I. Introduction

Throughout the 1990s, Latin America has been a good place to do business.* The regionís positive environment is the direct result of two far-reaching changes: the adoption of market-oriented economic policies and the proliferation of regional trade agreements. These changes -- occurring under the auspices of democratically-elected, constitutional governments and against the backdrop of an increasingly globalized world economy -- triggered an economic renaissance in the region. Inflation was down; trade, foreign investment and economic growth were all up. In 1997, regional GDP expanded at a rate of 5.5 percent, the highest in 25 years.

With trends such as these, it seemed as though Latin Americaís 33 countries and nearly 500 million inhabitants had turned the corner toward sustained growth, improved social welfare and stable democratic politics. But news from the region during 1998 turned disturbing, and developments in early 1999 have raised doubts about the sustainability of Latin Americaís new business environment. The financial crisis that began in Asia in 1997 and spread to Russia in late summer 1998 cut Latin Americaís growth rate in half. Then in January of this year, the Brazilian government abandoned its four-year stability program based on an "exchange rate anchor" and watched as its currency lost 60 percent of its value. Adding to the gloomy news was the inauguration in early February of a populist president in Venezuela who promised to turn his country upside down. In addition, the struggle continued in neighboring Colombia to keep violence -- perpetuated by left-wing guerrillas, right-wing paramilitary forces and drug traffickers -- from consuming the country.

This report assesses the state of the Latin American business environment in 1999 and beyond. The central question addressed is the following: Do the current economic slowdown and recent political developments threaten to undermine or even reverse the economic reforms and regional integration advances of recent years? Are they just temporary setbacks on the road to stabilizing, opening and integrating the economies of Latin America? Were these processes to be undermined and Latin America to return to the inward-looking, protected development pursued from the 1930s into the 1980s, the environment would be less attractive for business than it has been over the past decade.

In the context of this report, the business environment consists of government policies regulating economics and business; the external environment, both global and regional; and the economic, social and political domains of the domestic environment. Figure 2 captures a process in which external, economic and social developments are filtered through the political process to shape and reshape policies, which then effect changes in the rest of the domestic environment. Using this framework, part II presents a regional overview of the business environment, while part III assesses the performance of the 20 most important countries and prospects for integration in the subregions in which they are located. The conclusion highlights regional developments and individual countries that warrant special attention during the rest of 1999 and beyond. Country level data, grouped by subregion, is found in the tables at the end of the report. Finally, there is a list of selected references.

II. Regional Overview

Beginning with the policy reforms that constitute the core of Latin Americaís new business environment, this section examines the environment from a regional perspective, giving special attention to recent trends.

Policy Environment

The most distinctive feature of the new environment is the set of policy reforms that governments throughout the region systematically adopted to stabilize and liberalize their economies. With these measures, Latin America effectively abandoned the inward-looking development model pursued for most of this century in favor of export-led growth, relying on open markets and the private investment, ownership and management of capital. The first wave or generation of

reforms -- sometimes referred to as the "Washington consensus" because they were pushed by the US government, the international lending agencies and commercial banks -- emerged in the late 1980s in the context of the debt crisis. This was a time when Latin America was particularly responsive to external pressures. This inter-related set of policy prescriptions gained near universal acceptance in the region not only because of pressure from powerful external stakeholders, but also because of a growing realization within Latin America that the old model had exhausted itself. There was widespread acknowledgment that a fresh approach was needed which consisted of the following policies:

1. Macroeconomic Stabilization
The first order of business was to achieve and sustain macroeconomic stability by eliminating persistent internal and external disequilibria. On the internal side, this meant reducing the high rates of inflation that plagued Latin America throughout the 1980s, mainly by slashing budget deficits (ideally to 1-2 percent of GDP). Under the inward-looking model and rule of populist governments (both civilian and military) in the post -World War II era, the public sector had become a major employer. Consequently, subsidized public services consumed a significant proportion of the national budgets. These practices had to be replaced by reduced government spending favoring investment in infrastructure, health, education and social welfare. On the external side, the emphasis was on eliminating balance of payments deficits and reining in overvalued currencies that often led to exchange rate crises.

Trends: The current round of reform has given Latin America a degree of economic stability unprecedented in recent decades. Table 1 documents the extent to which most governments lowered their fiscal deficits to the prescribed levels as of 1997. Equally impressive are the low rates to which inflation had fallen (Table 2). Fighting inflation with exchange rate anchors was more problematic, as the January 1999 collapse of the Brazilian real painfully demonstrated. More ominously, Table 1 and more current information suggest that fiscal deficits are on the rise. The Asian financial crisis also generated growing trade and current account deficits (Table 3). This combination leaves governments with the two unpalatable alternatives: either defend their currencies by selling dollars and raising interest rates or devalue their currencies (as did both Colombia and Brazil) and risk the return of inflation. Either option threatens to disrupt macroeconomic stability and contribute to an economic slowdown throughout the region.

2. Trade Liberalization
As fiscal and monetary order is restored, reducing tariffs and eliminating non-tariff barriers (quotas, licensing, outright bans on imports) are key steps to opening economies to the efficiency and productivity gains of global competition. One of the hallmarks of Latin Americaís era of inward-looking development based on import substitution industrialization was highly protected domestic markets.

Trends: Barriers to trade have been significantly lowered throughout Latin America. Between the mid-1980s and 1995, average tariff rates fell from 44.6 percent to 13.1 percent (Holden and Sarath Rajapatirana, 1997, 4). Effective rates continue to decline when the free trade commitments subscribed through regional trade agreements are factored into the equation. Contemporary Latin America is more trade dependent than it was earlier this century, and trade is growing rapidly, more rapidly than GDP growth (see Figure 4 and Table 6 and Table 7). Thus far, governments have not responded to the Asian crisis by raising barriers, although it is easy to imagine that the pressure to do so will increase if Latin America falls into recession and current accounts deficits continue to grow.

3. Privatization
From the 1930s through the 1970s, state owned enterprises (SOEs) became common in Latin America. They were acquired through nationalization, expropriation, government purchase of private companies and governments establishing public companies. In many countries, SOEs dominated petroleum, steel, transportation and insurance industries but, despite their monopoly

status, frequently operated at a loss. Privatization promised greater market efficiencies as well as enhanced fiscal revenues via income from both the sale of assets and the reduction in subsidies to public enterprises.

Trends: Major economic assets -- from steel companies to infrastructure industries -- have been transferred from government to private ownership and/or management. By the end of 1996, the Economic Commission of Latin America and the Caribbean (1997, p. 50) estimates that the total value of privatizations in Latin America reached $77.7 billion. Chile was the pioneer in privatization, while in recent years Argentina, Mexico and Peru have been major players. During 1998, Brazil intensified its pace of privatization, but other countries canceled offerings for lack of competitive bids. Although there has been criticism of privatization -- terms too generous to the buyers, revenues not wisely invested, newly privatized firms have performed poorly and enjoy monopoly status -- no government has declared that privatization is over, which may mean that there are still valuable assets to be privatized.

