THE PERSPECTIVE OF THE WORLD REVIEW

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EDITORIAL

This second edition of *The Perspective of the World Review* focuses on a theme that is particularly important for Brazil and other Latin American countries, namely: the specifics of development in the context of the nations of the South. The conventional literature considers development as a process comprised of distinct and pre-defined steps. The ECLAC (Economic Commission for Latin America and the Caribbean) approach to explaining the Latin American experience that was first put forth in the 1950s demonstrated that this could not be more wrong. It argued instead that development is conditioned by historical factors and that this specificity does not imply that development has pre-defined steps, but instead, rather than being a stage, underdevelopment is a specific historical formation that will not necessarily turn into development, as Celso Furtado made clear in his masterful intellectual work.

This important and non-trivial finding enables us to face questions of development with a more appropriate and realistic perspective, because it suggests that achieving the status of a developed country is not only about following a pre-determined script. Achieving development is a collective building effort based on community values, the capacity to generate wealth and to articulate a dialogue that relies on the hegemonic acceptance by the actors who work there. It does not depend on anything else other than the capacity of human ingenuity to adapt to the values that seek to give meaning to existence.

Although the ECLAC approach has been the subject of much debate, the results of intellectual endeavors and systematization of reality were definitive proof of the quality of the discussion. Since then, countries that have managed to organize their societies, markets and a more harmonious State, even with intense debate and confrontation with dissent, were those who had more success with a trajectory that permitted aspiration for living conditions closer to those in more developed societies. Countries that failed to achieve that degree of mobilization and maturity face recurring problems and little progress. These countries are a permanent source of instability because of the challenges of exploding populations, aging and deteriorating living conditions, due mainly to a process of unplanned urbanization and extensive environmental degradation.

Finally, it is important to note that a substancial part of the contributions that are being presented in this issue focus attention upon the problems engendered by the serious and ongoing international crisis. Although their results are mixed and major developing countries are reacting effectively and

vigorously, parts of the developed world and the countries in the process of development still hesitate and suffers from a lack of reordering of international and financial relations. It is within this context of change, The Perspective of the World Review proposes to reflect upon the development of a South-South perspective, which is a scenario marked by relevant metamorphoses with results that are still uncertain, given that progress is not inevitable and the retraction of structures of society always go around that which is unresolved by action based on human values.

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ON THE DEVELOPMENT AGENDA

Octavio Rodríguez*

This article is based on categories and analytical frameworks drawn up by Celso Furtado aiming to examine development, understood as the *development of global cultural systems*. Furtado also confers high priority to certain elements that hamper the development of specific cultural systems, giving rise to the so-called underdevelopment. The elements mentioned and their operation – also present in the ideas of several authors of Latin American structuralism – are considered in four major topics:

- Self-centered growth – encompassing the technological and economic spheres.
- Sociopolitical relations and role of the State – which entail the actions of social groups and classes and their mutual impact on the state apparatus.
- Cultural identity and development – concerning the highest values of cultural systems and their importance for the continuity of development.
- National development – expressed in a *mixed strategy*, combining exports and an increased domestic market; in shaping a "new alliance", main agent of its socio-political drive; and in "ethical reaffirmation", imbued by the abovementioned high values.

SOBRE A AGENDA DO DESENVOLVIMENTO

O presente artigo se baseia em categorias e esquemas analíticos, elaborados por Celso Furtado, com o objetivo de examinar o desenvolvimento, entendido este como *desenvolvimento de sistemas culturais globais*. Furtado outorga também alta prioridade a certos elementos que travam o desenvolvimento de sistemas culturais específicos, dando origem ao chamado subdesenvolvimento. Os elementos recém-mencionados e sua operatória – presentes também nas ideias de diversos autores do estruturalismo latino-americano – são considerados em quatro grandes tópicos:

- Crescimento autocentrado – que diz respeito ao âmbito tecnológico e econômico.
- Relações sociopolíticas e papel do Estado – que dizem respeito à ação de grupos e classes sociais e sua incidência recíproca com o aparelho estatal.
- Identidade cultural e desenvolvimento – concernente aos mais altos valores dos sistemas culturais e sua importância para dar curso à continuidade do desenvolvimento.
- Desenvolvimento nacional – expressado em uma *estratégia mista*, ao mesmo tempo exportadora e com aumento do mercado interno; na conformação de uma "nova aliança", agente principal de seu impulso sociopolítico; e na "reafirmação ética", impregnada pelos altos valores já mencionados.

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The main source of this article is Chapter 15 of the recently published book by the same author "El estructuralismo latinoamericano".[1]

Both that chapter and this document use Celso Furtado's ideas on development as a guiding thread and framework, as well as the views of different structuralist authors, mentioned as appropriate.

Furtado's concept of development refers to a notion of totality, which is the global system of culture. In other words, Furtado seeks to theorize about the development of global cultural systems.

