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Latin America in the Global Crisis

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Origins and Consequensces of the Global Crisis

As everyone knows, the global crisis originated with the burst of the real estate bubble in the United States. The bubble was provoked by the competitive supply of credit to an increasing number of housing buyers, generating a continuous rise in demand for real estate, the prices for which grew nonstop for five years. The rise in prices re-fueled the bubble causing it to affect the entire economy. The new owners used the increased value of their assets, which served as a guarantee, to take on more loans, originating additional spending that transferred the high prices to other economic sectors. The increased demand for more consumption even reached imported products, causing the effects of the U.S. real estate bubble to spread throughout the world.

This spread was only possible because of the large influence of the United States in the world economy and the extent of commercial and financial globalization in recent years. The successive rounds of commercial liberalization culminated in the creation of the World Trade Organization (WTO) and the approval of treaties that in principle impose free trade on all nations. It is clear that the power of the WTO to enforce obedience to its resolutions is very unequal, being quite limited in relation to First World countries, which continue to protect and support their agriculture, but crushing in relation to smaller and poorer countries, which in general are very dependent on foreign commerce and foreign capital.

The commercial and financial integration of the Third World to the U.S., European, and Japanese economies resulted in a clear strengthening of the capitalist class in relation to the proletariat within these countries, because free trade and the free circulation of capital between the national economies allows transnational companies to shift their companies to countries in which the cost of labor is lower, leaving behind sad pockets of poverty and unemployment and a weakened labor movement, incapable of integrally defending its economic, social and political conquests. This change in relation of forces between classes was felt in all the industrialized countries and also expressed in the sharpening of inequality between the large transnationals and smaller companies, which operate only in domestic markets.

The exception noted by all was a small number of semi-developed countries with large populations and territories, which have absorbed most of the economic activity that shifted from the First World and have been able to take advantage of the bubbles produced by the financial deregulation to grow rapidly for a number of decades. Among the emerging countries, four stand out and are known as the BRIC – Brazil, Russia, India and China – with the latter becoming the world's third largest economy. In each continent, a number of not so large countries were able to take advantage of the U.S. bubble such as South Korea, Taiwan, Singapore, Malaysia, etc. in Asia, and here in Latin America, Argentina, Venezuela, Colombia, Peru, Panama and Costa Rica.

The same has taken place in Europe and South Africa. It appears that globalization only punished the proletariat, both in the center and in the periphery. In practically all the countries (including Brazil), labor income was strongly concentrated in the hands of the directors of large companies, with earnings that with the eruption of the crisis have become the focus of financial sector scandals. Commercial and financial globalization have certainly concentrated wealth and power in the classes that already enjoyed them and in the countries that encompassed large global financial markets, highlighted by New York and London. In addition, it removed from the Nation States (with the exception of those mentioned here) the power to regulate the commercial and financial relations of their own citizens with the rest of the world. The states had established these powers during the crisis of the 1930s and World War II and used them to recover from historic delays and establish the bases of Social Welfare States. Since 1979, the reactionary wave of neoliberalism caused a return to the hegemony of private capital, typical of the 19th century.

Latin America and the Caribbean in the Global Crisis

The crisis struck Latin America by means of changes in external economic conditions, such as the flight of strong currencies to the First World, extinction of external credit and sharp reductions of exports, direct foreign investments and transfers from emigrants to the First World. In the case of Brazil, although the private domestic banks did not suffer losses with the U.S. mortgage crisis, they succumbed to the panic and contracted the credit supply, punishing the smaller banks, which are dependent on funding from the large banks, which receive most of the deposits from companies and families. The small banks finance micro and small companies, which employ a large part of the economically active population. The contraction of their activity (which also did not spare the solidarity economy) provoked a considerable reduction of production in this segment. Large industry, in turn, was hit both by the drop in exports as well as by the decreased credit to buyers of automobiles, large appliances and other high value goods.

