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Will South America Drag Michigan Down with it?



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"It is vitally important for Latin America, the rest of the world and the United States that the international community take all steps sensible to limit the contagion that has come from the Asian financial crisis, and helping Brazil is very important in that respect also."

•**Treasury Secretary Robert Rubin**¹.

"The stakes are high. Any kind of collapse, economic or financial, (of Brazil) would endanger Argentina and all of Latin America and in turn the United States."

•**Allen Sinai, chief global economist at Primark Decision Economics in New York**².

The economic crisis which started in Southeast Asia in 1997 has now spread to other parts of the globe. In addition to a general malaise in many economies, first Russia and then South America experienced severe currency problems in the second half of 1998. Because of its proximity to the U.S. and the economic linkages between the two regions, the economic crisis hitting much of South America has created a lot of concern and speculation about the future health of the American economy. What does this mean for the U.S. economy in general, and the Michigan economy in particular? Are the problems in South America serious enough to hurt us here?

Brazil is a giant among the world's emerging markets. It is Latin America's largest and the world's 9th largest economy, with a population of over 160 million, and a purchasing power parity GDP of just over \$1 trillion. A 1998 survey by A. T. Kearney ranked Brazil as second only to the U.S. as a favored investment destination for multinational corporations, and there are around 2000 U.S. businesses operating there. Citibank also ranks Brazil as the most attractive investment target in South America, followed by Argentina and Venezuela. The country is Wal-Mart Corp.'s leading foreign market for kitchen appliances.

Now, however, the country is in economic turmoil; unemployment is at a 15 year high, the real, which the central bank had been trying to keep at a vastly overvalued rate, has been devalued, and growth in real GDP has all but evaporated. Throughout the continent other central banks have been forced to devalue their currencies as the crisis continues, with a notable exception being (at the time of writing) Argentina, which has a currency board that has maintained a fixed exchange rate of one peso for one U.S. dollar since 1991.

Interest rates in the region have increased, in some cases significantly, over the last year or so, as these countries battle to keep their currencies from collapsing (see Figure 1). Such high interest rates are causing considerable strain on these economies, and as Table 1 indicates, forecasters have cut their 1999 growth estimates for South America drastically. The \$41 billion in new IMF loans for Brazil that were announced in November will definitely help cushion the blow of the crisis, but the conditions of the loans require severe cuts in social services, and this, together with the time lag that exists before the benefits of the loans will be felt, means a tough coming year for Brazilians, and hence for the majority of South Americans.

Figure 1

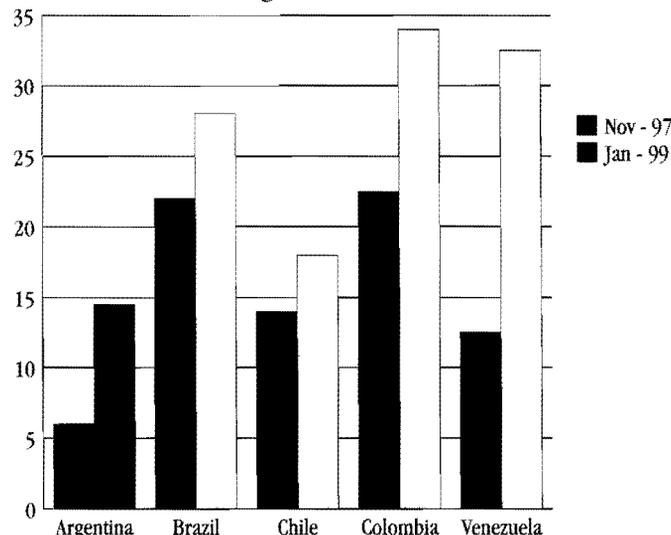


Table 1:
1999 Growth Forecasts for Selected South American Countries:

	1999 Real GDP % Change, forecasted in July 1998*	1999 Real GDP \$ Change, forecasted in October 1998**
Argentina	5.0	2.0
Brazil	3.3	-1.3
Chile	4.8	2.6
Colombia	4.0	1.9
Venezuela	3.4	-0.1

* *The Economist*, July 11, 1998. ** *The Economist*, October 17, 1998.

¹ "IMF Agrees on Brazil Loan," *CNN*, November 13, 1998.

² "IMF Plans for Brazil to Help Others," *Washington Post*, November 13, 1998.