These systems entail three major areas:

- The material culture, which is related to the systems' technical and economic aspects.
- The socio-political field, which is a primary aspect of non-material culture. It includes ideas and values related to this field, the actions of the classes and groups that comprise it, and also the role the State plays in it, by means of initiatives concerning the area; such initiatives may be expressions of the interests of classes and groups, but may also result from the level of autonomy usually enjoyed by the State. One will see that a driving strategy requires the State to play a key role, therefore, it entails an appropriate degree of autonomy, allowing the State to play such role.
- A second aspect of the non-material culture consists of ideas and values that are not socio-political, and that correspond to the highest purposes of human existence. These values can be associated to philosophical reflection, scientific research, artistic creation and mystical meditation.

Furtado's ideas also refer to underdevelopment, moreover, they focus mainly on explaining underdevelopment. It seems clear that if development means the enrichment of a global cultural system, underdevelopment is the reverse, i.e., the existence of barriers to such enrichment in certain specific cultural systems. It is understood that some cultural systems fail to develop their own cultural identity.

What is cultural identity? The term is nothing but a means or terminology to refer to a specific cultural system, unique to a country or nation. This term or category is introduced to say that in underdeveloped countries, such as those in Latin America, the development of a cultural identity is blocked. That is underdevelopment: the existence of obstacles that prevent the enrichment of a country or nation's own cultural identity.

1. ECLAC - Siglo XXI publishers, Mexico 2006 (published in Brazil, CEPAL - Civilização Brasileira, 2009). The said chapter is entitled "*Hacia una renovación de la agenda del desarrollo*". The book relied on the contribution of Oscar Burgueño, César Failache, Adela Houni, Lucía Pittaluga and Andrea Vigorito, of the College of Economic Sciences and Administration, University of the Republic, and also Gabriel Porcile, of the University of Curitiba.

Why do these obstacles occur? Furtado relates them to the penetration of elements from foreign cultures. He understands that such penetration undermines or impairs creativity in various spheres of culture. And here we consider the last two categories.

What is creativity? The concept becomes clear when applied to the technical sphere. One can define a new technology as knowledge, which is abstract by definition, of the characteristics of a new product or a new production process. When the knowledge of a technical change is applied in reality, it is said that it has led to innovation.

However, Furtado extends this terminology - that is, creativity and innovation – to the three major areas of cultural systems, and argues that foreign penetration inhibits both in all three areas.

This will all become more visible or more noticeable when referring to the components of a development strategy for Latin American countries, which have faced notorious difficulties to promote their own identities.

We begin by considering the first area, entitled “A) Self-centered growth”. Then, briefly address the other two: “B) Socio-political relations and the role of the State” and “C) Cultural identity and development”, to conclude by mentioning the so-called “D) National development”.

A) SELF-CENTERED GROWTH

It covers the technical-economic area, or what Furtado called “material culture.” We chose the word growth rather than development, because of a personal understanding that the concept of development involves the consideration of non-economic social relations, while the aspects that will be addressed under this topic leave them aside, focusing only on economic relations.

The term self-centered was chosen for two reasons: first, because in order to be sustained and efficient, growth requires continuous and significant increase of the domestic market. Second, because such growth also requires significant and growing national ownership over the assets of the peripheral country concerned.

The topics covered are:

1. Occupation.
2. Insertion (mixed strategy).
3. Macroeconomic direction.
4. Cooperation and asymmetries.
5. Overall considerations.

1 OCCUPATION OF THE WORKFORCE

In the occupation of the workforce, a distinction is made between employment and underemployment. For the sake of simplicity, open unemployment is left aside. Structural underemployment and/or informality means the absorption of labor with extremely low productivity levels.

It is different from employment because significantly higher levels of productivity prevail in employment. There is a first subgroup, consisting of occupation in activities where productivity is defined as high. Their levels may be the maximum that is feasible, the maximum allowed by available technologies, or levels close to them. The second subgroup includes the labor force working at intermediate levels of productivity, which, though far from high productivity activities, are far higher than those of underemployment. In short, for the ease of analysis, a distinction is made between three technical layers: high productivity, intermediate productivity and structural underemployment.

Both along time and at specific moments in time, it is clear that there is a misallocation, since many activities are carried out with less than their potential productivity. But, the issue of inadequate productivity levels involves a dynamic aspect of key importance. The new theories of technical progress point to a tendency towards technological disparities.

In order to eliminate the misallocation, and to reach increased productivity in a greater number of activities, and also to counteract technological disparity, it is necessary to design and implement policies in various technological and productive activities, or in different sets of selected activities, and - as already suggested – in such a way as to ensure that the greater number of occupations will actually generate increased productivity.

These policies will be more successful if they include the establishment or improvement of a National Innovation System (SNI) that can help diagnose existing possibilities for creating and/or mainstreaming technology, and help map out the way forward.

We return to the previous tripartite classification, to elaborate on the technical-productive policies mentioned above.

Underemployment. There will be no leaps in reabsorption, which will take place by the use of previously underemployed labor in intermediate productivity activities. A useful formula for reabsorption is what has been termed "transformation of backwardness", largely based on creation of micro-enterprises, as done in several municipalities in the State of São Paulo (Brazil).