4. Financial Market Liberalization

Most Latin American economies were held back by weak financial markets with ineffective intermediation, low rates of savings and investment and a proliferation of targeted credit programs. There were also complex controls on foreign investment; including licensing, limiting or proscribing its participation in certain sectors of the economy; and controls over repatriation of profits. The prescription for overcoming these rigidities was to adopt indiscriminate market-determined interest rates for all borrowers while instituting prudent supervision of the financial system. Governments were also encouraged to adopt open investment regimes that did not distinguish between foreign and domestic capital. The overall objective of these reforms is to generate higher savings rates and allocate investment more productively in order to achieve higher rates of growth.

Trends: Latin American governments have adopted measures to deregulate domestic capital markets and open them up on a nondiscriminatory basis to foreign investment. Financial market reforms generally include decontrolling interest rates, reduction of reserve requirements and elimination of directed credit. There has been less progress on institutionalizing supervision of banking systems and central bank autonomy, according to the Economic Commission of Latin America and the Caribbean (1997, p. 55). Only Chile, Colombia and Mexico have established independent central banks. Argentina, in effect, abolished its central bank in favor of a currency board, a heterodox approach to minimize political considerations in monetary policy.

5. Exchange Rate Reform

The fixed exchange rates, multiple rates and currency licensing arrangements adopted to promote import-substituting industries created rigidities and relative price distortions. Latin American economies fell into cycles of overvaluation and subsequent sharp devaluations that discouraged foreign investment and encouraged capital flight. Again the policy prescription to overcome this impediment was to let markets set exchange rates in order to get relative prices right and allow exports to become competitive on the basis of comparative advantage. Market-determined exchange rates also function best under central banks operating independently of political considerations.

Trends: Governments have taken steps toward establishing unified, market sensitive exchange rates (Table 4). With the January 1999 collapse of its currency, Brazil adopted an independent float for the first time in its history. However, most Latin American exchange rates are not completely market-determined as governments still reserve the right to influence the value of their currencies, usually through some form of a managed float. The most controversial exchange rate regime is Argentinaís convertibility/currency board arrangement. It guarantees a one-to-one peso-to-dollar rate based on the stock of dollar reserves which, among other things, has the effect of virtually eliminating national control over monetary policy. Argentinaís success with convertibility

has triggered a debate about fully "dollarizing" the Argentine economy (and other Latin American economies) as a logical step to avert currency crises like that in neighboring Brazil.

6. Tax Reform
Latin American tax systems featured complex rules, indirect and regressive taxes and widespread evasion, all of which resulted in the public revenue shortfalls that contributed to budget deficits and endemic inflation. To correct this situation, governments were urged to adopt taxes that would maximize revenue collected from a broad base with simple, easy to enforce rules and moderate marginal rates.

Trends: There has been a clear tendency to simplify tax systems by making them more neutral and less dependent on trade. One of the mechanisms to accomplish these goals has been the adoption of value added taxes. Yet neither tax reform, nor the effort to build a stable base for fiscal revenues, is finished.

7. Deregulation
Beyond specific recommendations for opening Latin American economies to greater private sector and foreign participation, the Washington consensus called for across-the-board deregulation. The Latin American economies had accumulated extensive, overlapping and often contradictory government regulations and agencies. Proponents of the new paradigm also recommended the establishment of new regulatory regimes appropriate for market economies linked to global markets.

Trends: While there has been an unmistakable trend in Latin America to deregulate the economy, the larger task of "reforming the state" -- reducing and restructuring the role of government -- is less clearly defined and more challenging.

8. Second and Third Generation Reforms
The policy reforms of the Washington consensus spread quickly through the hemisphere. Governments with divergent ideological orientations turned to these reforms under outside pressure or out of the conviction that they offered the best path for recovering from the debt crisis and sustaining development. But as Latin American leaders gained experience with this first generation of economic reform, it became clear that they would have to address far more fundamental features of their societies that have long hindered development. This "deepening" of the reform agenda focused on broad structural and institutional changes and generally included the following measures:

Labor Market Liberalization.
Latin American labor codes build rigidities into labor markets, most importantly by discouraging the hiring of new or temporary workers. Labor reform involves making it easier and less costly for employers to manage the size, composition and assignments of their work force in response to the requirements of competition in constantly changing global markets (*Latin American Economic Policies*, No. 3, Second Quarter, 1998). The challenge of labor reform is, first, how to protect legitimate workersí rights while deregulating labor markets and, second, how to secure the votes necessary to pass legislation, given the political power of organized labor in many Latin American countries.

Social Security Privatization.
Latin American social security systems were traditionally run by the state at a loss. Experts advocate social security reform to accomplish three goals: to help reduce the fiscal deficit, to assure the financial integrity of the system and to augment domestic savings and investment. The key is to replace exclusive "pay-as-you-go" programs with more flexible arrangements that allow for private investment of pension funds in capital markets. Chile has been a pioneer in social security reform.

New Regulatory Regimes.
Privatization, especially of public utilities, has created a new challenge for Latin America -- how to regulate private delivery of public goods and services. Countries, discovering that they have substituted private monopolies for public monopolies, are now trying to introduce competition into privatized activities. This in turn requires the creation of independent regulatory agencies that operate as "guardians of fairness in the market" (Constance in *IDBAMERICA*, January-February 1998, 4-7). Unclear and uncertain regulatory policies not only hurt consumers, they also discourage long-term investment as investors seek clearly defined rules of the game. The Latin American experience (a financial collapse in Chile in the early 1980s and the Mexican peso crisis of 1994/95) with liberalization of financial markets also underlines weaknesses in the institutional supervision of banking, finance and securities markets.

Judicial Reform.
The reforms of the Washington consensus have also exposed weaknesses in the judicial systems of Latin American. As one expert put it, "sustaining the new economic model requires a legal order that is fair, efficient, easily accessible and predictable" (Martinez in Jarquin and Carrillo, 1998, 3). Inefficient and corrupt judicial systems increase uncertainty and transaction costs. These considerations, combined with rising crime rates, have added judicial measures to the reform agenda.

Education.
It has become increasingly clear that Latin American educational institutions are inadequate for equipping a labor force with the necessary skills to compete in the global arena. Effective change does not necessarily mean increasing the amount of money spent on education. Latin Americaís educational expenditures are comparable to East Asiaís (where literacy and skills are much higher) when measured as a percent of GDP (Edwards, 1997, 99-100). Rather the challenge lies in improving the content and quality of education, while making it more relevant to labor market needs and opportunities. Accordingly, educational reform was declared a hemispheric priority at the 1998 Presidential Summit of the Americas in Santiago, Chile.

