Forum: The Second General Assembly

Issue: The question of the economic instability in South America

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Introduction

Economic Stability is paramount for a country as it helps in sustainable growth and high quality of life for its citizens. In addition, it helps the country to attain a long lasting development, because the investors, tax-payers and bankers have a predictable economic policy to follow. The majority of south American countries have been struggling with economic instability for decades.

South America constitutes of 12 countries, with a cumulative population of 430 million people, or 6% of the world's population. Though the region is full of natural resources, fertile land and young population, these countries are still struggling with decades-long economic instability. There are multifold reasons for the same. These countries took a number of steps to arrest the situation, however, they have not been able to overcome all the challenges. The report below provides a summary of some of the reasons of this economic instability, the action taken and possible solutions.

Definition of Key Terms

Economic Stability

When a nation's financial system displays only minor fluctuations in output growth and exhibits a consistently low inflation rate. Economic stability is usually seen as a desirable state for a developed country that is often encouraged by the policies and actions of its central bank.

Economic Policy

Economic policy covers a wide range of measures which governments use to manage their economy. These include monetary policy (money supply and demand), taxation, budget, job creation, etc.

Key Issues

Hyperinflation

Hyperinflation has been an issue for South American governments since the mid 1950s, with brief periods of stability in between. This has happened due to multiple reasons.

Poor Fiscal Policies

Poor fiscal policies are the most prevalent reason South American nations have such large inflation. Governments spend excessively on welfare schemes, such as free education and free healthcare. As such, more money is being spent, which requires more notes to be printed, diminishing the value of the country's currency. Additionally, weak control policies meant that central governments could not control the spending of provincial governments. In the end, this saw governments spending more than they were earning, which led to loans having to be taken from international creditors.

Debt

As highlighted above, governments kept borrowing from international creditors, and the debt kept mounting. However, instead of settling the debts on time, money was spent on other schemes, as the political elite was apprehensive about losing power. For example, in Argentina, proceeds received from privatization was spent into capital expenditure rather than refinancing debts.

Lack of Focus on Building internal structure (Financial and industrial)

Industries: Some of the governments was reliant on imports, hence took its eyes off from building domestic industries.

Financial: For a certain duration, a few countries built a strong banking system, however, during tough times, the governments kept intervening, which weakened the investor confidence in the financial system.

Corruption

Ominpresent corruption throughout the continent hinders economic growth and development. The most common form is seen through tax evasion by citizens, who bribe officials to show their tax has been paid. This causes reduced funds to reach the treasury, increasing the strain on economic systems.

Take Argentina for example. In 2021, the country's 48.4 per cent inflation rate was the world's sixth highest; in August 2022, it is 64 per cent year-on-year. Between 1980 and 2020, annual average inflation was a staggering 215.4%. It's neighbor Brazil has a similar trend; from 1980 to 2020, the average annual inflation rate was 294.0%. However it is Venezuela that takes top spot with an average annual inflation rate of 3,608.8% for the same time period.

Major Parties Involved and Their Views

Argentina

Inflation in Argentina has been on the rise since the Peronist period between 1943 and 1955, which saw mass spending on improving and nationalizing Argentine infrastructure. This period also saw Argentina isolated from the world in terms of trade, after Peron initiated a system of protection against imports. In 1966, Argentina started trading again in an effort to curb the rising inflation, however the extreme dependence on state support of the many protected industries exacerbated the sharp fall of the industrial output. Inflation continued until a financial collapse in 1979, due to overvaluation of the peso which led to capital flight. In 1982, Argentina approached the IMF for support, which after assessing the situation initiated a new currency, the Argentine Peso. The economy continued fluctuating until the great recession(caused by the 2008 financial crash). Inflation grew until it reached 40% in 2016, before coming back down to 2.5% in 2018. Now, the COVID 19 pandemic, alongside the war in eastern Europe and the resulting global food shortage, caused the monthly inflation rate to skyrocket to as high as 78.5% in August 2022.

Brazil

Brazil started off much like Argentina, pursuing a policy of ISI to nurture local industries. This policy worked and Brazil's average annual GDP grew by 7% between 1950 and 1961. After a period of stagnation due to a military coup, the economy skyrocketed between 1961 and 1972. In 1973, the OAPEC countries oil embargoes meant that Brazil suffered drastic reductions in terms of trade. After a brief recovery in which Brazil took massive loans, a second oil shock in 1981 doubled the price of oil imported to Brazil. The same oil shock also caused interest rates around the world to skyrocket, and thus the size of Brazil's foreign debt. Inflation had also increased radically, and by early 1990s the situation was so bad that a new currency pegged to the US Dollar, the Brazilian Real, was put into circulation. This helped solve inflation for 20 years, until 2014 saw the beginning of a recession. Covid 19 then impacted the economy with a 4% drop in GDP.