Intermediate productivity. With these types of policies, one expects a productivity rise. Not only through the gradual absorption of underemployment, but because productivity may be increased in many spheres, thus, raising average

productivity, but without reaching high and/or maximum productivity levels. While such levels are not reached in this group, there will not be competitive activities, either internally or in exports. Competition in the domestic market - except in cases entailing very high transport costs - will require certain levels of protection, whether through tariffs, subsidies or credit advantages.

High productivity. In this third group, the maximum productivity activities feasible are by definition competitive, both internally and externally. High productivity - but not maximum productivity - may also be so, both in the case of high transportation costs, and also due to wage differences. But here too, there will be cases when external and/or internal competitiveness will require either promotional or protection measures. Moreover, the achievement of competitiveness via stimuli does not exclude maximum productivity goods. This is so because productivity rises are more vigorous in centers, and it will be necessary to look after productivity levels even in cases of maximum productivity, because such level may drop. For that reason, we must encourage technological progress in them, to avoid lagging.

Viability and efficiency. The increase in labor productivity in the activities that make up the three abovementioned areas goes hand in hand with the introduction of new techniques (i.e., *ex-definitio*, it is accompanied and prompted by such introduction). But the increase in the number of jobs obtained this way, in itself, generates increases in the domestic market. If we look closely, such increases may be perceived as a component of the conditions of feasibility of the proposed strategy: the strategy itself opens up space for the increases in the market necessary for greater production.

On the other hand, the increases in labor productivity that define the strategy, shaping its essential profile, can be seen as related to the fulfillment of conditions of efficiency. Efficiency in a dynamic sense: they imply increased economic surplus, and, as a result, increased savings and capital accumulation.

2 INSERTION (MIXED STRATEGY)

In the publication mentioned above, the issue of international integration is addressed, admitting a trend towards trade deficits in peripheral economies. Now we proceed to summarize the arguments contained in that publication, accepting the same assumption, that is, accepting said trend is actually in place.

The previous section addressed a strategy that includes the development of various production activities and technologies to be adopted in each one of them, but orienting both production and techniques towards occupational problems. More explicitly, the proposal is to achieve occupation of the labor force at increasing levels of productivity. This entails two things: reaching the maximum production level that is technically feasible in the greater possible number of

activities, with gradual elimination of structural underemployment. But this strategy has another side that is addressed in this section. Both what is produced, and the techniques used in production, should also constitute a mixed strategy (the expression was coined by J.A. Ocampo). That is, a strategy that combines encouragement to exports with sustained increase of production for the domestic market.

The new theories of technical progress recognize the existence of a technological gap between centers and periphery. In turn, this technological gap – which is indeed quite visible – involves a trend towards trade deficit in the periphery. Why? Because this technological gap results in difficulty to expand various export activities involving technically advanced products, which the periphery lacks the means to produce. In addition, there is the need for importation as well.

The technology disparity and the trend towards trade deficit that is intrinsic to it, are the structural and underlying reason why the convenience of following an export-led growth model is denied from a neoliberal perspective. The need for a strong export effort is advocated, but it should be accompanied by a parallel effort to increase production for the domestic market.

In some more detail, the mixed strategy can be conceived as follows:

- There are sets of activities whose production is intended largely to foreign markets, many of which are competitive at the starting point of strategic design; there are others, which are also exporters, in which it is necessary to gradually gain competitiveness, based on temporary promotion measures.
- There are other activities whose production is intended for the domestic market, some of which are competitive virtually from the start, and other activities should be encouraged to generate competitiveness over time, by resorting to temporary protective measures also.
- Promotion and protection can be put in place in various ways, such as through subsidies, tariffs, tax exemptions or particularly favorable credit conditions.

The word temporary, used as an adjective for the proposals of protection and promotion, should be emphasized. Some time ago, a newspaper published a photo of Prebisch, with a caption saying: "The man who closed the continent, materially and mentally". The fact is that Prebisch proposed measures for temporary and decreasing protection and promotion, on the grounds that technological progress would not have continued if it were not imposed on peripheral production, spurred by international competition.

Today, this argument is even more valuable, given the speed of technological progress - we are experiencing a technological revolution - which determines its absorption in the periphery. To achieve it, the spur of competition cannot be left out. Hence, in the proposed mixed strategy one accepts the need for protection and promotion to foster exports and substitution. However, they should be minimum and decreasing, or minimal and transient. Also, the need to open opening the central markets should be taken into account.

The mixed strategy, which involves expanding exports and "substituting imports" can be viewed or addressed as a technical-productive policy aimed at preventing the trend towards trade imbalance. Or rather, it should be designed, and redesigned from time to time, to achieve such goal. That is why - because of the essential aspiration to avoid imbalance and ensure continuity of growth - the mixed strategy is a viability condition for peripheral growth and/or development.

