

In addition to the risk of financial contagion, the aggravation of Brazil's economic difficulties in mid-January (as a result, *inter alia*, of the devaluation of the *real*) may have trade effects on the rest of the region, mainly for two reasons: First, the economic recession already forecasted for Brazil in 1999 will have a negative impact on exports to Brazil. Second, the significant devaluation of the *real* will increase the price competitiveness of Brazilian products. The change in relative prices will facilitate an increase of Brazilian exports. The direct trade effects of the Brazilian devaluation are unlikely to go beyond the other MERCOSUR members (Argentina, Paraguay and Uruguay) and the associated countries (Bolivia and Chile) and therefore will have little or no direct effects on integration schemes in the region other than MERCOSUR.

In the current crisis, trade protectionism has fortunately been relatively muted, to date. It was pointed out that in Asia the adjustment process has included market opening and in LAC trade measures have been targeted rather than generalized, while incidents of tariff increases have been isolated and some countries have actually liberalized trade. Meanwhile, protectionism in the industrialized countries is largely limited to anti-dumping actions, a remedy which has been used increasingly throughout the 1990s.

Regional integration has been one of the pillars of reform, modernization and opening of these economies. In this area, the challenge involves: a) a political commitment so that initiatives underway continue; b) the strengthening and refining of rules and institutions; c) more attention to collective crisis management and support mechanisms.

IMPACT ON FOREIGN INVESTMENT IN LAC

Net private flows into Latin America fell to US \$75.2 billion in 1998 from US \$87.5 billion in 1997, according to IMF estimates. The IMF forecasts private capital flows into Latin America of US \$67 billion in 1999. The region depends on private capital inflows to cover its external financing requirements and compensate for low domestic savings. Faced with probable shortage of private capital, Latin American governments will be obliged to implement restrictive demand policies and maintain high interest rates, both of which will slow growth considerably. Confronted with capital shortfalls, governments in the region are engaged in intense competition to attract whatever foreign investment remains available. This is likely to mean not just the sale of more state assets, but also more reform packages, including market opening and institutional guarantees for foreign investors. Instead of incremental liberalisations, governments will be under pressure to adopt comprehensive and irreversible packages of reform. This would also reflect the growing desire to shift the composition of private capital inflows from short-term portfolio flows towards longer-term direct investment.

Foreign investors are wary of investing in natural resources projects for export at present, owing to poor price prospects and severe over-supply problems combined with restrictions on access to US and EU markets for processed raw materials. Natural resources (raw or processed) now make up two-thirds of Latin American exports. Moreover, as a location for industrial export operations, most of Latin America has difficulty in competing with Asia.

Foreign investors are currently more interested in infrastructure and service sectors such as telecommunications, power distribution and transport. From the LAC governments' point of view, infrastructure and service sector investments are beneficial but they do not generate much-needed export revenue. Indeed they often represent a drain on foreign reserves as they require considerable imports of equipment and material in the early stages.