

LATIN AMERICAN TRADE AND DEBT

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The term "Latin America" is very misleading in that it gives the impression of a coherent geographical economic and cultural unit. In area it stretches from the southern U.S.A. (in cultural terms it extends even north of this) to the Cape of Good Hope, 5000 miles away, taking the distinct regions of central America, the tropical rainforests of the Amazon to the First World modernity of Rio de Janeiro and Brasilia. The people of the region come from many different ethnic backgrounds and in political terms the area has produced everything from the most vicious right-wing dictatorships to the world's first democratically elected Marxist government. Nonetheless they do face many problems in common and this sense can be treated as a whole. The most pressing of these problems are those of trade and debt—how can they generate enough income to prevent sliding into bankruptcy and its attendant consequences? In this essay I concentrate on this issue, with reference to "Dependency Theory", arguably the most suitable framework for analysing post colonial LDC's.

The issues of trade and debt are heavily interlinked and can be seen in terms of a vicious circle. A country must borrow heavily in order to finance infrastructural improvements which would hopefully encourage industrialisation and allow it to reap the benefits of foreign trade. Conversely when the cost of servicing these debts becomes large, the same country must increase production and exports simply to repay the loans. Latin American countries must borrow to develop production to finance borrowing. The OECD in its report, puts a heavy emphasis on statistics but (necessarily) plays down the human and political factors so relevant to the development of Latin America. It ignores the responsibility of the rich North for past and present injustices, which seem to dominate media coverage of that region today.

One of the effects of the post colonial legacy is that Latin American countries have little or no control over the direction of their economic future. Development of trade in these countries is a reflection of and is consequent upon expansion in the core countries of the North. The mushrooming of Latin American debt recently has reinforced the hold of the industrialised world on Latin America, which was already firmly in place via Trans National Corporations (TNC's) whose wishes always had to be considered when formulating economic policy and in an extreme

case led to the downfall of a democratically elected regime (Chile 1973). In many cases however these governments are far from democratically elected and wouldn't serve the interests of the majority even if they could. A consequence of dependency is the existence of the clientele classes who act in the interests of foreign capital in order to ensure financial and sometimes military backing for the status quo, which typically involves the existence of a wealthy elite amidst dire poverty amongst the masses. These characteristics can be seen most glaringly in countries such as Chile, El Salvador, Argentina and Columbia but this characterisation is less accurate with respect to e.g. Brazil which has a large and growing educated middle class whose interests are typically more diverse than those of the super rich. In general though it can be said that the internal dynamics of dependency are as much a function of domination as are the more explicit pressures placed on LDC's by immediate financial circumstances.

The OECD report stresses the the problems facing Latin America cannot be analysed without reference to the troubled world economy. It identifies three shocks that affected world trade since 1970: exchange rate instability, balance of payments disequilibria as a result of oil shocks and the universal increase in non tariff trade barriers.

The breakup of the Bretton Woods system of fixed exchange rates has caused a large degree of price instability on world markets. The huge devaluations which resulted from the floating of exchange rates meant the beginnings of Latin America's most persistent problem - inflation. As countries such as the U.K. and Italy well know, a devaluation (resulting in a rise in the domestic price of imports and thus inflation) can form the beginnings of an inflationary spiral as workers seek pay rises to compensate for the rise in prices which in turn causes a further rise in prices. In countries where confidence in the ability of money to retain its value is not high (perhaps as a result of previous hyperinflations or political instability) this can quickly lead to incredible (by post war western standards) rates of inflation. For example in 1986 Argentina's inflation rate was estimated at 1300% per year and 100% a year seems to be quite acceptable. This inevitably results in further devaluation which compounds the problem even further. Governments have proved unable to provide lasting solutions, sometimes because of their populist orientation which makes them reluctant to implement measures which are bound to hurt somebody. Brazil's recent attempt to impose wage and price freezes (the "cruzado plan") lasted three months before collapsing under the strain of public outrage with the black marketeering and scarcities which ensued.

Another problem posed by exchange rate instability is in relation to Latin America's large external debt. It is very difficult for these countries to assess their ability to repay the debt when its value is changing with every fluctuation in whatever currency it is denominated in. In Brazil's case a one cent rise in the dollar means an additional \$1.5 billion of debt. As the domestic currency depreciates the burden of interest payments becomes more severe. This also means that the countries' export earnings are uncertain and a depreciation tends to reduce these earnings given that these countries are often reliant on exports of primary products for which the world demand has been depressed for some time.

Many of these exports are not price sensitive in that the lowering in (say) the \$ price which such a depreciation entails fails to produce a sufficient rise in demand to compensate for the lower value of existing exports. Obtaining foreign currency can often be very difficult and a black market selling foreign currency at way above the official rate is a standard feature.