Moreover, as long as the technological gap is bridged through the policies that constitute the mixed strategy, i.e., international competitiveness is achieved in a greater number of activities, either in exports or in activities aimed at the domestic market, as a result, the conditions of efficiency for production in peripheral structures will be reached and expanded.

We saw above (1.7) that occupational policies are proposed - and in practice, designed – to fulfill conditions of viability and efficiency. The previous topic explains that policies pertaining to external insertion that can be characterized as "mixed strategy" gather the conditions of feasibility and efficiency that belong to the latter.

In other words, overall, the proposed strategy essentially consists of pursuing productive sectoral policies covering occupational goals and objectives related to intersectoral compatibility of production, with a particular focus on compatibility between exports and imports. From both perspectives, the strategy was designed to fulfill the conditions of viability and efficiency.

3 MACROECONOMIC DIRECTION

It should be noted that the success of the strategies cited in the above sections require – and assume – appropriate implementation of macroeconomic policies usually considered short term: monetary, exchange rate and tax policies.

Ultimately, appropriateness means maintaining balance and avoiding imbalances in these areas, so that long-term growth - sustained transformation of high margins of savings into real investment – is not undermined.

Indeed, relatively recent papers related to ECLAC, by R. Ffrench-Davis and J. A. Ocampo, showed that a prerequisite for macro balances is the sustained growth of the economy. That is, they demonstrated that such balances are not obtained by mere facilitation (not interference) of operations in corresponding markets, but that, in order to maintain balances such as those in Latin America, it is necessary to maintain relatively stable growth.

But, beyond the substantive alteration of the usual neoliberal arguments, they propose another argument, of major significance: macro balances require adequate banking and/or financial systems, which Latin American economies definitely do not have.

An initial weakness noted by Ocampo is the structure of these markets, which have few areas aimed at long-term operations. A second weakness comprises the limitations of the secondary and/or derivatives markets.

Considering both weaknesses, one may conclude that peripheral financial markets are small, and that makes them vulnerable to the external speculative pressures they have been facing.

It may be admitted that this latter weakness, synthesizing the previous two, has no choice or cure but to reach the regulation of international financial markets, or the movements of financial capital that have been put into practice, and that have proliferated with the full liberalization of those markets.

Why is this? It is believed that structuralism gives rise to the need to regulate these markets in general, and very careful specific controls should be adopted for underdeveloped economies. This is because the trend towards imbalance on the real side of the balance of payments – trade balance – is not compatible with (does not support) any degree of foreign property in these economies. This has two characteristics: firstly, it is real property of assets, i.e., FDI. On the other hand, it is ideal property: external debt levels that represent an "ideal" share of the total value of peripheral assets. The resulting payments of both types of properties will deepen the latent crises of current account balance, which are based on the trend towards trade imbalance.

It is not known for sure what decisions will be taken. But there was clear rejection to regulation in the case of the Asian crisis. Thus, moving forward with this regulation requires thinking about it in geopolitical terms. For instance, a common position in Latin America, with additional support in developing as well as developed countries. We will return to this issue when addressing the current financial and macro crises.

4 COOPERATION AND ASYMMETRIES

4.1 Cooperation

In the first two items (1 and 2) it is suggested that, in peripheral conditions, a driving development strategy involves two key efforts. An effort to reabsorb underemployment and to increase labor productivity in multiple activities. And at the same time, an effort to increase production in different sectors.

These efforts require higher overall investment. The reason is that they both involve major structural changes - in employment and production - of such magnitude and complexity that they become difficult to achieve without the support of international cooperation. Such support should be twofold: support to real investment, complementing internal needs of high savings, and emerging foreign exchange shortages, complementing their volume in different periods, so as to enable the imports required for planned growth of GDP.

This is an argument already pointed out by Prebisch in his basic documents, which suggested linking resources to foreign savings over time, through organized trade and financial relationships – resorting to deficits, but providing for their payments – which would enable intense GDP growth based on industrial expansion. In other words, resulting in change in the pattern of development, which becomes based on such expansion.

Currently, an additional reason reinforces the need for cooperation in investment, coupled with an ongoing technological revolution; it started and is faster in large centers.

The result is the continuation or emergence of strong technology gaps that need to be mitigated and prevented in various sectors. To that effect, it is necessary to resort to savings and foreign investment, associating them with technology adaptation and/or creation. One may also consider that the support to SNI, potentially relevant for the purposes of technology adaptation and/or creation, pursues the same objectives.

In addition to technology gaps – taking into account that they may emerge repeatedly - strong barriers of structural underemployment are present. It should be noted that it may be necessary to overcome or at least mitigate them, in order to intensify the domestic market to an extent compatible with its growth, which required by sectors that become increasingly technology intensive.

Financial support - the partial backup of the planned investment in foreign savings – is a first aspect of cooperation. The second usually refers to "special and differential treatment."

On the one hand, the latter is related to exports promotion, which may take the form of direct subsidies, tax exemptions or privileged credit. It is also related to promotion of import substitution, that is, production for the domestic market by means of protection, whether through tariffs or other means identified above.