Trends: Latin America has made some progress in privatizing social security and pension systems. Mexico, Argentina, Colombia, Bolivia, Peru, Uruguay and El Salvador have followed Chileís lead of adopting social security systems that allow for some private management of funds. There have been fewer breakthroughs on either liberalizing labor markets -- although some labor codes have been modified on paper -- or building strong, transparent judicial systems. Likewise, the record on creating new regulatory regimes for privatized public utilities and infrastructure has been uneven. Finally, the commitment to improve education has not yet translated into concrete policies, although Costa Rica has made some progress.

These policies constitute Latin Americaís reform agenda at the beginning of 1999. Although the agenda has incorporated new policies over time, its core objectives are consistent: achieve macroeconomic stability prior to opening the economy through liberalization and deregulation. This combination has defined the Latin American business environment of the last decade.

External Environment
There are two broad dimensions to the external environment: global and regional. The former impacts Latin America through its growing incorporation into international trade and financial markets as well as membership in institutions like the International Monetary Fund and the World Trade Organization. One of the important characteristics of the contemporary global environment is the accelerated movement of short-term capital flows. The regional environment features a hemispheric free trade arrangement (the Free Trade Area of the Americas, FTAA, scheduled to begin operation in 2005) as well as subregional trade agreements. US policy is another component of the regional environment. As the events of 1998 and early 1999 have painfully demonstrated, developments in the global environment can have important consequences for the countries of Latin America, yet their abilities to affect global markets are quite limited. The

regional integration process is less asymmetrical, giving Latin America some control over the regional environment, although the US is still the dominant player in hemispheric economic and political affairs.

Trends: The global environment has turned decidedly more problematic for Latin America since the onset of the Asian financial crisis in 1997. The crisis negatively impacted the Latin American economies in several ways. First, an emerging markets contagion has created short-term capital volatility. Second, Asiaís financial crisis provoked an economic recession in much of the region which led to declining demand for Latin American exports to Asia and declining commodity prices on a global scale. Finally, the devaluation of Asian currencies has made Asian products more price competitive vis-ý-vis Latin American products both in Latin American as well as in third country markets. The net result of these effects, intensified by the collapse of the Russian ruble in August 1998, was an economic slowdown in Latin America throughout 1998. The region did, however, manage to avoid a direct introduction of the Asian crisis until January 1999 when the Brazilian government abandoned its defense of a fixed exchange rate. This resulted in a maxi devaluation of the real accompanied by many of the same side effects plaguing Asia. In effect, for the rest of Latin America, Brazil has become part of the problem, adding to the recessionary forces at work. Concern now focuses on whether the Brazilian crisis will spill directly over into other Latin American countries through currency devaluations. The most likely candidates for a "samba" effect are Brazilís Southern Cone neighbors, especially Argentina. There is even concern that the MERCOSURís integration efforts might suffer a setback. If that were to happen, it is not inconceivable that (1) the Andean Community and (2) prospects for a South American Free Trade Area might both be weakened. Meanwhile, the FTAA process entered a new phase in 1998 when the elected leaders of the Americas met in Santiago and authorized the initiation of formal negotiations to have the FTAA up and running by 2005. Failure of the US Congress to grant the president "fast track" authority does represent a potential obstacle to realization of the FTAA.

Domestic Environment

1. Economics

The economic domain both affects policy (through the political process) and is subsequently affected by it. It is easier to sustain economic reform under conditions of low inflation and steady economic growth, since economic performance (growth, trade, investment) is an important component of the business environment, regardless of policy linkages.

Trends: Throughout the current decade, economic growth has been positive. In 1995, regional growth dipped in response to the Mexican peso crisis, but two years later regional GDP grew at the highest rate in a quarter century (see Figure 4). In spite of this record, the Latin American economies have been "underperforming," both in terms of historical rates of growth and the rate necessary for significant improvements in standards of living (Edwards, 1997). Furthermore, regional growth, originally forecast to be 4.5 percent, fell to 2.0 percent in 1998 as a result of the Asian financial crisis. No growth is expected for 1999. Over the next 12-25 months, most Latin American economies will be marking time (see Table 5), while most Latin Americans will experience a decline in their standards of living. A second important indicator of macroeconomic performance, trade, shows impressive increases in both imports and exports (Figure 3 and Table 6 and Table 7), although the growing gap between the former and the latter has produced worrisome current accounts deficits. Thus far, this has been offset by foreign investment, which continued at a healthy rate through 1997 (Figure 5 and Table 8). However, dependence on foreign capital to offset internal and external deficits makes Latin America even more vulnerable to exogenous shocks and high interest rates. The slowdown in economic growth will in all likelihood help reduce the trade deficit through import compression.

2. Social Welfare

In assessing the business environment, it is important to keep in mind that Latin America is a region of developing, low-income countries with widespread poverty and sharp income inequality.

Sustaining economic reform and a friendly business environment would seem to be more likely in countries with rising incomes, strong employment, declining poverty and a narrowing gap between rich and poor. The failure of reform and growth to translate into improvements in the standard of living on all social levels makes it harder to sustain reform politically. Reform is even more untenable when the well-being of the middle and lower classes is deteriorating.

Trends: Some of the regionís long term social indicators are encouraging -- life expectancy is up as is literacy; fertility rates and population growth rates are down -- but others reveal a region of disturbing social pathologies (Table9). From 1990 to 1994, the incidence of poverty in Latin America declined from 41 percent of the population to 39 percent, but this meant that over 209 million Latin Americans still lived below the poverty line, larger in percentage terms than those in poverty at the beginning of the 1980s. Furthermore, Latin America continued to have the most inequitable distribution of income of any region in the world (CEPAL, 1997). Employment has not increased commensurably with economic growth. The net result of these trends is that Latin American social integration and welfare, after nearly a decade of economic reform and recovery, remain low, and the current economic slowdown promises to heighten social tensions.

3. Politics

There are short-term and long-term considerations in assessing the impact of politics on the business environment. Short-term factors include elections (fiscal constraint is more difficult in election years) and control of the executive and legislative branches of government (divided control complicates policy-making). Long-term considerations concern the extent to which electoral politics are institutionalized, as well as the extent to which the political systems reward accessibility, transparency and accountability, while simultaneously punishing corruption. While the relationship between democracy and markets is not precise, in the Latin American case it was elected civilian governments that directed the regionís shift toward market-oriented economic policies and regional integration. Additionally threats to democracy would surely destabilize the economic and business environment. Although it would be a mistake to assume that social stagnation translates automatically into political pressure, the widespread perception that the economic reforms of "neoliberalism," as critics label the current development model, have not addressed the social deficit could weaken, if not reverse, the reform.