After the oil shock of 1973, existing balance of payments disequilibria were exacerbated and new ones appeared. Oil importing countries now faced a massively increased import bill with the oil-shock induced recession depressing export earnings. In this respect Latin America cannot be treated as a unit because oil rich countries such as Venezuela, Mexico and Peru benefitted from the price rise. At the same time the countries of South East Asia (Newly Industrialising Countries) were beginning their big export-led push into Western markets which finally relected itself in the massive trade surpluses we see today. Latin American countries themselves have doubled their imports from the NICs in the last 20 years. Unfortunately they did not follow the example of export-led growth but concentrated on austere demand management policies coupled with import substitution. However not every country can pursue an export led growth strategy - if they did everyone would end up worse off (Of course this is, no reason not to pursue such policies). These policies resulted in a massive fall in imports e.g. in Brazil exports fell by 25% in real terms. The policies seem to have been motivated by the simplistic view that "exports good, imports bad" which is not true especially if you stop importing capital goods thus preventing the modernisation of domestic industry and hampering its ability to compete on world markets i.e. less imports now means less exports in the future. It should now be recognised that a major shift in world purchasing power appears to be taking place away from the North America and Western Europe towards the large surplus countries such as Japan and Taiwan. The Latin American countries need to reorient their export markets towards these potentially profitable markets and

away from the U.S.A. which is going to face severe adjustment problems as it tries to cope with its own very considerable balance of payments problems.

The third problem facing Latin America involves widespread increases in non-tariff trade barriers which affect the export markets that these countries need so badly. There is little point in financing huge capital expenditure in export industries if there are no open markets. As world opposition to free trade relaxed during the 60s and after in particular due to the general agreement on tariffs and trade (GATT) tariffs were lowered worldwide. However in recent years a general rise in nontariff barriers, has been noticeable. Quotas, strict regulations, red tape and automatic tariff hikes for processed goods are now the biggest barriers to free trade.

The development and strengthening of the European Community (EC), the European Free Trade Association (EFTA), and the relatively closed nature of the Asian NICs means that new policies will be needed by the richer countries if LDCs are to penetrate these markets. Another problem facing LDC exports is the structure of tariff barriers that discriminate against processed goods. Many primary products such as rice can be exported duty free to the EC, however products can face a 13% tariff if they are partly processed. This is a huge obstacle to Latin American countries who have the potential to process their own commodities, thereby increasing employment, diversifying industry and earning more export income. Instead these countries are forced to export these commodities in a raw condition minimizing value added within the country. For Latin American countries who earn 50-60% of their export income through primary raw materials, this is a heavy burden. Often the only processed goods that reach the world market from Latin America are those products produced by subsidiaries of TNCs. As we in Ireland are acutely aware increases in the profits earned by TNCs in the periphery countries accrue largely to non nationals and have little beneficial effect on the economy as a whole apart from the provision of immediate employment (often low pay and/or low skill).

TNCs have a huge stake in Latin America today. Most of them are U.S. owned and export most of their output to the European and North American markets. Although they introduced much needed capital to Latin America and provided employment it seems that in the long run their cost outweigh their benefits. These TNCs tend to become less and less beneficial over time to their host countries. Increasing concentration of capital and resources through horizontal and vertical integration means that the spinoff effects are reduced as time progresses and native contractors

lose out. Although Brazil produces almost 50% of the world's coffee output the whole process is controlled by non Brazilian owned firms from the planting of seeds in TNC plantations to the labelling of jars. A small number of TNCs e.g. Nestles reap most of the benefits of Brazil's huge coffee exports. It is very rare for the producer country to receive more than 25% of the final price charged to consumers. As these TNCs diversify they fill more niches in related markets. Indigenous industries find it impossible to compete with these TNCs due to the latter's massive economies of scale, which produce organisations with formidable market power, control of which remains in the core countries. All of these characteristics of TNCs give rise to the shared interests among them in the countries in which they operate. Their need to control all aspects of the production process encourages them to plan for the long term. Inherent in this plan is the need for TNCs to have some influence on the governments in their subsidiary countries. This is a further constraint on Latin American countries in their quest for independent development. However, the government and the TNCs may appear to oppose each other on certain issues - this may often be for appearances sake to allow the regimes to preserve some credibility in a region renowned for its political instability.

As regards foreign trade the OECD report categorises four output sectors - minerals, agricultural produce, services and manufactures. The growth of service industries throughout the world has been very rapid in recent years. Expenditure on services tend to rise as countries become richer - indeed the service sector has accounted for most of the oft boasted about increase in employment during the Reagan years in the U.S. However the growth of the service sector has not had much impact on the composition of world trade and there does not appear to be much potential for development in this area for the LDCs. It is important not to confuse services and nontraded goods. Service goods are typically nontraded - unless a haircut is outrageously expensive you won't travel to another country to buy it. However many services are traded e.g. financial services, consultancy services etc. But these all rely on existing expertise and advantages so there may not be much potential for development for LDCs in this area. In fact where services are exported it is usually from the richer countries to the LDCs. The large percentage of students from LDCs studying in Ireland and the export of Irish professional expertise to LDCs bears witness to this.

