

Factors Affecting Latin America's Development Prospects

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Since Latin America entered the 21st century, its economic reforms have been in the process of being deepened and relatively higher growth rates have been achieved. Democracy has been all the more resilient and, with the rise of the left, political dualism has been reinforced. In the foreign policy area, the region's diplomatic independence has been strengthened and its international position is on the rise. Last but not least, poverty rate has been curtailed in many countries of the region, though social issues are still very serious.

Despite the above progress, however, Latin America's development prospects are still determined by a number of internal and external factors.

I. Five Internal Factors

Of the many internal factors that can affect the future development of Latin America, the following are the most important:

1. *Development models.* After the war of independence was completed in the early 19th century, Latin American nations adopted what was called the development model of exporting primary products. After the Great Depression broke out in 1929, particularly after the Second World War, this model was replaced by the model of import substitution industrialization (ISI).

In its first two decades, the ISI model made remarkable achievements. By the end of the 1960s, however, its flaws and shortcomings had become increasingly conspicuous. These flaws and shortcomings, combined with the unfavorable external environment, led to an unprecedented economic crisis in the 1980s. For the region as a whole, Latin America's GDP growth rate was only 1.1%, whereas the growth rate of its per capita GDP was negative (-1%). No wonder the 1980s was considered as the lost decade for Latin America.

In order to get rid of the hardships, Latin American nations once again adjusted the development model by walking towards the road of reform and opening to the outside world. This model was mainly composed of privatization of the state-owned enterprises, trade liberalization, financial opening, and marketization of the economic system. Dubbed as the neoliberal model, these measures achieved some positive results, but the negative outcome was

also very serious.

2. *Political stability.* In the 1960s and 1970s, military governments dominated Latin America's political scene. On April 2, 1982, the military junta in Argentina attempted to take over sovereignty of the disputed Malvenas Island by dispatching 4000 soldiers. Argentina was defeated, causing its domestic contradictions to turn for the worse. Its economy was also negatively affected. Faced with the political and economic problems and popular demonstrations, the military agreed to hand over power to the civilians.

This transfer of power represented the beginning of a democratic wave that would soon spread across Latin America. Since then most of the countries in Latin America have been successfully maintained political stability and general election for presidents and legislators can be held within the democratic framework. At the same time, however, some countries have suffered from political turmoil, causing disarray to their political and economic development. It was estimated that, since the 1980s, there have been fourteen Latin American presidents who could not fulfill their duties as scheduled by the constitution. The reasons behind this abrupt halt include the following:

(1) Economic crisis. In November 2001, for instance, when Argentina failed to meet the target of bringing down its fiscal deficit to zero, the International Monetary Fund (IMF) decided to postpone the appropriation of a credit line to this South American country. Confidence of the domestic and international investors was gravely ruined. In order to stop the run on the banks, President Fernando de la Rúa announced a series of strict financial regulations on December 3. These measures prevented the financial sector from bankruptcy, but generated a great dispute within the political parties and created wide-spread discontent among the public. On December 18, unrest broke out in the capital city of Buenos Aires, protesting against the government's financial controls. President de la Rúa resigned. Within a short period of two weeks, Argentina witnessed four presidents coming and going. This absurd political development was quite rare even in human history. Argentina was then criticized as a failed state by the international media.

(2) Popular discontent against the government. Soon after assuming presidency of Venezuela in February 1989, Carlos Andrés Pérez Rodríguez raised the price of gasoline, cut subsidy for public transportation and food, and devalued the currency. As a result of these measures, which were expected to meet the demands of the IMF, exerted great pressure upon inflation, worsening the living standards of the poor people. On February 27, wide-scale demonstration broke out in the capital city of Caracas, protesting against the government policies. Several hundred people were killed in the clashes between the military police and protestors. This tragedy marked the end of the days when Venezuela was seen as the "model of democracy" in Latin America.

A similar story took place in Bolivia. In September 2003, President Gonzalo Sánchez de Lozada announced his plan to export natural gas to North America through a Chilean port, provoking large-scale protest. Transportation came to a standstill in many places across the nation, and there were even riots in some cities. Police came to restore order and a few hundred demonstrators were killed in the clashes, leading the resignation of President Sánchez, who then went into exile in the United States.

Sánchez's successor, President Carlos Mesa, once again met with strong popular resistance against his plan to export gas. Many people accused him of acting on behalf of the foreign companies at the cost of Bolivia's national interests. Wide-spread demonstrations broke out again in many parts of the country in May 2005. Almost one hundred highways in seven of the

nation's nice provinces were blocked, leading to shortages of many supplies and high inflation in the urban areas. On June 9, President Mesa's resignation was accepted by the congress.

