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Central America Paying Dearly For Overdependence On The Us Economy

by LADB Staff
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The rock upon which Central America has built its economic church is teetering. Experts expect that overreliance on the US economy will worsen the region's prospects for weathering the recession covering the world like a bad paint job. The isthmus cast its lot with a mix of maquilas, tourism infrastructure, trade agreements, and export of its excess labor force. Each of these tactics has shown considerable weakness during the past year, and all are expected to continue to do so. The 295,000 workers who streamed daily to the maquilas in 2008 are now a thinner multitude, their numbers dwindling by 14.59% more than 43,000 people as they march into 2009. They are beset not only by US consumer retrenchment but also by the fall of a protective barrier that shielded them from dreaded Asian competition. Jan. 1, 2005, marked the end of the Multi-Fiber Agreement (MFA) and, with it, the midnight flight of some South Korean maquilas along with their machines and equipment (see NotiCen, 2005-01-13). Jan. 1, 2009, saw the fall of another quota arrangement, this one with China, that is almost certain to further wither the flanks of Central Americans. What is at stake, as the sector weakens, is 72.7% of El Salvador's total exports to the US, 65.6% of Honduras', 60.2% of Nicaragua's, and 47.9% of Guatemala's. These figures are from the Central American Bank for Economic Integration (CABEI), whose chief, Pablo Rodas Martini, told the media last year, "The region is far too dependent on maquilas. Textiles are the number-one export to the US of four isthmus countries." The isthmus is in no condition to go head to head with China. Even with its hands tied by quotas, the Asian behemoth managed to capture almost 33.6% of the US clothing market, a figure that grew from 9.1% in 2003. By comparison, Honduras accounts for barely 5.7%. The competition has served only to freeze wages in the sector, as maquila owners have demanded, and largely gotten, government assurances of no new minimum-wage increases. That concession will do little to bolster the industry, said Mexican economist Enrique Dussel Peters. He said low wages by themselves do not make countries competitive. In 2007, before recession was felt, Guatemala's textile industry was contracting. The closure of 35 factories there put 17,000 workers on the street. "What really makes a country competitive is the ability to integrate the production of raw materials, design, and logistics to their own production chains," Dussel said. Central America plays only a small part in the process, its factories coming in only at the tail end of the chain to do the sewing and assembling of stuff made elsewhere. Nor is China the only threat Asia presents to the isthmus. 2008 was good for the industry in Honduras; it grew by about 11%. But, in the same period, apparel imports from Vietnam grew 36%, and average unit value was much greater US $3.60 versus just US$1.95. In a recession, low value could turn out to be a plus, however. Analysts have already discovered, and made the point, that, because the region produces low-cost items like T-shirts and socks, demand might continue strong, while demand for higher-priced goods weaken. This has been seen to be the case at Wal-Mart. But low value will not sustain the industry against the Asians, said John Fee, an international lawyer expert in trade agreements. "They need a greater number of different product lines. They won't be a viable apparel source if all they make is T-shirts and socks," he said. Questioning the relevance of CAFTA Since 2006 when the Central America Free Trade Agreement (CAFTA) came partially into being, the region's governments