Special and differential treatment promotes learning and innovation through the implementation of activities that otherwise could not be undertaken. However, as outlined since Prebisch, temporary promotion measures are proposed, since it is considered essential that at some point the spur of competition should take over (as clearly shown, for example, in the case of Korea).

Alongside and simultaneously with cooperation for the promotion of peripheral exports, or more precisely, in their acceptance by international organizations and by the centers themselves, the latter may adopt another form of cooperation: opening their economies.

The expected effect is the same as that of promotion, since export activities potentially conducts to learning and innovation would be undertaken.

The opening of the centers may bring about significant benefits, while enriching productive chains and promoting internal development of certain branches.

An example: exporting certain machine parts that require large markets can be the key to channel domestic manufacture and encourage the development of related activities. This example suggests the possibility that learning and innovation involved in the opening of centers would lead to production of new and better machines in the periphery.

So far, it has been claimed that the promotion of peripheral exports and/or greater opening of the centers create the possibility of producing and selling more goods for exportation, which goes hand in hand with more learning and innovation, and thus with the increase and acceleration of peripheral technical progress.

Therefore, exportation from peripheries grow, allowing an increase of the imports required to maintain high domestic growth. But these imports are, of course, exports from the centers, which will, in turn, lead to more learning and innovations, and thus to more opportunities for technical progress.

If one considers it carefully, the proposed strategy assumes that peripheries regulate the intensity of their international relations, while the center admits greater opening at a faster pace.

However, one may understand that these asymmetric behaviors - beneficially asymmetric - result in advantages and further technical progress for both sides of the system.

The two sides belong to a single system. So when vitality is increased in the peripheral side, the central side also benefits. Therefore, there will be further technical progress across the system, and with it, more capital accumulation and higher growth.

Prebisch generated the idea of joint industrialization. In the periphery, industrialization would entail importing less of certain goods but more of others, with benefits to both peripheries and centers.

However, it is possible to change Prebisch's expression into a similar one: joint technical progress. With appropriate conditions for it to flourish in the periphery, the periphery will intensify exports and imports, and thriving imports will result in increased rates of technical progress in centers that would not occur otherwise.

Seen from another angle, the term joint technical progress refers to unlocking peripheral development, through continuous productivity gains associated with the incorporation of technical progress, taking advantage of the ongoing technological revolution. The term also refers to the fact that this is accompanied by increased exports from the centers to the periphery, which may mean - it is expected to mean - further technical progress and development in centers.

4.2 Asymmetries

As mentioned previously, the "special and differential treatment" of the periphery, together with measures to open the centers, is aimed at exploring the opportunities provided by technological progress, promoting the development of both. However, the policies being implemented are not pointing in that direction.

Indeed, international economic policies are outlined on the basis of very asymmetric economic and political powers, strongly oriented towards the interests of larger centers.

A first aspect of this asymmetry is particularly visible in the centers' defense of agriculture through the two-pronged strategy of tariff protection and high subsidies. This has constituted an extremely strong barrier to peripheral exportation of various items.

Another aspect related to the use of greater power was the establishment of a scheme for protection of steel, which was actually enforced. However, it proved to be so negative and so unjustified that it was suspended before long.

Another area where asymmetric power is manifested is intellectual property, which covers, among other aspects, copyright, trademarks, patents and plant certification.

The World Organization for Intellectual Property (WOIP) was founded in Paris in 1967. It was committed to promoting and looking after the interests

of developing countries. In their legal framework, countries could establish the duration of patents - not 20 years for all cases, as it is currently -, establish exceptions and limit patents to those registered internally.

Since 1979, US diplomacy endeavored to replace the WOIP with a body subscribing to the GATT. It managed to do so in 1994, when the organization was turned into the WTO. The Council for Trade-Related Aspects of Intellectual Property Rights (TRIPS Council) was created.

The new framework established compulsory patenting of inventions, but with a universal value. The vast majority occur in the center.

However, there is a clause that somehow seeks to create safeguards for developing countries. It recognizes the special need for the least developed members to apply laws and regulations with the flexibility required to create a sound and feasible technological base.

It is a very general clause, with little application, but it potentially admits public support to SNI. There is strong ownership of technology or of the profits it produces. Sometimes exceptions are opened, not without much struggle, as in the case of anti HIV/AIDS drugs.

The same broader framework of liberalization in place at the time of the Morocco treaty (1994), when the WTO was established, tends to broaden the degree of freedom enjoyed by foreign direct investment. The number of facilities increases, not only in terms of dividends, but also in terms of major legal facilities: in some cases the laws and courts are those of head office. But an essential point is that R&D and S&T efforts tend to be focused on the companies and/or countries of origin, in detriment of technical progress in the peripheral countries where profits are obtained.

A final aspect – the most important - of power asymmetries and the problems they bring about relates to globalization and financial liberalization, i.e., the uncontrolled flow of financial resources between countries.