(3) Corruption. Latin America's corruption is notorious in the world. According to the 2006 Transparency International Corruption Perceptions Index, only three countries, i.e., Chile, Barbados and Uruguay, were among the thirty least corrupt countries in the world, whereas others ranked after the 50th and nine of them even fell below the one hundredth. Haiti was the most corrupt in the world.

(4) Lack of trust. In order to win more votes, many Latin American politicians tend to make gorgeous promises in the election campaign. After the winner of the campaign assumes power, he seldom fulfills his promises, causing a great disappointment among the constituency.

3. *Comparative advantage vs. industrial restructuring.* Latin America possesses 40% of the world's plant and animal life and 27% of the planet's water resources. Forty-seven percent of the region's land area is covered by forest. In South America, forest area totals 9.2 million square kilometers, accounting for 23% of the world's total amount. Mexico and Venezuela are the major oil producers in the world. Brazil has the world's sixth largest proven iron ore reserves. Regarding copper reserves, Chile and Peru stand at the second and fourth places in the world. Reserves for silver and sulphur in Mexico, nitre in Chile, nickel in Cuba and emerald in Colombia are among the largest in the world. Moreover, Latin America also has the best conditions for agricultural production.

In the past, exports of primary products turned some Latin American countries into the richest nations in the world. At the end of the 19th century, for instance, demand of the European market for agricultural produce was rising rapidly. In order to expand food production, Argentina brought in foreign capital and international immigrants. By taking advantage of the progress of maritime technology, Argentina shipped a large quantity of agricultural produce to Europe. As a matter of fact, economic growth rate in Argentina at that time was among the highest in world. By the early 20th century, this South American nation had been nicknamed the world's warehouse of grain and meat. By 1900, per capita GDP in Argentina had been equal to half of that in the United States, England and Australia, respectively, somewhat higher than that in Finland and Norway, or close to Italy and Sweden. In 1913, per capita income in Argentina had reached US\$3797, higher than France (US\$3485) and Germany (US\$3648). Even in 1950 Argentina was still richer than Japan and as rich as Italy, Austria and Germany.

After the Great Depression of the world economy in the 1930s, Argentina started to pay more attention to the industrialization drive. By the early 1940s, the importance of the industrial sector had surpassed the agricultural sector, though the industrial sector was still composed of food processing and simple assembly. Only in the 1950s did Argentina start to make more efforts to develop the heavy industry and chemical industry. Therefore, it can be concluded that Argentina had lost an opportunity to become industrialized before and during the Second World War. Indeed, agricultural development had successfully made Argentina rich, but it failed to catch up with other nations in the industrialization path.

In recent years, Latin American economy has benefited greatly from the rise of prices for primary products. According to the United Nations Economic Commission for Latin America and the Caribbean (ECLAC), the region's annual GDP growth rate during 2004 and 2007 was between 4.6% and 6.2%. This cycle of high growth was unprecedented in the region's own history.

However, many people doubt the sustainability of this high growth rate, which was mainly

the result of high rise of the prices for primary products in the world market. In other words, when the prices fall, growth momentum of Latin American economy would be weakened or even disappear.

4. *International competitiveness.* In the age of globalization, a nation's competitiveness has become increasingly important. Most of Latin American countries' competitiveness is not strong. According the World Economic Forum's *Global Competitiveness Report*, during 2005-2006, only Chile's rank was among the first 50 countries. Major countries such as Brazil, Argentina and Mexico lagged further behind.

Many factors affect a nation's competitiveness, and technological innovation is one of them. Regarding the factors that determine a nation's technological innovation, education and the capacity of research and development (R&D) are particularly important.

Indeed, education in Latin America is not undeveloped. According to the United Nations Development Program's *2005 Human Development Report*, Latin America possessed the highest combined gross enrolment ratio in all three levels of the educational system (81% for Latin America and 63% for developing countries as a whole). Nevertheless, its education system has two major flaws. First of all, higher education is given much more emphasis than on primary education. As a result, Latin American scientists can win Nobel Prizes, but ordinary workers cannot acquire enough skills, thus hindering the rise of labor productivity. Secondly, educational quality is not high. According to the Organization of Economic Cooperation and Development, in 2003, PISA scores in mathematics for Uruguay, Mexico, and Brazil were 422, 385 and 356, respectively, much lower than those in Finland, Japan and Ireland (all above 500). PISA scores in reading in Finland, Korea and Ireland were 543, 534 and 515, much higher than those in Uruguay, Argentina, Chile, Brazil and Mexico (between 400 and 434) and Peru (327).¹

Latin American countries have not allocated much capital on R&D activities. Compared with other regions of the world, Latin America ranks the lowest in terms of the share of R&D expenditure in GDP. According to the Inter-American Development Bank, for the region as a whole, the amount of this expenditure increased from US\$9.5 billion in 1995 to US\$11 billion in 2002, but it was still less than Korea (US\$12 billion). Moreover, 73% of Latin America's total R&D expenditure was concentrated on Brazil (42%), Argentina (20%) and Mexico (11%). This means that majority of the Latin American countries have not conducted many R&D activities.