The crisis deepened when industry conducted widespread layoffs. The flood of bad economic news, nationally and internationally, stridently presented by the media, spread the panic among business and consumers. In the fourth semester of 2008, Brazilian GNP fell 3.6% despite government efforts to quell the crisis and compensate the freeze in lending by the private banks with the provision of credit to producers and consumers from government banks. Investments in production dropped considerably, because of the lack of credit from private banks and the lack of business confidence that government policy would be able to quickly resolve the crisis.

The international crisis has been affecting Latin American countries in various ways due to the large differences between them. Medium and large countries and those that are quite industrialized and urbanized, such as Mexico, Argentina, Colombia, Peru, Venezuela and Chile, were hit by the crisis similarly to Brazil with capital flight, reduced exports and foreign credit and contaminated by panic among private domestic banks, which also cut credit and increased interest rates. This contracted domestic markets, causing a drop in production and increased unemployment.

The many small countries in the region, above all in the Caribbean, were affected more directly by the international crisis because they depend much more on imported products, paid for by export income and the limited number of primary products and especially tourism and income sent back by emigrants to families still in their native country. Costa Rica receives 19.5% of its GNP from first world exports and Honduras 12.5%. Tourism accounts for 40% of the GNP of Santa Lucia, 30% of that in the Bahamas, 28% in Barbados, and 25% in St. Kitts & Nevis. For the Caribbean as a whole, tourism accounts for a fifth of all economic activity. Since the crisis struck the real economy of the United States and Europe in mid 2008, tourists from these parts of the world grew sparse, in contrast with the cases of Brazil and others like it, which only felt the crisis in the final quarter of 2008.

The reduction of transfers from emigrants, due to the crisis in the First World, had a similar effect. These transfers represent 40% of the economy of Guiana, 25% in Haiti, 20% in Jamaica, 14% in Guatemala and 9% in Bolivia. These are all considerably poor countries and the hardship of their fellow countrymen, who lost their jobs abroad, has had strong repercussions on these national economies. Another loss of the small countries was the drop in Direct Foreign Investments on which depend many other countries in the region such as Antigua & Barbuda (where they account for 24.7% of economic activity) and Granada (21.8% of the economic activity). Although in absolute terms, the value of direct foreign investment that reaches the large countries is much greater, their weight in the GNP is incomparably lower: 1.6% in Argentina, 1.9% in Brazil, 2.4% in Chile, 2.5% in Mexico and 3.4% in Colombia (Cepal, 2008).

Government Measures to Combat the Global Crisis

The crisis of 2008 is qualitatively different from preceding crises, in both scope and depth. Unlike the crises of the 80's, 90's and the first years of this century, which in general were limited to one part of the world or a few countries, this crisis spread throughout the world, not sparing developed, semi-developed or undeveloped countries. In addition, it has imposed great damage on the world's large financial conglomerates, some of which remain completely undercapitalized. As publicly held companies, their shares are subject to daily trading on stock exchanges, and since they suffered unthinkable damage because of the non-payment of subprime mortgages, their share prices fell to nearly zero. That of Citibank, which until recently had been the world's largest bank, came to be traded at less than one dollar a share.

Under capitalized banks cannot make loans and suffer from a decrease in deposits, because it is their own capital that guarantees compliance with contracts with depositors and borrowers. Although technically still not bankrupt, they are open, but not functioning, considered "zombies." With a large part of their portfolios constituted by "toxic" securities, or that is, those that offer no returns, their share prices cannot recover, to such a degree that the international financial system became nearly paralyzed, affecting the operation of the real economy, which depends on financing to be able to buy sell and invest.

All this explains why this time the fight against the crisis was not left to intergovernmental financial regulatory agencies, such as the IMF and the World Bank, but mobilized all the national governments, which since the first moment resolved to abandon any presumption that the financial markets are self-regulating and sought to rescue their domestic banks, nearly at any cost. Since a large portion of these banks were directly responsible for the financial extravagances that created the real estate bubble, their pure and simple revival with taxpayers' resources was rejected by public opinion and the media, which reflects this public sentiment. When it became known that the banks in question were authors of "financial innovations" that hid the risks of securities sustained by real estate mortgages, in addition to disguising their balance sheets and offering their executives options to purchase shares at favorable prices, which provided billions in bonuses, there was deep and widespread opposition from public opinion to the purchase of toxic securities with taxpayer money.

