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Central America Not Expected to Feel Heavy Impact from Global Financial Crisis

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Central American governments are officially optimistic about the ability of their economies to withstand the effects of the developing global crisis. The optimism stems largely from what they consider a healthy macroeconomic position and weak trade and financial ties to the troubled economies of Russia and Southeast Asia.

But even as they pledge to continue painful market reforms, the entire global financial system is under severe attack. An Institute of International Finance (IIF) report issued Sept. 29 says investment flows declined rapidly in the most- affected Asian economies but remained near the average of the last few years in Latin America.

In the Asia and Pacific regions, investment flows dropped from US$161 billion in 1996 to US$19 billion in 1998. By comparison, flows to Latin America dropped from US$96 billion in 1996 to US $86 billion in 1998. The report, delivered at the annual joint meeting of the International Monetary Fund (IMF) and World Bank in early October, predicted only limited recessionary effects in Latin America. Growth should be 2.7% this year and 1% in 1999, compared to 5% in 1997.

The IMF is more optimistic, projecting 2.8% growth this year and 2.7% in 1999. The decline will come from restrictions on spending as governments impose restrictive fiscal and monetary measures, said the IIF report. In Central America, the major areas that could be hurt by the crisis are trade, capital flows, and tourism. Devaluation in Asia could make Asian products more competitive than Central American exports, while a slowdown in the US would reduce trade as well as cut into the tourist industry heavily dependent on visitors from the US.

Lack of dependence on Asian trade insulates region

While Central America has not seen the capital flight experienced in Asia, some slowing of new foreign investment can be expected. The Central Bank in Costa Rica reported that only US$86.4 million of an expected US$480.2 million entered the economy in the first half of the year.

But overall, Costa Rican officials are predicting the economy will not be hurt much by the crisis. Central Bank president Eduardo Lizano said in early October that because only 6% of Costa Rican exports go to Asia and Russia, a falloff in trade with those areas would have little negative effect at home. Furthermore, the stock market trades mostly in Costa Rican government issues and has not been affected by the bear markets of the US and Japan. Private-sector economists are now predicting 5.5% growth this year the highest this decade.

Other positive signs include an increase this year of US$200 million in direct investment, a government plan to pump US$450 million into infrastructure projects, 16% growth this year in

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tourism, and a modest increase in interest rates to prevent a massive dumping of colones and ward off devaluation. In addition, at the end of September, the Central Bank reported growth in exports and a reduction of the fiscal deficit from 5% of GDP in 1997 to an estimated 3.8% in 1998. With wide variation in macroeconomic numbers, the other isthmian governments have shown a similar confidence in their economic positions.

In El Salvador, Economy Minister Eduardo Zablah said the crisis has affected the country very little because of adequate reserves, low inflation and interest rates, and little speculative capital invested. Growth in the first semester was 4.4%. compared to 3.7% in 1997. The Central Bank reported Oct. 1 that the industrial sector had grown 10.3% in January-July, in large part because of a 22% growth in the maquila output. Salvadoran Finance Minister Manuel Enrique Hinds went so far as to claim the country was better prepared than any other in Latin America to withstand the crisis. "Our macroeconomic situation will keep us safe from the global financial crisis," he said.

Much the same optimism was reported in Panama and Honduras. Panama's Vice Minister of Planning Aracellys Mendez said the Panamanian economy is one of the few that have not felt the effects of the crisis, and Honduran Central Bank president Emon Barjum said that, because trade with Asia is light, he considers it "improbable that the Honduran economy will be significantly affected by the monetary crisis."

A downturn in the US could hurt the region

Private sector leaders and some government officials admit, however, that a severe recession in the US could make all predictions meaningless, since the US is the region's major trade partner. Another weak point for some countries is dependence on dollar remittances. Salvadoran confidence is partly anchored to the US$1 billion in annual remittances sent home by Salvadorans living in the US. These could shrink during a US recession just as donor nations could cut contributions, which would badly affect Nicaragua.

Zablah admitted that, while the situation is good, "that doesn't mean we are invulnerable. Certainly, if the US gets into trouble, no one in the world will be spared." The private sector in Panama sees the economy as most vulnerable through the Colon Free Zone because of its large volume of sales to South America where high interest rates and recession could cut deeply into sales. In testimony before the Legislative Assembly's Commerce Committee, Alberto Pons, president del Sindicato de Industriales de Panama (SIP), said Free Zone merchants could be stuck with large inventories as a result of a South American recession.

Panama's growth has already declined from 3.9% in the first quarter to 2.3% for the first half of the year. Since the crisis began, Latin American economy minsters have promised to "deepen" their free-market reforms. At the September meeting with IMF officials in Washington, they promised to stick with market reforms favored by the IMF but said the US and the multilateral institutions should stand ready with aid in case they are unable to withstand shocks from the Asian and Russian collapse. Global financial system under attack Meanwhile, some global leaders are demanding changes in the IMF system of fiscal austerity and costly bailouts to maintain global financial equilibrium.

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At the October meting of central bankers and finance ministers with the IMF and World Bank, European leaders raised major objections to the IMF formula and even suggested that multilateral institutions might drop their opposition to national controls on capital flows. Increasingly, criticism of the IMF's market-oriented policies has moved from leftist political parties and trade unions to European central bankers. President Bill Clinton has followed the traditional IMF line that any reforms in the global financial system should continue to stress guarantees and protections for investors and the free movement of capital.

But attention is now being given to demands for poverty eradication and protection of national economies championed by the World Bank. World Bank president James Wolfensohn told the economy officials at the meeting that IMF currency stabilization policies exacted too big a price from the poor. One of the most-pessimistic assessments of the crisis came from the UN Conference on Trade and Development (UNCTAD). Its annual report, issued in mid-September in Geneva, said the global crisis will not be solved by IMF bailouts since it was the IMF strategy that helped bring on the crisis in the first place.

At a meeting in Mexico City, UNCTAD consultant Jan Kregel told reporters that Latin America should abandon IMF prescriptions that force reductions of the governments' role in the economy in favor of unregulated market forces. In another report on globalization, economists attending the Oct. 1 meeting of the XI Congreso de Economistas de America Central y el Caribe in Tegucigalpa said the region is among the losers in the globalization process.

Globalization has increased poverty as the region transfers hard currency to creditors in the developed countries and governments cut spending on social programs and sell state properties to conform to IMF requirements. "Contrary to what the neoliberal theory assumes, in our region, the empirical evidence shows that it is inflationary and recessive," the report said. It also said the region's governments ignore the economic problems affecting the majority because their policies are not tuned to job creation, development of small and medium-sized businesses, or agriculture.

The report called for adoption of alternative economic models more suited to erasing the deficits in health, education, and investment in production. [Sources: Inter Press Service, 09/08/98, 09/15/98, 09/16/98, 10/01/98; La Prensa (Nicaragua), Notimex, Agence France-Presse, 10/01/98; El Panama America, El Tiempo (Honduras), Tico Times (Costa Rica), 10/02/98; Spanish news service EFE, 10/01/98, 10/02/98; El Diario de Hoy (El Salvador), 10/03/98; The New York Times,

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