Trends: With the exception of Cuba, Latin America has exhibited a strong preference for elected civilian governance. The threat of military intervention, once a fact of politics, now seems remote. Less assured is the consolidation of elected rule into effective representative, liberal democracy (Diamond, 1996). Instead of broadening and deepening democracy, several Latin American countries have actually slipped backwards on these dimensions (Table 10). Others seem incapable of implementing such key political reforms as strengthening their judicial systems. There is evidence of a positive, though not linear, relationship between strength and stability of democratic governance, policy reform and economic performance. The greatest uncertainty, therefore, lies in those countries where social stagnation coincides with increasingly discredited political institutions, weak economic performance and national elections. Sustaining reform under such conditions is problematic, as the December 1998 election of Hugo Chavez, a military officer jailed in 1992 for leading an unsuccessful military coup, to the presidency of Venezuela suggests. Likewise, the detention of General Pinochet has polarized Chilean public opinion, suggesting that important unresolved political issues could slow down the reform process even in Chile. The current economic downturn coincides with national elections in Guatemala, El Salvador, Panama, Chile, Argentina and Uruguay during 1999.

III. Country Performances

Thus far we have examined the Latin American business environment from a regional perspective. However, in reality, there are 33 distinct business environments in Latin America. These countries share a general approach to development, but their policies and performances are far from identical. It is therefore imperative to assess individual countries by geographic location and subregional trade groups. With this in mind, we now analyze the 20 largest Latin

American economies and the extent to which they are part of emerging subregional markets. Tables 1-10 present economic, social and political data on these countries, while Table 11 profiles the trade agreements corresponding to the five subregions. First, we provide a summary of country performances.

Viewed from the perspective of the turbulent 1980s, Latin American governments have made undeniable progress in stabilizing and opening their economies. Their business environments today are strikingly different than they were 10 years ago. But the transition to export-led, market-oriented development is neither complete nor uniform throughout the region. Nor, for that matter, are their economic, social and political environments the same. External developments impact each subregion and country in a slightly distinctive fashion. In this regard, it is possible to evaluate policies and compare country performances along a four-stage continuum, from the lowest to the highest level of transition to the new growth paradigm: First Stage -- macroeconomic stabilization in terms of both inflation and serious external disequilibria; Second Stage -- systematic implementation of structural reforms to liberalize and deregulate the economy; Third Stage -- take-off of investment, production and employment; and Fourth Stage -- consolidation of export-led growth based on domestic savings and investment. While the 20 nations find themselves at different stages along this continuum, none has completed the transition.

At the end of 1998, four countries -- Chile, Argentina, Mexico and Trinidad & Tobago -- stood out as ***leaders***. These countries had stabilized their economies; they had advanced into second and third generation reforms; they were attracting major foreign investment flows with the resulting production gains (but fewer gains in employment); and domestic savings and investment were growing. Four other countries qualify as ***late bloomers.*** Three Central American countries -- Guatemala, El Salvador and Nicaragua -- had stabilized their economies and enacted much of the reform agenda since the peace process ended civil war and political violence in that region. In South America, Brazil finally embarked on serious stabilization and liberalization, but delay in enacting fiscal reforms and alleviating pressures on the currency put the fate of reform in Latin Americaís largest country in doubt. At the low end of the spectrum in creating and sustaining a new business environment are the ***laggards*** -- Venezuela, Ecuador and Paraguay. The ***remaining*** countries present a mixed picture. In some cases, unconsolidated political systems hinder effective policy-making and generate long-term uncertainty, even when current economic performance is positive (Peru, Dominican Republic, Bolivia). In others, nominally strong, well institutionalized democracies seem incapable of maintaining macroeconomic stability and deepening reform (Costa Rica, Jamaica). The remaining countries (Panama, Uruguay) fall somewhere in between or face special problems (Colombia, Honduras).

NAFTA Region

The North American Free Trade Agreement between the US, Canada and Mexico celebrated its fifth anniversary at the beginning of 1999. Although it is unlikely to expand or deepen in the foreseeable future, NAFTA is a positive force behind the creation of an integrated North American economy with full Mexican membership. In the face of US resistance to expanding NAFTA, both Canada and Mexico are pursuing bilateral trade agreements with other countries in the Americas, and Mexico is in talks with the European Union and Central America. Because the US economy dominates NAFTA, the Brazilian crisis is likely to have minimal direct effects on the region, including Mexico.

Mexico, the second largest country in Latin America (and the most important market for the US) embarked on serious reform in the mid-1980s in an attempt to escape from the debt-induced recession gripping the country. Both President Carlos Salinas and his predecessor enacted policies opening Mexico to international trade and capital and reducing the role of the state in the economy. The reforms of the Washington consensus were, in effect, field tested in Mexico, while Salinasí call for a free trade agreement with the U.S. and Canada revived regional integration in the Americas. And President Ernesto Zedilloís resolve to push ahead with reform in response to the collapse of the peso and deep recession in 1995 strengthened the reform agenda in Mexico.

The reforms adopted in response to the peso crisis have helped Mexico cope with the Asian crisis and falling oil prices. As Zedilloís term draws to a close, politics may become more important than economics in shaping Mexicoís business environment. Historically, the sixth and final year of presidential terms have produced uncertainty and occasionally disaster (1982 nationalization of private banks and 1994 peso crisis). The political scenario leading up to the August 2000 election is even more complex than in the past because Zedillo has presided over a political opening comparable to the economic liberalization of his predecessors. As a result, the opposition has a real chance to win the presidency for the first time in over 70 years. In 1997 the opposition PAN and PRD formed a coalition to control the lower house of Congress. They also won governorships and the mayorís office of Mexico City, although the ruling PRI has won most of the recent state elections. Regardless of who wins the presidency, Mexican politics increasingly resemble those in the rest of Latin America, which means that the policy process is more contested and less predictable. So far, this has not undermined the reform agenda (usually because the conservative PAN sides with the PRI against the more liberal PRD), although Congress is extracting compromises (important examples include 1998 legislation to clean up the banking crisis and the 1999 budget) from President Zedillo. Mexico is expected to grow in 1999, but the government has announced that it will resort to greater fiscal austerity (bringing the fiscal deficit down to 1.25 percent of GDP) to rein in inflation. Although the peso has been under some pressure, it seems safe to assume that President Zedillo will do everything in his power to avoid a repeat of the peso crisis. As evidence of the Mexican economyís growing integration into North America, Mexicoís stock market appreciated in dollar terms in the first two months of 1999 moving in concert with Wall Street and opposite the Latin American markets which continued to drop in dollar terms (*Wall Street Journal*, March 2, 1999, p. C18). On the privatization front, Zedillo has announced that he will seek congressional approval to open Mexicoís electricity sector to greater private participation. If approved, the plan would be implemented by his successor.