To escape the impasse between trying to confront public opinion or prolong the financial paralysis and the drop in production and employment in the real economy, one government after another began to nationalize the "living-dead" banks by purchasing part or all of their assets with Treasury funds. These nationalizations were faced by the most conservative governments as provisional measures, to be revoked as soon as the financial crisis is overcome, and for this reason the administration of these banks remained in the hands of the same people who led them before the crisis. More progressive governments, in turn, substituted the administrations of the nationalized banks with people of confidence, prepared to reactivate the institutions, given that deposits and loans earned government guarantees. This was the situation in the United States, Europe and Japan, where the banking hecatomb was serious.

In Latin America and the Caribbean, only the affiliates of the global financial conglomerates were directly affected by the crisis, and in their case, the solution adopted depended on the position of the governments in the countries where their global headquarters are based. The domestic private banks in Latin America, in general, were not involved in the second-hand mortgage securities, and were able to continue operating. They only do not do so because they were engulfed by the panic that their loans would not be repaid. Despite efforts by Latin American and Caribbean governments to convince the bankers that they would not permit the crisis to last, it is clear that the "national" banks have not restored the supply of credit to the real economy of their countries. In Brazil, the government created new lines of credit at the public banks and tried to force them to reduce the interest rates that they charged. But, even here, the government decisions met resistance, which in Brazil recently provoked the substitution by the government of the president of the country's largest public bank, the Banco do Brasil.

In addition to the financial revival policies, the governments of various countries – including those in Latin American and the Caribbean – are introducing various policies designed to stimulate demand for consumer goods and services and among companies in the real economy for production services and goods. Considering that spending on vital consumption cannot fall, it would be impossible to compensate the drop in exports by means of redirecting production to the domestic market, except by reviving discretionary spending and investment in the real economy. [1] The discretionary spending of families can be stimulated through temporary reduction of taxes on durable goods and redistribution of income to the most poor by increasing subsidies such as the Family Grant program, pensions, the minimum wage, free openings in public schools and hospitals and similar measures. Private investment is stimulated by reducing long term interest and taxes on the sales of machinery, vehicles, computers and similar items.

One policy strongly recommended by John Maynard Keynes to increase internal demand is to raise public spending, both current as well as investment. The expansion of public services, which in general do not meet demand, in addition to being an end in itself, expands public employment and therefore the demand for goods and services from those who were previously unemployed. The construction of roads, ports and airports, energy generation, storage and distribution systems, etc, generate jobs first in construction and later in the operation of the services that will be offered after the construction.

Equally important policies to combat the crisis are social programs to reduce poverty and social exclusion. This category includes building low income housing, schools, street paving, the reurbanization of urban slums and similar measures. Nearly all of the Latin American and Caribbean governments are conducting steps of this nature, evidently within the limits of their budgets and the ability to expand the public debt.

Dilemmas Concerning the Prevention of Future Crises

The formulation, discussion and approval of the measures to fight the global crisis, in various countries, will necessarily take some time. Even after their approval by legislatures, some of these policies, such as those that involve construction or civil service exams to expand the ranks of public employees, demand considerable time before they produce the desired effects. This is what makes it difficult to predict when the results of the fight against the global crisis will begin to appear, inaugurating the recovery of economic activity.

Since the countries hit by the crisis are connected through globalization, above all by the presence in nearly all the countries of large enterprises affiliated to the giant transnational networks, the fight against the crisis cannot be conducted in isolation by each Nation State. If the transnational companies do not cooperate with the national governments, above all in the poorest countries, the fight against the crisis by government can fail. Coordination of national policies is probably the only way to induce the global leaders of transnationals to overcome their pessimism and strive to increase production and employment in the countries where they act.

In reality, the fight against the crisis does not depend on all of the two hundred some odd countries in the world coordinating their policies. It is sufficient for the governments of the largest economies to do so. This is why the G-7, the group of governments of the world's seven largest economies has had such a strategic role since the current crisis erupted. But the much greater growth of the emerging economies in recent decades has changed the global economic and political balance, requiring opening the circle of economies considered "dominant," the coordination among which is indispensable to control the global crisis.