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Will South America Drag Michigan Down with it? (cont)

As Table 2 indicates, the largest South American economies do not account for a large portion of U.S. international trade – only 5.49% of U.S. exports in 1997. But this does amount to almost \$38 billion, so a downturn in the region will definitely be felt in the U.S. Also Latin America as a whole, with its recent high growth rates, has been an important stimulus to world growth. In October, a survey released by the Business Council indicated that 95% of U.S. CEOs said that they believe financial troubles in the world's emerging economies will have an impact on their businesses, with 41% believing that the effects would be significant.³

The survey also found that 64% said that they plan less hiring, and 36% said they are reducing capital spending. Some economists' growth forecasts for the U.S. have now been revised downwards to 1.7% growth in real GDP in 1999.

Table 2:
1997 U.S. Trade Status with Selected South American Countries:

	U.S. Exports as a % of total U.S. Exports	1996-97 % change U.S. Exports	1996-97 % change U.S. Imports	U.S. Exports \$ Millions
Brazil	2.31	25.1	9.7	15,915
Venezuela	.96	39	2.3	6,602
Argentina	0.84	28.6	-2.2	5,810
Colombia	0.75	10.2	7.1	5,197
Chile	0.63	5.5	1.4	4,368

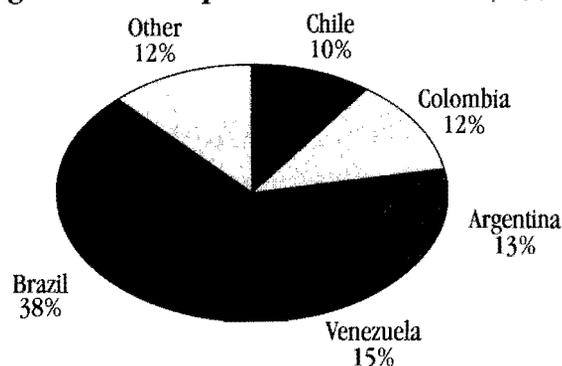
Source: *International Trade Administration, Department of Commerce.*

For those South American countries that have devalued their currencies, the lower exchange rates cushion the blow for their exporters, as they can raise their prices (in terms of domestic currency) and still remain competitive in dollar terms. Indeed, this possibility has led some trading partners to take steps to protect their domestic market from these lower priced imports – Chile, for example, has been limiting imports from countries that have devalued their currencies to protect itself from "exchange dumping." Conversely, the currency devaluations bode ill for American businesses exporting to the region as well as those U.S. businesses with subsidiaries located there, as they might be forced to lower their dollar prices in order to remain competitive.

The situation for our region is similar to that for the U.S. Exports from Michigan to South America amounted to some \$148 million in 1997, about 4% of the state's exports, while 1996 exports to South America from the Grand Rapids-Muskegon-Holland MSA are valued at about \$53.6 million (2% of the area's exports), with \$24 million going to Brazil and Argentina alone. This indicates that for our regional economy the largest impact of the economic crisis will unlikely come directly from decreases in sales to that area. Rather there will be a more significant indirect impact, as the problems there feed into other countries, and the resulting snowball effect dampens growth in the U.S. as a whole.

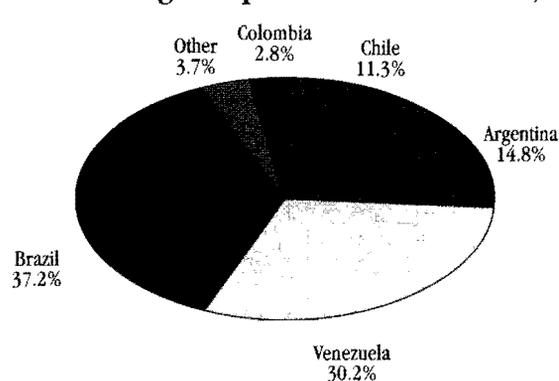
A major determinant of the size of the impact on Michigan and the U.S. will be how well Argentina and Venezuela are able to ride the storm. These two countries comprise a large portion of U.S. and Michigan exports to South America (see Figures 2 and 3), and if the problems in Brazil cause them a significant amount of turmoil, then the spillover effects onto our regional economy will be more severe.