5. *Social problems.* Latin America has been suffering from the grave social problems for a long time. These problems include:

(1) There is wide-spread poverty in the region. According to ECLAC, in 2005, more than 200 million people (almost 40% of the total population) lived in poverty and 81 million people (15% of the total population) in extreme poverty.

(2) Income distribution is seriously unequal. Latin America is the region whose wealth concentration is the most serious in the world. According to the World Bank, even countries like Uruguay and Costa Rico, whose income gap is often considered as relatively narrow, are much more unequal than any OECD members or East European countries. Brazil's Gini Coefficient is almost 0.6, one of the highest in the world. In most of the Latin American countries, the richest decile controls 40-70% of the total wealth, whereas the share of the poorest two deciles is only 2-4%. ECLAC statistics also shows that Gini Coefficient in Brazil and Bolivia is above 0.6, and

¹ The Program for International Student Assessment (PISA) is a system of international assessments that focus on 15-year-olds' capabilities in reading literacy, mathematics literacy, and science literacy.

the index for many other Latin American countries is close to 0.6.

(3) Public safety is worsening. In the 1970s and 1980s, there were 8 murders a year per 100,000 inhabitants. In the 1990s, the number increased to 13 per 100,000 persons, four times the rate in other regions except for Africa. With the exception of only a few countries like Chile and Costa Rica, murder rates in Latin America have increased as much as five times or more. Indeed, though crime rates are rising everywhere around the world, Latin America, along with Africa, has registered the rapidest increase in terms of murder rates. Given the fact that many victims would not bother to report to the police, crime statistics tend to be underestimated in most of the Latin American countries.

Social problems have incurred immense damages to the region's socioeconomic development. Lack of public safety has worsened investment environment and foreign investors have become hesitant to make investments there. Moreover, poverty and unequal income distribution have deprived people of their trust and confidence in the government. Burgeoning social movement in recent years has clearly jeopardized the region's political stability.

II. Two External Factors

Latin America's development prospects will also be affected by external factors. On the one hand, changes of the world order and rapid tendency of globalization have exerted significant repercussion on Latin America; on the other, the region's deepening reforms have made it more integrated with the outside world. As some observers noted, Latin America is much more different from what it was two decades ago and the most impressive change is that it has become an important part of the global economy. The following factors will affect Latin America's development prospects:

1. *U.S. economic situation.* Close integration with the world economy also means that Latin America has become more dependent upon it. Joseph Stiglitz, the Nobel Prize laureate in economics, once said that, in an increasingly globalized world, when the U.S. sneezes, Mexico would catch a cold. As a matter of fact, not only Mexico, but also other Latin American countries would suffer from an possible American economic recession. Some commentators even argue that what the U.S. Federal Reserve Chairman said would have greater repercussion upon Latin America's stock market than what a Latin American president says.

Apparently, of the external factors that can affect Latin America's development prospects, the U.S. factor is the most important. The U.S. is not only the largest trade partner for Latin America, accounting for roughly 40% of the region's foreign trade, but also the major provider of capital and technology. Most of the remittance Latin American countries can receive regularly comes from the U.S. Naturally, U.S. economic situation would have tremendous influence upon the Latin American economy.

2. *China and India.* In recent years China and India have also become an important factor influencing Latin American economic development. According to the World Bank report titled *Latin America and the Caribbean's Response to the Growth of China and India: Overview of Research Findings and Policy Implications*, authored by Guillermo Perry et al, and published in August 2006, "China and India's growth has not been a zero-sum game for LAC [Latin America and the Caribbean], but the potential benefits are not being fully realized. It is crucial that LAC countries take full advantage of the growing presence of China and India in world markets by

adopting offensive strategies that facilitate both the participation of LAC firms in global production networks and their commercial presence in the two Asian economies' markets. Governments should avoid protectionist temptations and should focus on facilitating the adjustment in affected sectors, as well as the emerging structural shift towards more natural-resource and scientific-knowledge-intensive sectors by adopting adequate education, innovation (both patentable and non patentable), natural resource management, and rural development policies.”