To illustrate this important process of re-establishing equilibrium in the global economy, we can look at the growth of GNP in the world as a whole and in the first and third worlds from 2003- 2008. In this period, the global economy grew 22.32%, with annual average growth of 3.4%; first world economies in the same period grew 9.19%, at an average annual rate of 1.48%; and third world economies grew 45.89% in the same period, or at an average annual rate of 6.5%. The difference in the growth rate between the first and third worlds is expressive: the latter grew nearly five times more than the former. That is in these six years, third world economies grew nearly 50% while the first world grew about 10% (Cepal, 2008).

This broad difference in economic growth rates between developed and developing nations has made inevitable the substitution of the G-7 for the G-20 in the coordination of national economic policies. The G-20 includes all the G-7 nations, as well as all the other countries that compose the European Union (which are treated as a block and have one vote) and a variety of other nations, many from the Third World. It is probable that the severe shock of the global crisis on the hegemony of the G-7 and on neoliberal thinking has also contributed to this unedited expansion of the center of coordination of the global economy.

The financial system faces the first dilemma raised in the historic conjunction of this effort to reverse the crisis. There is apparent unanimity in the G-20 that it should be changed, through the institution of an international agency for the regulation of global finances. The objectives of the regulation appear clear: to avoid a repeat of the crisis, by establishing stricter limits on financial speculation and eliminating the existing ease of transgressing the few limits to the freedom of action of financial transnationals, including that of avoiding national taxes, by hiding large sums of money in secret accounts in "tax havens. "

The very idea of an international regulatory agency is only justified if financial globalization continues to be based on the unrestricted liberty of the movement of financial instruments across the borders of nearly all nations. The only exceptions are found in a number of Asian countries such as China, India and Malaysia and in Latin America in Argentina, Venezuela and Cuba (this is not a complete list). Governments in these countries establish controls by imposing limits and or taxes on remittances of funds both in and out of the country. The massive entrance of dollars and other strong currencies attracted by high interest and tax advantages, and by the ability to leave as soon as the perspectives for speculative gains decrease, lead to increased value for national currencies, reduced savings and increased consumption on high value and often imported goods – by those who come to save less. There is, in these cases, a substitution of national savings for foreign savings, a high foreign debt and therefore, risk of a currency crisis.

At times of economic crisis, the panic leads the propertied classes to hoard their net wealth instead of investing it directly or making it available to those who want to, through the financial system. Another harmful manifestation of the panic is "capital flight," which occurs when affiliates of multinationals transfer large sums to their headquarters, located outside of the country of operation, so that they can cover losses and meet obligations. This in fact occurred in many Latin American countries immediately after the eclosion of the financial crisis in 2008. The capital flight reduced the supply of funds, leading to a devaluation of the national currency in relation to the currency that was being removed from the country and consequently to strong inflationary pressure due to the rise in prices of all imported products.

The international financial crisis raises a fundamental question: why not do away with financial globalization as a whole, restoring in all countries the power of the people to decide, by electing the government and the parliament, *in what way their savings, or that is their social surplus, should be administered?* The manner that the public or private owners administer their savings has strong effects on the economy and on the social and political life of each country, as we have just seen.

The liberty of each one to manipulate their property should be subordinated to the guidelines of economic authorities to maintain economic stability and progress. The large majority of savers are composed of simple people who by saving, sacrifice satisfactions they put off to be able to attend to emergencies not covered by social security - and even those covered in the cases of the many who do not have these benefits. These savers are usually not concerned with the interest they may earn and even less on speculative investments. It is those savers with income so high that it far exceeds their total spending on daily needs who tend to see their non-spent income as capital, and therefore as a source of more income through its investment in securities, the values of which are redefined daily in stock, commodity and futures exchanges. This also applies to the savings of large companies and naturally to the financial firms who live directly on their own financial speculation and as consultants to others.[2]