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and private sectors articulated great expectations for it, but that pact has proven in the present environment to have just aggravated the overreliance problem. Trumpeted by the administration of former US President George W. Bush as a boon to poverty alleviation, it was downplayed by US President Barack H. Obama during his campaign as a deal that had failed to live up to labor and environmental standards. As far as the maquila industry is concerned, CAFTA may be irrelevant. Only three of the 10 leading exporters to the US have free-trade agreements (FTAs) with the US Honduras, El Salvador, and Mexico, a North America Free Trade Agreement (NAFTA) partner. The rest, China, Vietnam, Bangladesh, Indonesia, Cambodia, India, and Pakistan, do not have these deals. David Scott Palmer of Boston University, a specialist in US relations with Latin America, told the media, "The issue at this moment in Central America is what may happen with free-trade agreements negotiated but not yet ratified in Colombia and Panama." Panama negotiated its own FTA with the US and was no part of CAFTA. That agreement has been stalled in the US Congress for years and faces an uncertain future, even as it continues to negotiate a key trade agreement with the rest of Central America and with Canada. CAFTA performed well for some parts of the regional economies and was a disappointment for others. But now it has the potential to reverse rising trends throughout the economies, an ebbing tide capable of lowering all boats to the point where everyone has to get out and walk. Said Rafael Amiel, Latin American economist for IHS Global Insight, trade barriers, which the agreement does away with, are not at issue. "The big problem is the US recession," he said. "We see Central American trade volume to the United States falling up to 10%." Amiel sees the recession falling unequally on the region in the future consistent with the degree of dependence on the US. Thus, "Honduras, Guatemala, and Nicaragua are the most vulnerable because they depend heavily on US trade," he said. "Panama and Costa Rica are a little more diversified, plus they have niche areas like tourism." A better idea, according to Economic Commission for Latin American and the Caribbean (ECLAC) deputy director for Mexico and Central America Jorge Mattar, is for the region to turn toward Asia and try to increase eastward trade while not ignoring regional agriculture and commerce. Mattar said Central America ought to find a place in the Asian production chains, observing that the region has failed to regard Asia as an opportunity. As the US declines as a market, China and India, which alone represent a third of the world's economic growth in the past half-decade, could continue to increase their share. He also notes that Costa Rica is alone among the countries in having diplomatic relations with China (see NotiCen, 2007-06-14). Mattar said he believes the time has come to come out from behind the sewing machines and start getting involved in better export offerings, including services. "It is very difficult to advance in social welfare if we remain in a maquila framework with little technological content and low salaries," said Mattar. "This would require reorientation on the part of governments toward an emphasis on training, including the learning of English and technical education as well as engineering." Another of Central America's strategies that has begun to reek of overdependence is tourism. The amount of emphasis and investment in a permanent state of footloose-and-fancy-freeness of the US consumer is in need of rethinking. The ECLAC report, Preliminary Overview of the Economies of Latin America and the Caribbean 2008, said these adjacent regions stand to get hurt by stagnation in tourism. The report notes, "About 75% of tourists to the English-speaking Caribbean, over 40% of those visiting Central America, and more than 75% of tourists to Cuba and the Dominican Republic come from developed economies in recession." Between June and August of 2008, a strong deceleration in tourism was recorded along with declines of real incomes and consumer expectations. Also playing into the decline of the sector has been exchange-rate volatility and credit contraction. Profligacy in leisure can no longer be financed, the report suggests. Tourism represents about 5% of GDP in most of Central America, rising to nearly 10% in Costa Rica. In the

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Caribbean, it represents as much as 20%, but Cuba and the Dominican Republic register about 10%. In some specific Caribbean countries the figure goes as high as 41%, says ECLAC. The end of an era ECLAC is predicting an end of an era for regional growth. Although some strata of the populations felt it barely or not at all, regional GDP growth averaged nearly 5% a year for the past five years, with per capita GDP growing at more than 3%. The roaring global economy has been a factor in this and, therefore, says ECLAC, "These results will not be repeated in 2009. Growth projections for next year are much lower than for the period that is now coming to a close." The rosiest scenario the report cared to share for Latin America and the Caribbean projected a 2009 growth rate of 1.9%, with unemployment rising from an estimated 7.5% to between 7.8% and 8.1% for the current year. If there is anything resembling good news in this, it is that bursting commodity bubbles will likely drive inflation down to about 6% from a current 8.5%. That is scant recompense for the job losses and other dislocations attendant on the price declines. The meager regional-growth estimate is based for the most part not on anything the region might do but rather on what the US and the developed countries do to turn the global economy around. If the rich countries fail to get their affairs in order quickly, then, says ECLAC, things would get much worse for the region. Meanwhile, the most recent data from El Salvador indicate that the situation is already worse than the regional figures would indicate. Just-released Economic Activity Volume Index (IVAE) figures from the Central Bank of El Salvador show the country is already in contraction. The trend-cycle index is indicating a 2.2% year-on-year (y/y) contraction, with a likely negative GDP growth rate in the last quarter of 2008. The most badly hit sectors are construction and mining. Overall, says a Global Insight analysis of the data, the index shows "the strongest contraction to occur for a decade." The only sector in the country to escape a bashing has been agriculture, mostly because of programs put in place during last year's food crisis. The payoff for governmental defensive investment in food production has made agriculture the leading sector, with growth of 7.1% y/y. Coffee, corn, sugar, basic grains, and fishing are now the engines of Salvadoran economic progress, all quite the reverse of now-comatose CAFTA expectations. Like the ECLAC report, the IVAE implication is that agriculture will continue to lead, and to some degree offset, the decline in other areas until the US economy recovers.

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