Central America

The peace process has allowed the combatant countries to undertake serious reform and has facilitated revival of the Central American Common Market, the oldest of the subregional trade agreements. Intraregional trade now comprises over 20 percent of total trade -- and is growing faster than extraregional trade -- although progress in implementing the agreed upon common external tariff for CACM is vague (McCleary, 1997). In late 1998, the natural environment turned against Central America when Hurricane Mitch devastated Honduras and Nicaragua. Over 11,000 people died; hundreds of thousands were displaced; infrastructure was destroyed; and the economies of these two countries were set back several years. In response to the tragedy, the international community has mounted a recovery effort which could offer business opportunities and may include debt forgiveness. It seems unlikely that the Brazilian crisis will spread directly into Central America. It will, however, be affected by lower commodity prices and credit volatility.

Costa Rica is the most developed country in Central American as well as the most effectively consolidated political democracy in Latin America. It has, however, exercised caution in opening its economy and experienced dynamic growth. But on balance, the business climate in Costa Rica seems quite positive, judging from the flow of foreign investment into the country. Intel invested $500 million in state-of-the-art plants that will employ up to 3,500 Costa Ricans by 2003 (*Latin Trade*, August, 1998, pp. 45-48). Other foreign investors are attracted by the countryís free trade zones and strong education system. Former President Jose Figueres promoted educational reforms aimed at giving Costa Rica a modern, computer-literate work force. His successor, Miguel Angel Rodriguez, has promised to attack the fiscal deficit, reduce inflation and accelerate privatization (banks, telecommunications), although he must work with an opposition-controlled congress. Another problem for Rodriguez, as he tries to energize reform and the economy, is Costa Ricaís large internal debt.

El Salvador has embarked on one of the boldest reform programs in Latin America and regained much of the economic dynamism it lost to a decade of civil war. President Calderon opened both power and telecommunications to private investment (and to immediate competition in the case of

telecommunications); reformed the social security system to allow for privately managed pension plans; and privatized banking while agriculture marketing boards have lost their monopolies (*Wall Street Journal*, July 30, 1998). All of these measures have increased the flow of foreign investment into El Salvador, while solid fiscal and monetary policies reduced the deficit and inflation, putting the economy on firm footing. The *maquila* industry is doing especially well, but local manufacturers serving the internal market face stiff competition from imported consumer goods. While El Salvador escaped major destruction from Hurricane Mitch, its business environment is weakened by widespread poverty and rising crime. On the political front, the country elects a new president in March 1999, but even if the FMLN wins, it seems unlikely that the former Marxist guerrillas would reverse the reforms of the last two conservative administrations.

Guatemala, the largest and most conservative country in Central America, has taken significant steps toward political and economic liberalization in recent years. On the economic front, Guatemala features relatively healthy macro-economic indicators, an open investment regime and significant privatization of public enterprises. While it has thus far escaped major repercussions from the Asian/Brazilian financial crisis, the collapse of several local financial institutions and over-restrictive monetary policies have dampened the economy. Politically, the picture is less positive but improving. Guatemala was the last of the Central American countries to reach a peace accord (it did so in 1996 bringing to an end over three decades of civil conflict that killed at least 100,000 Guatemalans). Since 1985, the country has had an elected civilian government and, in recent years, human rights violations have declined. Guatemalaís biggest challenge is effectively integrating its large indigenous population into the economic and political life of the country. With 75 percent of the population living in poverty, the Guatemalan business environment features a major structural impediment. Guatemala holds national elections in October.

Honduras, one of the poorest countries in Latin America and one rarely associated with innovative policies, has recently demonstrated a commitment to undertake serious reform. President Carlos Flores, who took office in 1998, adopted a fiscal adjustment package, reformed the tax system and announced the privatization of telecommunications and other assets. All of these reforms have been set aside as the country struggles to recover and rebuild from the devastation of Hurricane Mitch, a process that promises to occupy the government, the private sector and international lending agencies for the next several years. Estimates project that GDP may contract by 7-8 percent in 1999 (leading to a fiscal deficit of 7 percent of GDP if the flow of international aid is maintained).

Nicaragua had begun to recover from years of political unrest and economic chaos and initiate economic reform before Hurricane Mitch hit in November 1998. Under the last two administrations, Nicaragua stabilized and opened its economy, and it experienced four years of economic growth. While the economic reforms will remain on the books, the country now must contend with recovery and rebuilding.

Panama features an economy dominated by the canal and a currency tied to the dollar. The confluence of a presidential election and handing over of the Canal to Panama promised to produce an uncertain business climate in 1999, but both appear to be proceeding calmly. The nominee of the governing party, Martin Torrijos, is the favorite because of a divided opposition, and it seems likely that he will pursue the pro-business (though not especially reformist) policies of the Balladares administration rather than revert to the populism of his father, Omar Torrijos. In spite of the maneuvering and uncertainty that have surrounded the transfer of the canal, the major issues now seem resolved. Panama has set up two semi-autonomous agencies; one to manage the canal and the other (Autoridad de la Region Interoceanica) to oversee development of the former canal zone. This latter endeavor, described as the "largest real estate project of the century," is a major component of Panamaís business environment. For 1999, the economy is

likely to slow down due to the impact of the global financial crisis on Panamaís financial services and export sectors, especially the Colon free zone.

Caribbean Region

Economic liberalization and globalization pose special challenges to the small island economies of the Caribbean, and CARICOM (Caribbean Community and Common Market) is struggling to find a fit for the region in hemispheric integration. With the addition of Haiti to full membership in 1997, CARICOM now boasts 15 members, but a total population of only 12.5 million people. More importantly, the two largest Caribbean countries -- Cuba and the Dominican Republic -- are not full members (the former is an associate member, while the latter signed a free trade agreement with CARICOM in 1998). Uncertainty around the 37-year US embargo of Cuba continues to cloud the regionís future. Another unresolved challenge is how to wean the Caribbean from preferential to reciprocal trade (McCoy, 1997). Currently, Caribbean governments are fighting to preserve preferential access to the European Union, win NAFTA parity for the Caribbean Basin Initiative from the US and secure special protection for small economies within the FTAA. None seems likely. Caribbean banana producers were big losers (Central and South American exporters were winners) in the 1998 World Trade Organization ruling that EU banana import arrangements violate free trade. Implementation of a common external tariff has also been elusive for CARICOM. In an effort to draw the nations of the Caribbean Basin together, the CARICOM countries joined with those in Central America, Mexico and northern South America in 1994 to establish the Association of Caribbean States (ACS). In theory, this association would constitute a regional market of 200 million people, but it is a long way from being a functioning trade bloc. On balance, the Caribbean does not present a dynamic profile, but on the other hand, it does not seem to be directly prejudiced by what is happening in Brazil.

Dominican Republic has enjoyed six years of economic growth (including two straight over 7 percent) propelled primarily by foreign investment in tourism and export-processing zones. The DRís record on economic reform is less impressive. Although the government of President Leonel Fernandez did adopt an open investment regime, the pace of privatization and liberalization (including tariff reductions and pension reform) has been slower than in other Latin American countries. A primary reason is that Fernandez faces a hostile, opposition-controlled congress, and executive/legislative conflict promises to increase as the three major political parties gear up for the May 2000 presidential elections. Other troubling aspects of the business environment, which are likely to hinder growth in 1999, include the damage caused by Hurricane Georges, a chronic shortfall in electric power and 16 percent unemployment.