The savings of the middle and upper class, when there is no crisis, is trusted to banks or funds, public or private. These are capitalist companies that seek to maximize profits, and to do so, must invest money deposited in them by clients in securities issued by different firms. These are contracts through which their holders receive interest or dividends during the time in which the money remains with those that issue the securities. The banks and funds that invest the deposits receive an administrative fee that is proportional to the earning obtained by the depositors. But since the future of the enterprises is unknown, a part of them suffer losses, which can impede them from complying with the contracts they have with the institutions that invest in them. The losses produced are suffered by depositors in banks or funds that apply the money of the depositors in firms that went bad. When the losses are many and large, the banks and funds are required to compensate the depositors with their own capital, which in general is not enough to cover all the losses. When this takes place on a large scale, many banks and funds fail and the crisis is the consequence.

Small savers often place the little that they have after paying their bills in entities that they create and generate. These may be collective enterprises, which seek to preserve the purchasing power of the deposits entrusted in them and invest the funds deposited in loans to the partners (rotating funds) or in other collective enterprises. Examples of these operations are credit cooperatives, rotating "solidarity funds" and community banks.

Since each family has savings of small value, the interest that they may earn is miniscule and does not compensate the risk of losing the saving that they will need in case of illness, unemployment or death. For this reason, the propensity to speculate of working people and of the entities that administer their savings is insignificant.

Conclusions

The international financial and economic crisis is the result of instability that characterizes any economy guided by market mechanisms. This instability is characteristic of any *free* market. That is, in which there is no institution that conciliates the interest of sellers and buyers. The free market is a space in which a variable number of agents exchange money for financial goods or assets. Both the quantity of exchanges as well as their value depend on the will of the agents, which is not predetermined, and therefore, depends on the interaction between those who buy and those who sell. The indetermination is even greater because of the presence of agents who can be both buyers and sellers of the same goods: they are the speculators, who look for profits selling products after they increase in value and buying products after a decrease in value, during the transactions in a market or in a larger group of globalized markets.

Oscillations in prices and quantities of goods are inevitable if the complete liberty of the market agents is respected. Since the oscillations are harmful to the agents, since its birth in the 19th century, economic policy has sought to find a market structure that eliminates the oscillations or causes them to be predictable. The conclusion that can be gathered from these centuries of discussion is that any market structure that does not allow prices and quantities to vary, or that makes the variations obey rules that make them predictable, inevitably must impose heavy restrictions on the liberty of the agents to conduct transactions.

It was during the last century that attempts at market stabilization moved from the theoretical plane to the practical plane, in the countries that adopted centrally planned economies. There is no space here to discuss these experiments, but the conclusion is unavoidable that the disadvantages caused by these restrictions to the liberty of the agents were much greater than the advantages created by the elimination of the oscillations of quantities and prices in the markets.

This is not to say that markets should not or cannot be regulated by some level of government authority. It is the responsibility of governments to prevent the sale of products harmful to consumers' health, and to oversee the fulfillment of contracts for future delivery of goods sold or of future payment of goods sold and already delivered. This type of regulation serves to prevent that the will and expectations of agents be violated, but does not prevent markets to continue to be instable as they always have been.

If, therefore, the current desideratum is to prevent new financial crises, it is necessary that the markets in which money is exchanged for financial assets not be free, in the sense that they not be governed solely by the private interests of individual people or companies. This is perfectly possible without harming economic liberties in other markets. But, to do so, it must be recognized that the financial service of guarding the net wealth (that is, money) of the public and of loaning it to private and public companies and individuals is, *in and of itself, a public service* and, therefore, this service must be reserved to governments or associated not for profit entities.

Financial intermediation must, therefore, be exercised exclusively by government, because only in this way can banks, funds and similar agents stop looking to maximize their own surplus and dedicate themselves to the public good, defined democratically in periodic electoral disputes. Since there is still no democratically elected public government at the global level, it is logical to conclude that a public financial authority can only be national, given that it is only in the realm of the Nation-State that the practice of democracy takes place.