Early on, some theorists assumed that a panacea had been found, since full market freedom would be as optimizing as it is generally assumed in the economy for commodity markets. they also assumed that the increase in funds for investment would support development in general, particularly in the poorest countries with the least capital (a position strongly denied by George Soros).

Financial liberalization and globalization did not bring about these promising outcomes as expected, rather, they gave rise to successive crises.

In recent years, two features stand out in such crises.

The first is their frequency, otherwise recognized by Nouriel Roubini, whose information is presented below.[2]

In the decade from 1994-2003, a significant number of crises occurred in so-called emerging countries. They were:

1994 - Mexico

1997/8 - Thailand, Indonesia, Malaysia and Korea.

1998 - Russia.

1999 - Brazil, Ecuador, Pakistan and Ukraine.

2001 - Turkey and Argentina.

2002 - Dominican Republic and Uruguay.

It amounts to 14 crisis in 10 years. But there is also a high frequency of crises prior to them that took place in developed countries, namely:

i) The US stock market crash in 1987.

ii) The US real estate bubble that led to a credit crash in 1990/91.

iii) Again in the US, there was a crisis in the management of long-term capital that became visible in 1988.

iv) The technology bubble of the '90s – bonds with values linked to the future development of ICT's – burst in 2000/01.

v) There was a bubble in real estate and securities in Japan in the 80's, which collapsed in the 90's and led the country to stagnation throughout that decade.

vi) The banking crisis in Scandinavia, in the early nineties.

vii) The collapse of the European Monetary System (92/93).

viii) The real estate crisis in Germany in the early nineties, with its reunification.

Thus, starting in the eighties, the early nineties witnessed 8 crises in 4 developed countries: USA, Japan, Germany and Scandinavia (the latter counting as one country). As mentioned above, in emerging countries, crises occurred in more countries and at a later stage.

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2. Nouriel Roubini: Chapter 1.3. Financial Crises, Financial Stability, and Reform: Supervision and Regulation of Financial Systems in a World of Financial Globalization. The Financial Development. Report 2008.

The latest crisis should also be mentioned: the mortgage and credit crisis that began to take shape in 2000 and burst in 2007/2008, leading to the current global financial crisis.

The second element to consider is the link between these crises and their frequency with the ongoing Technological Revolution and its effects on the implementation and management of financial assets and systems.

Sometimes, one tends to think of the Technological Revolution as the cause of these crises. However, those who have closely followed the issue argue that their key cause lies, in fact, in the interest and power of large banks and financial institutions, and their influence over the governments concerned. As they were the ones - in fact, it was the international liberalizing of operations - to establish the practices that led to the crises throughout the world.

That power became consolidated and visible in the Asian crisis. At that time, within the G7, a proposal was put forth to regulate international capital movements and/or the system they compose. The proposal was rejected due to opposition from the United States and Britain, precisely the countries where the major and largest banks are located.

But even accepting the basic premise mentioned previously, the notion remains that new techniques, while not the "ultimate cause", constitute a mechanism that allows the components and operations of financial systems to lead to particularly strong speculative tendencies, as they expand and become more complex.

5 OVERVIEW

The above considerations allow one to realize to what extent – to what extreme degree - the proposed strategy is an abstract model. A model whose key points are the occupation of the work force at increased productivity levels, and a pattern of international integration that includes simultaneous expansion of exports and increased production in the domestic market. Such goals involve mapping occupation and production per sector, both export-oriented sectors and those intended to the domestic market.

Also, this sectoral mapping is proposed under the assumption that the centers grow continuously, making it easier to change their relations with a periphery that also grows. It was also demonstrated that under both counts, the strategy meets the requirements of viability and efficiency.

What to do - how to rethink the issue - when the conditions of growth are no longer met?

What happens is that one has to redefine the sectors that lead to meeting these conditions, considering the changes in the real world.

What are the predictable changes? The generation of open unemployment - or rather, its increase - which is left out of the strategy under analysis.

It is clear that the hope of gradually eliminating underemployment will not suffice, rather, the strategy to be designed should explicitly address unemployment.

A second visible change is the global financial crisis. Even from the peripheral perspective, this is another key issue to consider, which entails striving for the regulation of international financial relations. No one knows what major centers will propose, or even impose, in this matter. Sarkozy has proposed including BRICs in the discussion. But it seems clear that peripheral countries will have to raise their own issues, which may point to regulations that take into account their specific status, or the possibility of accessing specific and favorable forms of financing in general, or regulation of exports and imports.

It is clear that any success achieved in this area cannot be thought of in terms of the positions and efforts of individual countries. Geopolitics is needed, which Latin American countries have favorable conditions to implement. On the other hand, Brazil seems to be in position to carry out such task, since it belongs to the BRICs.

The third issue to consider is the US mortgage crisis, which has resulted in a complex and severe financial crisis and a production crisis that is becoming more and more visible.

On this matter there are opposing views. At one end, some think there is likely to be major and generalized depression, as in the thirties. At the other end, some say that there will be recession, but relatively mild and brief, and limited to large centers.