The World Bank report mentioned three reasons why Latin America can benefit from the economic rise of China and India. First, the two Asian nations can offer large markets for Latin America, but the potential is yet to be fully tapped. Second, China and India can be important sources of capital for Latin America. With the opening of the financial market in China, for instance, Latin America will get more capital from it. By 2004, China had become one of the top-ten creditor nations. If India's economic growth can be maintained, it will also be turned into another exporter of capital. Third, there is great scope of cooperation in the field of science and technology. One of the best examples is the joint launch of three satellites by China and Brazil.

The ECLAC report, *Latin America and the Caribbean in the World Economy (2005-2006)*, also pointed out that the robust growth in China and India is of great importance for the world economy and in particular for Latin America. The current growth pattern exhibited by China, India and other developing Asian countries, as the new global trend-setters in terms of production, trade and financial movements, offers an encouraging outlook for the trade performance of the Latin American countries.

According to the ECALC report, “China has already become a major export market for a number of countries in the region. Trade relations between South America and China tend to be complementary, taking the form of inter-industry trade in which the region exports primary commodities and imports manufactures, whereas Mexico's and Central America's trade with China is more asymmetrical. In fact, China buys less than 1% of Mexico's total exports but is its second-largest supplier of imports. As a result, Mexico and Central America have been building up a growing trade deficit with China.”

3. *Prices for the primary products.* Movement of prices for the primary products in the world market would also be an important factor that determines Latin America's development prospects. As mentioned earlier, recent years' high growth rate in Latin America was partially explained by the price rise of the primary products Latin America exported to the world market. In Venezuela, for instance, during 2002-2006, though volume of oil export grew only 10%, oil export revenues expanded by 130%.

4. *Foreign capital.* Inflow of foreign capital will play a pivotal role in Latin America's future of development as well. The region's long-standing low capacity of capital accumulation means it has been heavily dependent upon the use of foreign capital. Since the 1990s, its privatization of the state-owned enterprises and implementation of the open-door policies have attracted a large amount of foreign investment. Therefore, economic recovery of the region in the 1990s could be partly attributed to the enormous inflow of external resources, which enabled it to make more investments and import more machineries and daily consumer goods.

5. *Globalization.* Globalization has been an irresistible trend of the mankind. However, it has also incurred a heavy cost for Latin America. With the opening of the market, foreign competition has closed down many of the region's small- and medium-sized enterprises. At the

same time, short-term capital inflow, closely associated with the development of financial globalization, has created greater uncertainty for Latin America's financial system. From 1994 to 2001, Latin America witnessed three financial crises, i.e., Mexico in 1994, Brazil in 1999 and Argentina in 2001. No less important is the fact that Latin American economy has become all the more dependent upon the developed countries' economic situation.

III. A Bright Future for Latin America

Most of the internal and external factors that will affect Latin America in the future are positive. As a result, though the region will continue to face great challenges in the social arena, it is likely to maintain political stability, sustain sound economic development and uphold multilateral foreign diplomacy.

1. *New development model.* Countries like Venezuela, Bolivia and Ecuador under the leadership of the left-wing presidents, Hugo Chávez, Evo Morales and Rafael Corea, have put forward the notion of 21st century socialism. Development model under this label is greatly different from the neoliberal model pursued by Latin America in the 1990s.

Three major characteristics of the new model can be summarized as the following. (1) Based on economic nationalism, the state maintains a dominant position over the economic life. In the three countries, i.e., Venezuela, Bolivia and Ecuador, the economic backbone is oil and gas, and the leaders believe that they welcome foreign capital but it should not make extravagant profits. (2) More efforts need to be made to improve the well-beings of the poor. It is believed that the objective of economic development is to reduce poverty and raise the living standards of the vulnerable masses. Towards this end, the three governments have been attempting to take advantage of the oil windfall to increase social expenditures. (3) Presidential power has been enormously strengthened so that the presidents can order such measures as re-writing the constitution and promulgating decrees.

2. *Continued political stability.* The reasons why most Latin American countries can maintain overall political stability are manifold. First of all, mechanism of Latin America's party politics has been improved so that there is a whole set of fair, transparent and free "rules of the game" guiding competition among the parties. Second, the military has been highly professionalized over the years and its desire to intervene in politics is becoming weak and weak. Even when the country is caught in a crisis, the military tends to stay away from politics and acts as a political "stabilizer". Third, in a globalized world, political democracy is proceeding smoothly in other regions and this external factor has been quite positive in promoting Latin American democracy. Finally, for its own sake, the U.S. does not wish to see unrest in its backyard of Latin America.