The world trade in minerals appears to have reached its peak. Efforts made to economise in the use of the mineral products following on the oil shocks have caused a fall off in demand for

many minerals in recent years. The prime exported mineral from Latin America is oil, the bulk of which comes from Mexico, Venezuela and Peru. These countries benefitted from the high price of oil up until the early 1980s but with the falloff in demand for oil and the plunge in oil prices these countries have suffered a sharp decline in their terms of trade (the amount they need to export to pay for a given amount of imports). The associated falls in their exchange rates vis-a-vis the rest of the world have further reduced their export earnings. The risks associated with dependence on one commodity are well known. When the price of copper plummeted by 60% in 1975 it caused near bankruptcy for Zambia which depended on copper for an incredible 94% of its export earnings. There is potential for high earnings for exports of minerals from LDCs but the demand has been reduced by the drive for self sufficiency in energy in the core countries. It has been established that today 90% of world expenditure on exploration is in the rich countries of the world. Since exploration is a long term costly activity, this trend could leave LDCs with a serious gap in their export earning ability in the coming years.

The most important area of trade for most Latin American countries is agricultural produce, be it timber, fruit, cocoa, coffee etc. Non tariff barriers represent a large obstacle to development in this area, especially in relation to processed goods. This is a problem that should be familiar to Ireland as we export raw agricultural produce to be processed in the core countries of the EC. The prices of raw agricultural produce are highly volatile leading to unstable incomes and associated long term planning difficulties. Some kind of price control would obviously help, and the absence of such controls partly explains why so many farmers in Colombia and Bolivia have turned to exporting cocaine for a living. This gives them a guaranteed income and their collective actions this year could amount to production of \$25bn worth of cocaine valued at New York street prices. Economists can hardly question the rationality of switching production from commodities whose price is highly unstable to a commodity which experiences stable or increasing demand and thus a stable price. There is a sad irony in the fact that the Latin American countries, having been largely left out of the "petrodollar" boom of the 1970s are now at the centre of the "narcodollar" boom of the 1980s.

Although demand for agricultural imports is falling worldwide, Japan imports half what it used to 20 years ago, the U.S.A. 1/3. With this in mind Latin American countries should move towards higher value added produce, but this brings in the core of the trade-debt problem. The West cannot expect Latin America to

pay of its debts to western banks and at the same time close their import markets through trade associations such as the EC, EFTA or the USA. 50% of world trade is subject to nontariff barriers and this figure must be reduced if we are really committed to free trade and co-operation. While we are quick to recommend free market remedies within LDCs (via the IMF) we seem less willing to implement free market measures between countries. The message seems to be that LDCs must be free to buy our exports (on credit if necessary) but that they mustn't be free to import to us in return. Scare mongering by politicians in the West warning of unemployment if LDC imports are given free access to "our" markets has not been substantiated by fact. Richer countries have benefitted from lower priced imports in the form of low inflation. On the terms of the "New Right" this of itself should be a good thing. Britain for instance has proved willing to sacrifice at least 1.5m jobs for the goal of low inflation - if this is representative of the value that the West now places on low inflation then cheap imports are surely a good thing. In addition many LDC imports don't compete with developed country goods anyway - though this is partly due to the response of European and American industry to low price competition i.e. by moving into the upmarket, value added sector.

To conclude with a comment on a current topic: the Stock Market crash of 1987. The uncertainty in the markets which contributed to the crash can be traced to at least two factors - the enormous U.S. trade and budget deficits and the enormous Latin American foreign debt. The year 1987 brought the realizations that (1) much of the Latin American debt would never be paid back (2) the correction of the U.S. twin deficits would probably precipitate a world recession. The second factor shows that the issues of trade and debt are not purely confined to Latin America. These two issues are often treated separately but they are closely linked. On the one hand, Latin American countries need to export more in order to pay back their debts and/or develop their economies. On the other hand we have the massive trade imbalances between the U.S. and Japan and other Far Eastern countries. The traditional Latin American export destination i.e. is the U.S. faces severe balance of payments, budgetary and exchange-rare adjustments. As has already been mentioned they need to reorient their exports towards the booming "Pacific Basin". More generally we need to redistribute existing trade flows and get away from the Japan-U.S. nexus. Apart from anything else it is economically unsound to have the world's two largest economies overly dependent on each other. Of course such a reorientation requires money which brings us back to where we started. Perhaps this could be achieved by a new "Marshall Plan". The original post World War II plan

incorporated the essential vision that it suited the U.S. to engineer a recovery in its largest potential export markets, even if these countries would one day compete with the U.S. on its home ground. If a similar plan was implemented with respect to Latin America they could buy more U.S. goods thus alleviating the trade deficit and also export more to each other and the U.S. thus giving them the necessary earnings to pay back their debts and in turn stabilize world financial markets. On reality things would be as simple as that. For one thing Europe started with a clean balance sheet, and also current Latin American policy indicates that the U.S. would attach strong political conditions to any aid. It took a shattering war to precipitate the introduction of such a bold and imaginative plan in 1945; one wonders what further tragedies Latin America will have to endure before some real effort is finally put into ensuring that the region can fully realise its enormous potential. Whatever steps are taken they will involve risks, but given the greater risks we face if no action is taken, not to mention our collective responsibility to the poverty stricken nations of the Southern hemisphere, some action is imperative.

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