Venezuela

As the 25th largest producer of oil in the world, the Venezuelan economy is largely based on the export of petroleum. So in 2015, under the Maduro government when a drop in Venezuela's oil production from lack of maintenance and investment, the economic crisis started to brew as a result of low oil prices. The crises was further aggravated when Maduro hosted a controversial election inn 2018, in which he won by a landslide. Multiple nations and blocs, including the US, Canada, EU, UK, Japan etc., placed economic sanctions on the nation. Covid-19 aggravated the situation even more. IMF estimates put the 2020 inflation rate at 15,000%.

Development of Issue/Timeline

Date	Event	Outcome
1970-1979	Oil Crisis	The predominant oil exporting Arab nations cut off exports due to the Yom Kippur war, which caused oil prices to skyrocket. After a brief period of stabilization, the Iranian revolution of 1979, and then the Iran-Iraq war in 1980 further deteriorated the oil rates. The rise in oil prices led to petrol shortages and thus increased prices of commodities in South American nations. Venezuela benefitted from this period through increased exports.
1982	Latin American Debt Crisis	Latin American countries, notably Brazil, Argentina and Mexico, borrowed huge sums of money from international creditors for industrialization. However, an increase in interest rates in the US and Europe made these loans difficult to repay. When trade

		contracted in 1981, the prices of South America's biggest exports, primary resources, fell. In August 1982, Mexico announced its inability to repay its debt, which served as a wake-up call to banks, and led to banks significantly reducing lending to Brazil and Argentina. As much of Latin America's loans were short-term, a crisis ensued when their refinancing was refused. Billions of dollars of loans that previously would have been refinanced, were now due immediately.
December 1994	Mexican Peso Crisis	the Mexican government's sudden devaluation of the peso against the U.S. dollar caused the peso to inflate 52%. This caused investors to lose faith in the region's financial stability, which lead to capital flight, slowing down economic growth in Central and South America.

1999	Devaluation of the Brazilian Real	the 1997 Asian financial crisis, which led Brazil to increase interest rates and to institute spending cuts and tax increases in an attempt to maintain the value of its currency. These measures failed to produce the intended effect, and the Brazilian government floated its currency against the US dollar, which led to the dramatic decrease in its value of 35%. The devaluation also precipitated fears that the ongoing economic crisis in Asia would spread to South America, as many South American countries were heavily dependent on industrial exports from Brazil. These fears resulted in the Brazilian government adopting an austerity program in order to receive a $41.5 billion aid package from the International Monetary Fund and other world lenders.

2007-2009	Global Financial Crisis	The effects of the crisis that originated in America could be felt all over the world. Economic slowdowns were reported in all South American nations.
2019-present	COVID-19 Pandemic	The continent suffered a larger economic contraction than any other of the emerging regions. IMF forecasts shows the region's economic recovery to be lower the projected pre-pandemic levels.
February 2022-present	Russia-Ukraine war	Rising food and energy prices have further compounded inflation and deteriorated living standards in South America.

Previous Attempts to Solve the Issue

Price Controls

Governments tried to tackle inflation by controlling the prices for goods and services, as well as setting wages. However, when there was a change of regime, measures were taken to increase wages, which proved to be counterproductive.

Financial System

As mentioned previously, many South American nations tried to build a strong financial system, however when they were faced with a difficult situation at the turn of the millennium, many governments intervened in the financial markets, which led to weakened investor confidence.

Possible Solutions

Austerity Measures

As mentioned previously, the primary reason inflation is so prevalent is the excessive government spending. Austerity measures, such as increasing taxes, making health and education paid services, and spending cuts on defence etc. can assist in raising sufficient funds to reduce public debt and combat inflation.

Improving local production and diversifying the economy

Many South American nations focus on a primary export, while importing other goods that can be produced locally. For example, Venezuela’s largest export is crude oil, but its largest import is refined petroleum. In this case, investing in refineries can help the economic situation over the long term. Another issue this can solve is the overdependence on one export. Taking Venezuela’s example again, when the price of oil plummeted in the 1980s, Venezuela's economy contracted and inflation soared. Diversifying the economy can help nullify the effects if the prices of one export falls.

Reform of legal system against corruption

Widespread corruption in South America haunts the economy. At one end, citizens bribe officials to evade taxes, while higher up, government ministers take money from treasuries for their own well-being. Reforming the legal system to prevent this corruption can allow the flow of more money to the government and ease the financial pressure.

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