America should ask for investment in solar panels in the region. (Porter, 2014)

The focus on trade could be understood from the various free trade agreements signed between the two regions. The number stood at 22 in 2013. But still a lot needs to be done. If the region could come together and be part of transpacific partnership, it would help accelerate greater exchange between the region and new sectors like services could be covered. While countries like Chile and Peru have taken a lead in signing these FTAs, Brazil has a dismal number of just 1.

Latin America needs to carry out labor reforms, cut red tape and facilitate co-operation between the two regions.

Promoting intra-regional trade and co-operation and resolving social issues

Countries across the globe are working on trade agreements like transatlantic trade and investment partnership (TTIP) between EU and US, TPP (Trans pacific partnership) among others, it is the need of the hour for Latin American countries to step up, resolve their differences. The region has some of the world major economies like Mexico and Brazil but still the intra trade within the region is dismal. It accounts for just 18% of the total international trade. The region remains divided between the Pacific Alliance – Chile, Colombia, Mexico and Peru – and Mercosur, whose full members are Argentina, Brazil, Paraguay, Uruguay and Venezuela. The key is to co-operate and find mutually beneficial common-ground. (Muñoz, 2015)

The region need not look far to realise the advantage of intra-regional co-operation. Looking into regional group Mercosur itself, one can see the potential which is waiting to be unleashed. Since the creation of the block, internal trade has multiplied eleven times. In 2014, the exports and imports within the block stood at $52 billion. (EUBrasil, 2015)

Despite undergoing good growth in recent years the region is marred with income inequality. The region faces issues of land grabs, violence among women and exploitation of the poor. This region is seeking help of its trading partners to facilitate in the social balance. It is requesting trading partners to not only trade based on goods but also on the business conduct of the parties involved i.e. parties be accountable for actions. As an example, if an EU company is importing agricultural products, it should also look into exactly where these products are coming from. Therefore, as oppose to EU companies awarding offenders with deals, they should refrain from doing business with businesses carrying out social injustice which may vary from land grabs to inhumane conditions of the workers among others. Expectations are high from the EU as they happen to be Latin America's third largest trading partner. (Sullivan, 2015)

As mentioned above, this region is blessed with natural resources and has high economic potential. The region enjoys proximity to the developed and emerging markets and should try to take advantage of its geographical location. Economically, they should not only focus on international co-operation but also on intra-regional co-operation. Most importantly, while the region works towards growth and economic well-being it must consider the interests of its people and target creation of jobs and decreasing income inequality.

To my mind, South America is remarkably interesting; it has an intangible, special atmosphere. This document explored Latin America's future and mentioned some possible alternatives. The reason why I have chosen this topic is because I have been interested in the future of South America, and I have read several books on this topic. Many people do not take interest in this issue in Europe because they feel that they are culturally different. Finding the "truth" in this topic is very difficult and may not be possible at all. These days cultivating international relationships is really essential, this is another reason why I find it useful to get acquainted with the culture of distant countries.

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