Jamaica has one of the most stable, democratic political systems in the Americas, and beginning in the early 1980s, the conservative government of Edward Seaga reversed most of the statist, protectionist measures adopted during the 1970s under the left-wing administration of Michael Manley. The process of economic liberalization continued when Manley returned to office and under his successor P. J. Patterson. Despite this record, the Jamaican economy is still relatively closed, and the Patterson government has struggled to bring the fiscal deficit, inflation, the current accounts deficit and the exchange rate into compliance with the conditions mandated by IMF-structural adjustment programs. In recent years, export-processing operations first set up in Jamaica under CBI have moved to Mexico to take advantage of NAFTA. Jamaicaís GDP declined in 1996 and 1997 in the face of these problems and declining bauxite prices.

Trinidad & Tobago, with large natural gas reserves, has embarked on an ambitious industrialization program aimed at global markets and based on synergistic joint ventures with neighboring countries that have complementary resources. Trinidad & Tobagoís strong democratic tradition, British legal system and comprehensive economic reform program are added assets. The results have been high levels of long term investment by large transnational corporations, low inflation and sustained, if modest, growth. The business environment is one of the most attractive in the region and seems likely to stay that way.

Andean South America
Although one of the earliest integration arrangements, the Andean Community (formerly the Andean Pact, then the Andean Group) has not been particularly effective in creating a regional economy. During 1998, its members took steps to jump start the integration process by agreeing to institute a full common market by 2005, but the continuing reluctance of Peru to resume full membership calls this goal into question. For 1999, major challenges to the Community are the implementation of a common external tariff and progress in merger negotiations with MERCOSUR to create a South American free trade area. The 1998 peace treaty, which ended the longstanding border conflict between Peru and Ecuador, offers hope of closer ties among the Andean nations. The peace process secured pledges of investment to help develop the disputed frontier region. On the downside, drug trafficking continues to weaken the Andean business environment, and El NiÒo inflicted over $15 billion worth of damage in the region. Other clouds over the Andean region include the Brazilian crisis and the fact that three of the five Andean republics -- Venezuela, Colombia and Ecuador -- are wrestling with serious problems.

Bolivia, the poorest country in South America, was a pioneer in reforming its economy. In the late 1980s, the government implemented a drastic austerity program to successfully tame hyper-inflation, and then President Gonzalo Sanchez de Losada sponsored a package of innovative measures to open and capitalize the economy. These measures resulted in reasonably robust growth during the 1990s. However, given Boliviaís weak institutions and history of political instability, there were doubts as to whether President (and former military dictator) Hugo Banzer, who took office in 1997, would sustain the reforms. In fact, the Banzer has continued much, if not all, of of his predecessorís program. Weak social integration and geographical disadvantages (including no outlet to the sea) hurt Boliviaís prospects in the long-run. The discovery of major natural gas reserves and their export to Brazil may help offset these liabilities, once the Brazilian economy recovers.

Colombia has earned a reputation for careful policy-making and maintenance of sound economic fundamentals even in the face of social and political unrest. This reputation is now being put to even greater tests. President Ernesto Samper (1994-98) involved Colombia in a dispute with the US government over his countryís anti-drug measures, and allowed Colombiaís macroeconomic position to deteriorate. The 1998 election of Andres Pastrana offered hope for a turnaround. On the economic front, Pastrana took the painful, but necessary step of devaluing the peso. He also announced major privatizations in the electricity and telecommunications sectors. Private pension funds and alternative health schemes were also singled out for further reform. The challenges facing Pastrana on the political front are daunting. Washington and Bogota have patched up their differences, and Pastrana launched a bold peace initiative for negotiations with the left-wing guerrillas and right-wing paramilitary groups. In the meantime, these armed groups -- both have ties to the drug traffickers -- control large areas of Colombia. Colombia remains one of the riskiest places in the world to do business. Security is especially problematic in the oil and mineral sector where foreign companies show increasing reluctance to invest. As if these challenges were not enough, a major earthquake hit Colombia in January 1999. In an effort to demonstrate that it will not let Brazilís problems cut off access to the foreign funds it needs, Colombia returned to global bond markets (where it is only one of three investment-grade countries in South America) in March 1999, but it paid a premium for investor concerns by selling bonds that mature in only five years (*Wall Street Journal*, March 3, 1999, p. A14).

Ecuador, after two years of political crisis, policy stagnation and macroeconomic deterioration, elected a new president and congress in 1998. The countryís situation has shown improvement since the new government took office. On the macroeconomic side, Ecuador has a very large and persistent fiscal deficit, inflation, a current accounts deficit and an unstable currency. In late February, the government gave up trying to maintain a sucre-dollar peg, allowing its currency to float. Immediately the devaluation, the sucre lost 35 percent of its value, while foreign currency reserves dropped preciptiously. On taking office, President Mahuad promised to accelerate economic liberalization, but this initiative has also foundered. In the face of these difficulties,

foreign investment has declined. Part of the blame rests with falling oil prices. However, equally at fault are Ecuadorís weak political institutions and the inability of the President and Congress to work together. In regard to the latter, the constitution was reformed so that Congress can not longer force the ministers to resign. Finally, the social situation has deteriorated in Ecuador, and President Mahaudís adoption of a series of austerity measures triggered strikes and street demonstrations in late 1998.

Peru has a good record on reform, but the countryís long-term political prospects are troubling. President Fujimori not only restored macroeconomic stability to a country that was in chaos, but he opened Peru to foreign trade and private investment. "Fuji-shock" was complemented by the actions against terrorism. Restoration of peace and stability made Peru an attractive destination for foreign capital. What is unclear is whether Fujimoriís accomplishments will be institutionalized or not. He has ruled in an highly personalistic manner, suspending the constitution in 1992 when Congress failed to approve his program. Now Fujimori insists -- even though his popularity is at very low levels -- on running for an unprecidented (and constitutionally questionable) third term in 2000. Should Fujimori win re-election, the issue regarding the fate of the institutionalization of his policies will be postponed, not resolved.