There are also those with a feasible hypothesis who think that this lower intensity and duration will occur in the European Union, while in the United States it will be more serious. And they also argue that emerging economies - China, India, Southeast Asia and Latin America - will drop their growth rates, but to some extent will manage to detach themselves from the central or main economies, avoiding worse evils.

If that is the case, one might think that Latin America has an opportunity to implement sector policies conducive to technical progress, deepening and broadening regional integration.

This is perhaps the easiest area in which to achieve progress. It is possible that the strong need to seek solutions for the export/import sector dynamics may help to test them at the Latin American level, or close to it.

The other levels of pursuit of solutions may reside in the deepening of Mercosur relations, or better yet, of Latin America with the European Union, which have been moving forward slowly.

The third area to consider is that of the opportunities offered by rich and emerging Asian countries. Connections with these new partners do not mean ignoring certain key points: continued production for the domestic market; and selection of exports to them and imports from them, which, coupled with production, take into account the pursuit of a sector composition capable of driving technical progress as much as possible. That is, it is not only about exporting, but having goals other than just the availability of foreign currency, hindered by the "closing" of centers and low prices. It is about proposing such availability, but considering also the crucial objective of technical progress across sectors.

It is clear that a program along these lines is not easy. And it is even less so because it must not disregard the future, it must not fail to take into account that at some point the crisis of the great centers tends to fade, and this will allow reconsidering relations with them towards a sectoral production regime and exchange of technical progress that will be gradually achieved, opening the door to improvement, or expansion, or acceleration of progress.

In short, the abstract model, the proposed strategy, still has the same goals set before the crisis, which are related to overcoming the peripheral condition: reabsorbing underemployment and unemployment, producing for exportation and for the domestic market, and mapping sectoral production that is decidedly favorable to technical progress. The abstract scheme is the same, but now one needs to consider the progress of relations with the new rich, and to consider the gradual resumption of enriching relationships with major centers, currently in crisis.

The above point is the climax of an uninspired *finale,* because it does not say where measures should be taken, nor with whom, or at what moment in time, but that all this should be planned not only to balance accounts, but prioritizing the vitality of technical progress, which is what will truly allow Latin American countries to leave the "peripheral condition" in the long run.

But one can build an optimistic scenario, recognizing the relative precariousness of optimism at this point. According to Mentas, every crisis is accompanied by opportunities, and this dialectic of opposites could be favorable in the case of Latin America. This is because one can glimpse in this area special

opportunities in the field of non-material culture, identified as "socio-political", and also in the other "higher" area of it, linked to positions regarding ethical values. Brief references to these two issues are made below.

B) Socio-political relations and the role of the State

The battles around income distribution are a clear indication that the relations to be taken into account in a development strategy are both economic and socio-political. But there is more: to be viable and efficient, such strategies have to contemplate deep structural changes: changes in the structure of employment that ensure persistent increase in labor productivity at its various technical levels, and changes in the underlying production structure, consistent with patterns of international reintegration, with a view to preventing external risk at the periphery, and promoting global trade as a whole.

By its very "structural" nature (due to the extreme complexity involved), these changes are unattainable only through the operation of market mechanisms. In connection with this, it must be recognized that the analysis of economic phenomena, even when you start abstracting other social and political phenomena, in the long run must be inserted into a framework that takes their interactions and mutual constraints into account.

A path towards this perspective involves addressing the role of the State, which is particularly important. This approach relates directly to the role the State must play in conducting economic policy and, more generally, in the design and achievement of both economic and social objectives. This key role of the State is closely linked to two others: one is that of socio-political relations that provide a supporting base and the second, that of the geopolitical relations in which it is situated.[3]

Together with the globalization process, there has been renewed and intensified presence of foreign capital and interests within Latin American countries, and this presence is verified in more branches and sectors, including the financial sector, also with much higher levels of concentration. Given its nature and magnitude, the aforementioned presence is accompanied by a reframing of socio-political relations, which includes not only those that are formed between internal groups and classes, but also their relations with foreign groups and interests. There are changes, for example, in the relative weight and patterns of connection between productive and/or financial interests tied to large transnationalized capitals, and those with essentially local roots.

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3. This dual perspective evokes the most frequent concept leading to dependency, which is defined as external-internal structural relationship. According to this concept, "the action of social groups, which in their behavior actually connect the economic and political spheres... (refers both to the nation and) ... their links of all kinds with the global economic and political system. Dependency is thus expressed not only internally, but also its true character as a particular mode of structural relationships: a specific type of relationship between classes and groups, which entails a situation of domination that involves structural links with the outside." Cardoso, F. H. and Faletto, E. "*Dependência e desenvolvimento na América Latina*", Mexico: Siglo XXI, 1969, p. 29.

In other words, when a certain basic external structural relationship (mentioned in the footnote on page 23) is altered, it disrupts the foundations of the existing political hegemony. But this change in the political power framework is inseparable from the geopolitical relations in which it is inserted, through which changes in global economic regulations are driven and implemented with the mediation and support from major international agencies.

