

Latin america, overview of economy, business and challenges



Latin America An Overview of Economy, Business and Challenges

Introduction Latin America suffered during the years of 1980-1990 with political instability and low growth rates. Nowadays the situation is different, the region is improving towards economic stability and greater democracy, however the reforms performed during the last decade are still incomplete. High rates of poverty and bad income distribution remain as the main problems of the region. The last few years has shown that Latin America economy is getting stronger and growing at unprecedented rates in the recent decades, making the environment for business much more attractive.

Economic Overview and Challenges From the middle 1980s to the beginning of the 1990s Latin America was suffering from hyperinflation, which damaged the economic activities. World Bank and International Monetary Fund recommended the fixed exchange rate as an anchor to inflation and as a mean of obtaining economical stability. This policy showed itself very harmful and inefficient socially and economically, and in the end of the eighties Argentina and Brazil experienced major financial crisis. The economic policy strategy was changed to inflation targeting and some years latter the situation improved. The favorable international context, and the boom of the commodity prices, has given a boost to the Latin American economy.

However, the region could not take full advantage of this scenario without the macroeconomic fundamentals stabilized. The region is enjoying sustained current account surplus for the first time in decades and reduction of fiscal debt and increase in international reserves, this more stable macroeconomic environment and the less vulnerability to external shocks

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has lead to a negative trend on the risk analysis of the region. However, fiscal reform and consolidation remains as one of the biggest issues and challenges for the next few years. A reduction in public debt is important, because it leads the financial markets to trust more on the country's policies, allowing it continuous access to capital markets. If the debt levels are high it can retard growth.

Although some important advances have been done in Brazil, where the debt to GDP ratio was more than 65 percent in 2002, it is sill a little over 50 percent. Mexico also have reduced is debt level by about 10 percentage points from the levels of the late 1990s, but the ratio is still around 45 percent. Bolivia and Uruguay both have debt ratios of around 70 percent of GDP. With the better performance of the macroeconomic variables in the past few years, the risk of foreign direct investments (FDI) in those countries have dramatically reduced, in consequence to that Brazil, Peru, Mexico and Chile have the Investment Grade from the majority risk analysis banks and institutions. However, there are some exceptions, during the past year Bolivia nationalized the oil and gas companies that were established there.

Venezuela, as well, does not present a good business environment for foreign global companies, with threats of nationalization and expropriation. The appearance of populist leaders is a threat to the political stability of the region. Although recently some countries have been introducing some reforms, it is still a difficult task for the region. To remove obstacle to investments, institutional reforms are still needed. For example, labor laws are out dated, also the social security and welfare policy need to be revised

for the new demographic reality of the region. Last, but definitely not least, the tax reform is an urgent measure to the economic growth of the region.

International Trade The commercial openness of Latin America is relatively small when compared to other regions, it is necessary to increase the liberalization of foreign trade. Despite the political effort made over the last two decades the region is not as integrated as it could be, Mercosur, the regional trade agreement established in 1991 which the purpose is to promote free trade and the fluid movement of goods, people and currency, has had some improvement in the region but is far away from what it could be. Even inside the region is possible to find examples of favorable effects of a high trade openness, the experiences of Chile (through unilateral liberalization) and Mexico (strongly benefited from NAFTA and a bigger trade with USA). One topic pointed by the World Economic Forum on Latin America as key factor for the development of the region is the necessity to adapt to the increasing participation of China and India in the economy of the world.

At the same time, China is becoming a important importer of commodities from Latin America and a competitor in textiles and labor-intensive manufacture goods. The region have to take advantage of the opportunities raised by China's growing economy and, at the same time, adapt to its competition. **Consumer Characteristics** The Latin America consumer market is composed of 550 million emerging consumers, with average yearly per capita incomes of USD 4, 000, immense natural resources and substantial human capital. It accounts for eight percent of world production and grew by more than five percent in the past three years.

The consumer market in Latin America is very diversified, is not just an aggregate of low income and poor consumers, as most people would think. It is highly segmented, “ their differences, based on lifestyle and attitudes, have a significant impact on shopping behavior”, “ emerging consumer aspire to buy brands regardless of price, because they embody quality and status”, “ emerging consumers use credit to extend they purchasing in power” (Guillermo D’Andrea, E. Alejandro Stengel, and Anne Goebel-Krstelj). Infra-structure Challenges Infra-Structure, such as transport system (ports, railways, airports, roads), energy and communications is one of the limitations for growth in Latin America. It can be a challenge for a foreign company to establish itself in poor infra-structure conditions, but at the same time it can be a big business opportunity for infra-structure global companies.

Most of the infra-structure depends on the government investment, however, the recent privatization process is beginning to change this scenario towards private investments on infra-structure. Some results can already be noticed, such as Telefonica (Spanish global communications company) has radically changed the communication system in a big part of Latin America. Natural Resources Latin America is abundant in natural resources, such as, oil, minerals, land, water, good climate conditions for agriculture, it shows great opportunities and potential for agriculture and mining. The recent records in commodity and food prices have encouraged a greater participation of Latin America in this segment because of its potential in agriculture. An opportunity for international companies related to fertilizing, machinery, genetically modified seeds, and high technology instruments appears.