Venezuela has been on a downward slide through most of the 1990s. There have been promising attempts at stabilization and liberalization, but they have all failed, ultimately due to the weaknesses of a decaying political system. In 1989, several hundred people died in the streets of Caracas protesting austerity measures included in President Carlos Andres Perezís reform plan. There were two unsuccessful military coups against Perez. Then in 1994, Venezuelans voted in another former president (Perez had been president earlier), Rafael Caldera -- this time running as an independent -- to the presidency. Caldera initially backed away from the stabilization/liberalization paradigm but then resurected it. In the face of this indecision and falling oil prices, the economy and social well being both plummeted. Economic, social and political frustrations culminated in December 1998 with the election of Hugo Chavez as president. Chavez, who as a military officer led the coups against President Perez, ran as an anti-establishment candidate who openly questioned the reform paradigm. His victory, by a much larger than expected margin, represented a total repudiation of the traditional political parties. Since the election, Chavez has adopted a more conciliatory tone on economic issues, but it is clear that he has a popular mandate to change things. It is possible that he could out turn out to be the Venezuelan Fujimori -- zealously implementing the neoliberal platform he ran against -- but this is neither assured nor without risk. In the meantime, Venezuela is in a deep recession.

Brazil and the Southern Cone

As 1998 ended, the most urgent question facing MERCOSUR, the largest and most advanced of the Latin American subregional trade agreements, was whether it would merge with the Andean Community to form the South American free trade challenger to NAFTA in the FTAA process. The January 1999 Brazilian devaluation placed enormous strains on MERCOSUR. Now the central question is: Can the four MERCOSUR members (Chile and Bolivia are associate members) find a way to protect producers, especially in Argentina, from the devalued Brazilian real and survive without resorting protective measures that would weaken Mercosur?

Brazil was a "reluctant convert" to reform (Thorp, 1998). Upon assuming office for his first term in 1995, President Cardoso promised that Brazil would catch up with the rest of Latin America. The key to his strategy was the Real Plan, which tied the real in a closely managed band to the dollar, as the first step in breaking the hold of inflation on Brazil. As a second step, Cardoso promised to push a series of fiscal reforms through Congress to reduce the deficit and institutionalize macroeconomic stability. Finally, he opened the Brazilian economy through trade liberalization and privatization. Cardoso succeeded in lowering inflation and opening the economy, but the goal of fiscal reform was repeatedly pushed aside in favor of a second term (which required congressional approval) for the President. Cardosoís October 1998 re-election and IMF financial rescue package seemed to clear the way for dealing with the fiscal deficit and securing the real.

Yet, in the face of Cardosoís continued inability to get the reforms out of Congress, rapid depletion of Brazilís foreign currency reserves and a sharp slowdown in the economy, the government let the real float on January 15, 1999. With this, Cardoso has abandoned the core of his reform agenda, and it is not yet clear how he will reconstruct it. For 1999, the country is headed for recession -- by some estimates the worst in three decades -- and a resurgence of inflation. By early March, the real had dropped to below 2.20 to the dollar in spite of periodic interventions to stabilize it. Concern is now emerging about Brazilís ability to service its debt. The only bright spot was a positive trade balance.

Argentina is the country most affected by the Brazilian crisis. Under the two-term presidency of Carlos Menem, Argentina shed its inward-looking protectionist past and became a reform leader. The key to Menemís strategy was the convertibility scheme guaranteeing, through the constitution, a one-to-one peso-dollar exchange rate. This assures that the government cannot finance itself by printing pesos. Menem has also pursued a dynamic privatization program and trade liberalization. Equally impressive was the governmentís insistence on deepening reform in response to the "tequila effect" of 1994-95 peso crisis. Together these measures provoked a painful restructuring of the Argentine economy with high unemployment. They have also produced record amounts of foreign investment in Argentina and brisk growth rates. On the political front, Menemís decision not to seek a third term in the 1999 strengthened Argentine democracy. As 1998 came to a close, the outlook for Argentina was very positiive. However, the Brazilian devaluation created serious problems for Argentina. Its exports to Brazil, its principle trading partner, are less competitive, while imports from Brazil to Argentina are 40-50 percent cheaper in dollar/peso terms. It now looks as though the Argentine economy will not grow in 1999, and unemployment will increase. This sudden reversal of fortunes could lead to critical questioning of the Menemís policies in this yearís presidential campaign and convince his successor to dilute reform.

Chile, the pioneer and model for market-oriented reform in Latin America, is paying a price for increasing its economic ties with Asia. About 25 percent of its exports go to Asia. Falling copper prices (down 50 percent from mid-1997) and copper exports meant lower economic growth for Chile, even before the Brazilian crisis. In response to these exogenous forces, the Chilean government reduced controls on short-term foreign capital and adjusted monetary policies to counteract effects of the global financial crisis. In an effort to expand the stock market and strengthen the privatized pension funds which dominate trading, Chilean law allows foreign companies to offer shares and security deposit certificates on the local market. The challenge facing President Frei on the political front is how to keep the governing coalition and country together in the face of the Pinochet affair. His cautious approach has been effective. The likelihood of a shift in policy will become clearer once the major political forces nominate theri candidates to succeed Frei. Thus far it does not seem as though either the Pinochet affair or the economic slowdown -- in a country accustomed to GDP growth rates of over 6.0 percent per year -- will provoke any political surprises or drastic changes in Chileís business climate. In fact, Chileís stability, open economy and high business standards positioned the country to reassert its status as the most attractive environment for business and investment in Latin America, especially as economic and political uncertainty sweep through the rest of region.

Paraguay has not made serious headway in reforming its economy despite the return to democratic rule in 1989 following 34 years of military dictatorship. For the past two years, the country has been embroiled in a political struggle between factions of the ruling Colorado party. Meanwhile, the country has been hit by a series of banking crises; its currency has lost much of its value; and Congress refuses to act until the President resolves the political crisis to its satisfaction. Continued political turmoil and weak economic performance along with Paraguayís reputation for corruption make for an very unattractive business environment.

Uruguay, with one of the highest standards of living in Latin America and relatively strong political institutions, has been reasonably successful in stabilizing and reforming its economy. However, it is a small economy which is very dependent on Brazil and Argentina.

IV. Conclusion

The Latin American business environment has steadily deteriorated since late 1997. This paper concludes, first, by suggesting what signs of recovery or further deterioration to look for at the regional level and, second, by examining prospects at the country level. The business environment is worse in every country of Latin America than it was 18 months ago, but it is decidedly more unsettling in some countries than in others.

Outlook for the Business Environment

1. External Environment

The global environment and its impact on Latin America will remain unsettled throughout the rest of 1999 and well into 2000. Signs of an Asian recovery are good news -- the Korean and Thai economies are predicted to grow again in 1999 after two years in deep recessions -- but the onset of a slowdown in Europe is bad news. As always, the most important component of the external environment for Latin America is the US economy. The consensus forecast is for continued US growth, but protectionist sentiments may also be on the ascendancy. Beyond the uncertainty regarding global growth for 1999, there are proposals under discussion to modify the "global financial architecture." The principal objectives of such measures would be to reduce volatility in short-term capital flows and enhance IMF effectiveness in addressing currency crises in emerging economies. Since Washington adamantly supports open markets, the calls coming from Europe and Japan (with growing support in Latin America) to regulate global finance seem unlikely to take root. There is, however, broader support for the reform of IMF procedures, allowing it to head off currency crises before they happen and, where preventative measures do not work, to act in such a way as to reduce the probability of recessions induced by IMF intervention. Mexico is a leading candidate for preventative IMF assistance, while Brazil may benefit from the attempt to leaven IMF conditionality to preserve growth.