Figure 2: U.S. Exports to South America, 1997



Source: *International Trade Administration, Department of Commerce*

Figure 3: Michigan Exports to South America, 1997



Source: *International Trade Administration, Department of Commerce.*

³ "Survey of CEOs Yields Dour View of Economy," *Wall Street Journal*, October 9, 1998.

⁴ "Emerging Market Indicators," *The Economist*, November 7, 1998.



So far, Argentina appears to be surviving the crisis well. The Argentine economy has been extremely strong in recent years, and the impetus from its recent growth should be able to carry the country through into a year of low but still positive expansion in GDP. Interest rates are also at modest levels (for South America). Of course, the situation is not without its downsides. Approximately 30% of Argentina's exports go to Brazil, and 23% of its imports come from there. One quarter of Argentina's industrial output comes from auto production and related industries alone, and before the onset of Brazil's economic troubles 90% of Argentina's auto exports went to Brazil. As a result, local plants in Argentina have experienced temporary shutdowns, and the Brazilian divisions of Ford and General Motors have also announced work stoppages. As noted earlier, Argentina uses a currency board to maintain its fixed exchange rate. Currency boards generally maintain a more credible fixed exchange rate than central banks, because they hold a stock of foreign currency equal to 100% of the outstanding currency supply of the nation. However, a currency board can still be tested by speculators, and is by no means a perfect hedge against pressures to devalue.

Venezuela is in quite a different situation. Interest rates there are over 30%, and foreign reserves fell by over \$4.5 billion during 1998 as the Central Bank of Venezuela tried to slow down the fall in the value of the bolivar. Venezuela's problems have also been exacerbated by 1998's sharp drops in the price of its main export, oil, which cost the government \$5 billion in revenues. As a gauge of investor concern, Venezuela's stockmarkets fell by 45% in local currency terms in 1998, the largest drop of any South American country.

In conclusion then, the economic crisis in South America is likely to have a noticeable but small detrimental impact on the U.S. and Michigan. Both the state and the nation currently have strong economies, with low unemployment, low inflation, and steady economic growth indicating that we are in good position to withstand the fallout from South America. Brazil, and to a lesser extent Venezuela, are already experiencing significant problems in their economies, and it is likely to be several months before the IMF's bailout package has much of an impact on consumers in those countries. The repercussions from South America will definitely be exacerbated if Argentina is unable to continue keeping its currency fixed to the dollar at its current parity, as the country is regarded by many as a keystone in the region, which means that a devaluation of the Argentine peso would reignite capital flight from the area. So we are likely to continue seeing high interest rates in South America, in attempts to attract investors back. The slight falling off in economic growth that could result in the U.S. is also likely to put pressure on the Federal Reserve Bank to maintain or even lower interest rates.

Succeeding in New Markets Through a Market Orientation: The Case of India

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In 1991, the Indian government introduced a series of measures aimed at removing the barriers to foreign investment. These measures, which were collectively called the "Economic Liberalization Program", had an immediate effect on the amount of foreign capital that came into India. From \$8 million in 1991-1992, it burgeoned to \$2.214 billion in 1995-1996 as leading companies such as Coca-Cola, PepsiCo, Kelloggs, Toyota, and Daewoo entered the Indian market. The influx of foreign companies soon changed a hitherto sellers market to one where companies competed aggressively for the consumer. The contrast between the pre- and post-liberalization environment in India is tellingly underscored by an observer who states that "in a shortage economy (prior to 1991), the customer was a commoner, never a king. Nowadays, the company is the supplicant, fighting elbow to elbow with others to try and catch the client's eye. The enthronement of the buyer constitutes a major revolution for Indian business. And it finds its shiniest reflection in the post-1991 explosion of marketing and advertising."

To study the competitive aspects of the changed Indian business milieu, our research looked at the performance implications of a recently introduced concept called "market orientation." Market orientation operationalizes an organization's interface with its external environment by looking at three things: the organization's ability to keep track of customer needs (both present as well as future), its ability to size up accurately the moves of competitors in meeting customer needs, and finally, communicating this market information to all organizational units so as to prepare an optimal response to this market information. The third dimension, called "interfunctional coordination" is thus the action part of this concept.

We developed a set of 25 questions that accurately captured the essence of these 3 dimensions. These questions have been extensively tested in the U.S. context (both by us and by other researchers), but have not been extended to developing countries. We first conducted a pilot study with a few select executives in India to ensure that the terminology was understandable and relevant to the Indian context. Using a professional market

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