3. *Development of science and technology.* More and more Latin American countries have realized the importance of reinforcing international competitiveness through the promotion of science and technology. The joint statement, for instance, issued by Brazilian President Luiz Inácio Lula da Silva and British Prime Minister Tony Blair during Lula's state visit to London in March 2006, declared that "We acknowledge the fundamental role of science, technology and innovation in shaping sustainable development, eradicating poverty, promoting social inclusion and improving quality of life." In his opening remarks at the conference on "U.S.-Mexico Collaborative: Partnering for Technological Advancement" in New York in September 2003,

Mexican President Vicente Fox said, “The center of economic growth for Mexico, and our interest as a government, is focused on Information Technology. Our goal is to have a minimum of 1% of Mexico's Gross National Product (GNP) invested back into IT.” In Argentina, according to a government announcement released in November 2007, the combined Ministry of Education, Science and Technology would be separated into two, i.e., Ministry of Education, and Ministry of Science, Technology and Productive Innovation. Formation of the new ministry in charge of science and technology would attach more importance to R&D. In 2007, investment in Argentina's R&D stood at 0.65% of GDP, and by 2010 the share will climb to 1.0%. The new ministry would continue the government's current science plan for 2004-2010.

4. *Social cohesion.* The notion of social cohesion was put forward by ECLAC in 2006. Since then, this notion has been accepted by most of the Latin American governments.

According to ECLAC, social cohesion can help ease the serious social problems in Latin America. In order to consolidate social cohesion, ECLAC suggested three types of policies: (1) To generate more employment. Employment is the most important link between economic development and social progress because it is the main source of household income (about 80% of the total in Latin America). (2) To promote education. Education is essential for reducing poverty, since it prepares people to exercise citizenship, protects the most socially vulnerable groups and promotes greater equity in access to opportunities for well-being. (3) To reinforce social protection. Social protection can give all citizens the access they need to services that reduce their vulnerability and improve their quality of life. It can also reduce the risks such as unemployment, underemployment, sickness and the loss or drastic curtailment of income in old age.

Latin America has become increasingly aware of the need to strengthen social cohesion. This issue was the theme of the Ibero-America Summit in Chile in November 2007. At the summit Latin American government leaders reached a consensus that sustainable economic development must be based on social cohesion, and policies should be made to ensure that every citizen can enjoy his fundamental right to have access to medical care, education, housing, pension and other social benefits.

Indeed, no country in the world is free from social problems. The only difference lies in the varied degrees of the severity of the problems. Latin America will not be able to eliminate all the social problems, but this does not mean that they can be left untackled. It is encouraging to note that, since the end of the 1990s, governments of Venezuela, Brazil, Chile and Mexico, among others, have designed several measures to deal with these problems. It is recognized that the anti-poverty program in Venezuela and the “zero-hunger plan” in Brazil have accomplished remarkable achievements. If Latin American countries can take advantage of the good economic situation and rising fiscal revenues in recent years by continuing to assist the vulnerable groups and make more investments in the social area, its social problems can be effectively reduced.

5. *External conditions.* On the whole, Latin America is faced with quite favorable external conditions. First of all, despite the sub-prime crisis, the long-term prospects of the U.S. economy are promising. Second, while it is not easy to predict how speculation affects the movement of the prices for primary products in the world market, analysis of the supply and demand conditions can prove that long-term price rise for these products will not be diverted. Finally, having recognized the importance of improving the investment environment, strengthening institutional building and developing infrastructures, Latin American countries will be in a better position to attract more

foreign capital.

6. *Opportunities of globalization.* Since the 1990s, Latin American countries have adjusted their development models to take the good opportunities from globalization. As a matter of fact, they have benefited greatly from market opening and inflow of foreign capital. For instance, faced with increased foreign competition after cutting tariff barriers, Latin American enterprises were forced to pay more attention to raising productivity so as to upgrade their international competitiveness. At the same time, as globalization has made it possible for international capital to move swiftly across borders and in larger volumes, Latin America remains a hot spot for foreign investment. Large inflow of external resources has enabled them to increase investment and finance current account deficit. Finally, rapid movement of goods across borders has offered Latin America a chance to increase international trade. As a result, its exports grew from US\$237 billion in 1995 to US\$577 billion in 2005.

It is wrong to view globalization as a panacea for all the difficulties in developing countries. At the same time, it is also inaccurate to see it as the origin of evil. Therefore, the inevitable question for Latin American countries is how to avoid the pitfalls of globalization and utilize its opportunities for their future development.