Since 1945, the world has enjoyed the services of a set of entities that constitute the so-called U.N. family, integrated by a large number of nations, most of them democratic. Despite this, it cannot be said that global instances of power formed by representatives of governments can be democratic, although the large majority of the member governments are. They are not because global democracy would require that the election of the people who exercise power by means of entities in the U.N. family or similar entities be conducted by global citizens, in direct elections in which candidates can be people from any country that is a member of the entities in question.

It is clear that the large majority of governments today are not willing to transfer part of their constitutional power to extra-national entities. This is found both in the United Nations as well as in the European Union, and as long as this is the case, there is no other option than to propose the nationalization of the financial systems, terminating for good the experience of weakening Nation States to the advantage of the empowering of the complexes of private capital, above all those that are transnational.

The large international crisis of 2008 was borne from the revocation of the Bretton Woods regulations and national laws that enforced them by submitting financial markets to the control of national governments. The global regulation of the circulation of capital passed from public agencies to a set of immense financial companies seeking profit that dominated the globalized financial markets *for their own benefit and not for the benefit of any national government.* The crisis has the enormous scope that it does because the Nation States did not have and do not now have the power to prevent it. In this respect, the Commission of Experts of the President of the General Assembly on reforms of the international monetary and financial system, directed by the 2001 Nobel Prize winning economist, Joseph Stiglitz, and composed of renowned economists and public policy makers and executors from Japan, Western Europe, Africa, Latin America and South and East Asia, approved the following recommendation:

> *Market-driven international capital flows are of such a magnitude and volatility that they can offset any formal mechanism to provide additional finance for development. Thus, an active management of foreign capital inflows will be required to ensure that they are supportive of the counter-cyclical policies of Governments. The Articles of Agreement of IMF provide members with the authority to control capital inflows and expressly exclude the use of Fund resources to meet imbalances resulting from capital account disequilibrium. The Fund should be encouraged to return to its original principles and to support countries that attempt to manage external capital flows in support of domestic counter-cyclical policies.*[3]

Notes

1 Discretionary spending is that not motivated by immediate and unavoidable needs such as food, lodging (rent, maintenance), transportation, medicine and similar items, but for durable goods, homes, furniture, appliances, automobiles, clothing) and services whose purchase can be put off (having children, vacation travel, plastic surgery, sports and similar activities).

2 These facts inspired the great Polish economist Michael Kaletski to formulate the following law: "Workers spend what they earn and capitalists earn what they earn." This means that workers who earn only what is needed to live, or little more than this, must necessarily spend soon nearly everything they earn. Capitalists earn much more than they need, but if (as a class) they do not spend all that they earn, they will not find anyone to purchase all that they have to sell, because the money withheld from commercial circulation by hoarding will cause a similar amount in goods produced for the market to not find buyers.

3. Recommendations of the Commission of Experts of the President of the General Assembly on Reforms of the International Monetary and Financial System, United Nations General Assembly, New York, April 29, 2009.

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Abstract – Global commercial and financial integration has strengthened the capitalist class in comparison with the proletariat around the globe as it permitted multinationals to relocate their companies to countries in which the cost of the labor force is lower. The crisis reached Latin America through the flight of capital, disappearance of external credit and a drop in exports, foreign investment and emigrant remittances. The crisis spread due to mass layoffs, a diffusion of panic that negatively affected credit availability and decreased sales of higher added value goods and investments. Developed-country governments rescued their bankrupt banks by acquiring part of their capital or even the entire institution with Treasury resources. In Brazil, the government forced public banks to extend credit to the sectors that had been abandoned by the private market and to decrease their interest rates. Latin-American governments stimulated the domestic market to absorb the production that could no longer find buyers abroad in return for redistribution of income and increase of public investment. In the last six years, emerging economies have grown 50% while industrialized countries have grown only 10%. This fact has increased the number of nations that must coordinate among each other to tackle the global crisis from seven (G7) to twenty (G20). One of the lessons to be learned from the crisis is that instead of financial globalization, the people of each country must have the right to decide how their social surplus must be managed. Monitoring the use of public money as well as public loans to investors and consumers must be the responsibility solely of public authorities and not-for-profit organizations.

Keywords: Global financial crisis, Financial globalization, Nationalization of bankrupt banks, Public banks, Nationalization of financial activity.

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