Main industries Most of South-Americas trade is with wealthiest countries, Western Europe, Japan and the United States are their main trading partners. Most of the continent's export is done by the two major countries, Brazil and Venezuela. While gross of the imports is done by Brazil. Foreign trade consist mostly out of commodities such as copper, coffee and petroleum while mining and agricultural are the main industries responsible for external trade.

Two examples of major industries in the region which are still growing and still have enough investment opportunities are mining (as diverse as copper, iron and gold) and car assembly plants. Mining As said before, Latin America is a continent rich in natural resources, of which many are yet untouched. Although the mining industry had in the 1990's a set back because of low metal prices, (which was a cause for many foreign companies to leave the continent). The last decade or so, prices have gone up, and the mining industry is again important for the region.

Since almost 50% of the worlds copper is produced in South America and also gold and zinc mining project can be found scattered over the continent. Almost all the major mining and resource companies are active in Latin America. Some of the largest are Australia's BHP Billiton, which is one of largest diversified resource companies in the world, in the copper industry it is mainly active in Chile and Peru. Another major player in the region is Xstrata, which is the fifth largest diversified metals and mining company in the world.

And the most important one is the Brazilian, Vale, this company was recently privatized and became one of the world top three mining companies. Motor vehicle assembly plants Another major industry that can be found throughout Latin America are the motor vehicle (assembly) plants. Because of the relatively low labor cost, the upcoming market in the region and being close to other markets, such as the United States. Latin America and especially Brazil are a good base for automobile companies such as Volkswagen, Ford, General Motors and Honda to place manufacturing plants. Sao Paulo, where all these plants are based, is seen as “ the Detroit of South America” (Zeman 2007). In the early 90’s car sales were high and also exports were high.

In the recess of the 1990’s, caused by a global crisis which also made the Real to depreciate, car sales plummeted. After 10 years of meager growth, the automotive industry in Brazil revived, and sales reached record heights. The difference now is that, the production capacity is focused on the local market. The rise in consumption brings with it the opportunity cost of having a less inexpensive production platform. Besides that, the local taxes and the appreciated currency, makes the country expensive compared to other countries (Rideg 2007).

For case studies of organizations and companies that are active in the region. Best can be looked at the major global industries mentioned above. So in the mining industry, Vale, BHP Billiton and Xstrata are big players but there are also Canadian companies active in these markets. As for the motor vehicle (assembly) plants and the automobile market, companies such as Ford, Volkswagen, Fiat, Honda and General Motors can be examined. Other

Challenges One of the problems that foreign companies who want to settle <https://assignbuster.com/latin-america-overview-of-economy-business-and-challenges/>

themselves in Latin America had to face is the language barrier. With the exception of Brazil (that have as a official language portuguese), all the countries in Latin America speak spanish.

However, this should not be a big concerned as most of the skilled workers already speaks english and this is a trend that is likely to intensified on the next years. Another problem is corruption, especially in the government. Unfortunately, in Latin America corruption, the abuse of public power for private gain, is very common. Companies bribe government officials and, as result of that, competition is not always fair and dishonest practices occur. The companies would like the corruption to disappear more than the politicians do.

The last ones cannot openly fight against corruption since they want to do everything to be re-elected, including paying people for their votes. In a large part of Latin America the politic situation can be a risk for companies who want to settle themselves in the area, since the governmental situations are often unstable, that influences investments. Then we have the fiscal policy, in Brazil the system is highly complex. There are more than 57 taxes and there are even tax-differences between regions. To overcome this problem it is important that foreign companies work together with local people or people that are well-informed on this topic.

If they do not pay enough attention to it, paying taxes on a double basis can be the result. Some of these problems can be solved by setting up a partnership with an existing company (joint venture). And of course, we have the problem that anyone going abroad has to deal with: adapting with a

different culture. Be patient when you want to set up a company in Latin America.

People spend lots of time on getting to know each other on a personal level, also on a business perspective. The foreign investors can gain lots of money when their businesses operate well in the emerging markets. But what are the benefits for the locals? “ We are helping the local economy” used to be an answer that satisfied the government, but times are changing because the governments of the emerging markets want proof (Kapstein, 2008).

According to Kapstein, the governments are going to be more selective in the future, about which foreign investments they will accept. Potential entrants of the Emerging markets must come with better arguments and proof, before they can enter a specific market. Conclusions Overall, the tendency in Latin America is positive, the advances in democracy and greater political and economical stability in countries like Brazil, Mexico, Chile, Colombia and Peru, among others, are distancing from the problems of the past such as radical policies that resulted in instability, discouraged investment and property.

These countries are betting on the continuity of economic policies that have been attracting internal and foreign investments. In many cases, those decisions have been made by a new type of left-wing governments economic responsible. However, there are still a lot to be done. Institutional reforms, greater openness to international trade, income distribution and a reduction of the vulnerability to external shocks are among the targets for the region on the next years.

A region with a huge and diversified consumer market as Latin America, that have been growing at high rates, present many opportunities for foreign companies and investors. However, the entry has to be carefully analyzed and studied, as there many cultural differences, legal issues, infra structural and social problems to take in consideration. References Export zone, British Chambers of Commerce Available at <http://www.link2exports.co.uk/marketprofiles/regions.asp?Isid=1207>

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