At the regional level, there are two developments to monitor. The first is the fate of "fast track" in the US Congress. Congressional approval in 1999 is essential since 2000 is an election year. The second, and more important, is the ability of the MERCOSUR member countries to reach mutually acceptable accommodations to the Brazilian crisis.

2. Domestic Environment

Economics:

Regional GDP will not grow in 1999; it might even contract. National growth rates will be uniformly lower while some countries, led by Brazil, will be in recession. Both fiscal deficits and inflation are likely to increase while foreign investment will fall. This means that commercial banks, private lenders and multilateral banks will have to cover foreign currency needs, in some cases to avoid loan defaults. One positive result of the economic slowdown will be smaller current accounts deficits as imports decline. Exactly when Latin American economies begin to recover depends in part on how they manage the crisis -- and here there will be significant differences -- and in part on developments in the external environment, most importantly the revival of commodity prices.

Social Welfare:

The Popeís January 1999 visit to Mexico refocused attention on the fact that a decade of market-oriented, export-led growth has not significantly reduced the incidence of poverty in Latin America nor has it narrowed the gap between rich and poor. Unemployment continues to be a pressing problem. Now, in order to reverse deteriorating economic fundamentals, governments are again calling on those Latin Americans in the middle and lower classes to make further sacrifices. The spread of labor stoppages, general strikes, street protests and even street crime would constitute

clear evidence that the level of social tension has intensified to the point where governments may be forced to take repressive action and/or modify their policies.

Politics:
In a year when the economic and social environments are deteriorating, six Latin American countries have national elections. The campaigns associated with these elections and their outcomes, discussed below, will tell us a great deal about the prospects for Latin Americaís open, market-oriented business environment. Even if this yearís elections do not immediately disrupt the business environment, the persistent failure to institutionalize Latin American democracy and make it more effective and truly representative may prove just as destructive in the long run.

3. Policy Environment
The most pressing question concerning the policy environment is whether or not economic liberalization can be sustained in the face of growing fiscal deficits, increased inflation, weakened currencies, low growth rates and growing social unrest. Raising trade barriers to protect domestic producers from the effects of devalued currencies in neighboring countries (and to generate fiscal revenues) would be one expected response to these pressures. However, it is important to note that protectionism has not erupted on a wide scale, at least in part because of commitments made under the multilateral trade agreements now adhered to by all Latin American countries. Liberalized financial markets and free floating exchange rates are two other reforms vulnerable to rollbacks in the face of growing macroeconomic destabilization. Additional privatization, on the other hand, offers the promise of needed revenue in a time of fiscal imbalances. In the face of past crises, some countries -- Chile, Argentina and Mexico are prominent examples -- have responded by deepening the reform process. Retreat from the policy reforms of the 1990s is not inevitable; neither is defense of the reform agenda where there is little to show for it.

Country Prospects
1. Countries with Serious Problems
Brazil presents the most problematic scenario. ***Venezuela*** is a close second. The rest of Latin America has a great deal at stake in whether or not Brazil is able to restore macroeconomic stability in an orderly and timely fashion. The key to turnaround is the ability of President Cardoso to craft a coherent replacement for the Real Plan and sell it to Congress and international financial institutions. Otherwise, Brazil is on the road back to inflation. Evidence that Cardoso is on the right path will come in the form of congressional approval of credible fiscal reforms and the real holding value.

The Venezuelan threat is a preeminently political one, since economic crises in Venezuela are not all that unusual. Should President Chavez suspend constitutional guarantees (or worse, the armed forces intervene to remove him) in his efforts to reform Venezuelaís politics, the other governments of the hemisphere have an obligation through the Organization of American States to adopt collective measures against him. Hemispheric action to defend democracy in Venezuela would be difficult, but failure to act would be a setback for democracy throughout the region. On the other hand, if Chavez successfully addresses the flaws of Venezuelaís widely discredited system in a democratic manner, everyone comes out ahead. The first indication of the likely course of events will come with Aprilís national referendum on drafting a new constitution.

In some respects, the challenges facing ***Colombia*** in 1999 are more daunting than those in Brazil and Venezuela. The biggest breakthrough would be the initiation of substantive negotiations with the guerrillas and a decline in paramilitary violence. At the same time, the Pastrana government must restore Colombiaís reputation for sound fiscal management. In neighboring ***Ecuador,*** President Mahuad is desperately, and thus far unsuccessfully, struggling to do what his predecessors all failed to accomplish -- stabilize the economy and implement a coherent reform program. In early March, the government had to declare a banking holiday and institute a state of emergency to cope with unrest in the country. ***Paraguay*** will find it difficult to make it through 1999 without the breakdown of its 10-year old democratic political system. The high stakes

political struggle combined with the Brazilian crisis guarantees that the Paraguayan economy will perform poorly. ***Honduras*** and ***Nicaragua*** will struggle to cope with devastation of Hurricane Mitch, but at least their political situations are more secure than at any time in recent years. To an important degree, their fates depend on external assistance for rebuilding and debt relief.

2. Countries with Elections
None of the six national elections scheduled for 1999 are comparable in terms of the choices facing the voters in the 1998 Brazilian and Venezuelan elections. While worsening economic and social trends in ***Argentina*** could influence the November election, there is no Chavez or Lula on the ballot. Although the ruling Peronist party could resurrect its populist past with Eduardo Duhalde at the head of its ticket, an equally likely scenario would be for Menem to find a way to get back into the race. For the time being, the nominee of the opposition coalition, which is firmly committed to Menemís policies, leads in the polls. It is even more difficult to foresee a result in the December election in ***Chile*** that would seriously undermine that countryís well-entrenched, well-managed development model. The October election in ***Uruguay*** also has little potential for a radical modification in current policies, while the elections in ***Panama*** (May) and ***Guatemala*** (October) will produce little change in policy and business environment, in part because these Central American nations are somewhat insulated from the economic disruption of the Brazilian crisis. Voters in ***El Salvadorís*** March election gave a first round victory to the candidate of the governing party. In essence, some change is inevitable, but the wrong countries are holding elections this year for a radical departure from the reform paradigm.

3. Others to Watch
Because of its size and close links to the US, ***Mexico*** is the most important of the remaining countries to monitor. Here attention will be on the stability of the peso and jockeying for the presidential elections in August 2000. In South America, ***Peru*** deserves attention as the national elections scheduled for 2000 approach. The major issue affecting the ***Caribbean*** will be resolution of the banana dispute between the EU and the US, since it bears on future prospects for the preferential trade agreements so important to the small economies of this region.

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