Peripheral countries are thus submerged in attenuated and flexible patterns of control of foreign direct investment and the movement of financial capital. The resulting increase of external vulnerability – observed through the real or potential deficiencies of foreign exchange reserves - brings about a reduction in the States' room for maneuver, which restricts them at different levels of short-term macroeconomic policies.

In short, together with the recent process of globalization, socio-political relations undergo significant change, increasing the complexity of the paths that lead to future transformation of such relations. Seen from the perspective of the peripheral countries, the accompanying changes in geopolitical relations are clearly unfavorable, expressing a new correlation of forces involving greater difficulties in agreeing on a strategy for international negotiation. These two changes are associated with a third: in contrast to the recognized need for decisive action, the State's role is reformulated on the basis of positions that, to a greater or lesser extent, are close to minimalist, and that hinder economic management and development and the reduction of severe social inequality.[4]

The above is a paragraph on negative aspects. Conversely, one should outline some considerations on the paths to be taken, which will certainly be marked by serious difficulties. In current times, the reformulation of development strategies must begin by the explicit proposal of political and geopolitical equations. That is, the search for broad and inclusive internal agreements, and in connection therewith, through consensus among peripheral countries to mitigate their weaknesses and promote the defense of their positions in international negotiations. These agreements and consensus provide a framework for redefinition of the role of the State, which, however, should not be unconnected to the advantage of the relative autonomy of the State itself. The latter is also relevant to outline the new legal and institutional frameworks required by its actions, which in turn are related to the consolidation of democracy and the deepening of its contents.

4. Other visions that define the role of the State in order to promote "market-oriented" development strategies include the World Bank document entitled "The State in a Changing World, 1997. In "The State as a problem and a solution" (1996), P. Evans reviews recent approaches on their role in development.

C) Cultural identity and development

The above observations allow highlighting certain aspects of a development agenda that are particularly relevant when addressed from the angle of the strategies required for implementation. A first prominent aspect implicit in these considerations is the design of technological, productive and institutional policies that form the economic basis of such strategies. Such policies must recognize and take into account the centrality of labor problems, whose gradual resolution opens opportunities to access more equitable income distribution options. Those policies should also consider the patterns of reinsertion of peripheral economies, as well as appropriate international cooperation to support and drive them. Also, in the economic field, the prevailing financial asymmetries between center and periphery should be noted, so that they are considered in the design of a consistent macroeconomic policy compatible with the development of the periphery. Finally, it was noted that good progress of this complex economic base does not exclude, but assumes, the definition of socio-political requirements of internal agreements (among them, those pertaining to the distribution) and requirements for international reinsertion, and in connection therewith, the requirements of the role to be played by the State.

The brief summary above facilitates the perception that development presupposes a socio-political drive to guide and encourage the changes required in the financial area, and to induce and consolidate the necessary changes in the socio-political field itself. The present section proposes that the intent of this drive has to be extended also to a third area, consisting of those elements of non-material culture other than those which constitute the second of the areas mentioned.[5]

Broadly speaking, the core of development is the strengthening of cultural identity, and therefore it requires unleashing creativity in the three fields mentioned. However, it is also understood that stimulating creativity, or if you will, releasing energies capable of strengthening it, has great significance in the third area. This is where ideas and values, including ethical values, are rooted. They are critical to strengthen the profiles of identity, and to boost the creativity capable of supporting it and providing renewed wealth.

With regard to cultural identity, it is worth examining other basic perceptions of Furtado, trying to reduce to the simplest form his vision of the phenomenon of underdevelopment, in the light of the characteristics with which it is expressed in the Latin American periphery.

5. Here, Celso Furtado's categorization, considered previously, is adopted. As shown, it distinguishes between material culture and non-material culture. The former is related to technology and economic affairs. The latter distinguishes the socio-political sphere and the ideas that are peculiar to it, and also an additional set of elements that includes the "higher" or more significant ideas and values, while the very meaning of human existence is linked to them.

Since the late nineteenth century, Latin America has been a privileged locus for the penetration of capitalism. This penetration is not limited to the physical aspects of technical progress and accumulation, but extends to the purposes of development, i.e., ideas and values that shape certain key profiles of non-material culture.

Thus, these more general perceptions imply that the development of the Latin American periphery can and should be seen as repeated instances of cultural penetration. The new foreign elements that this penetration gradually incorporates, and the mix produced in each instance with pre-existing elements (both native and previously acquired foreign elements) hold back the emergence and expansion of a distinct cultural identity. In other words, it is not possible to generate the "systemic connections" required to unlock development (in the broadest sense of the term, i.e., global cultural development) and to open the path to correct social heterogeneity.

The above considerations take us back to the issue of underemployment. The previous items focused on a purely quantitative aspect of underemployment, pertaining to the levels of labor productivity. When addressing the issue from a broader perspective, a recent document has thrown new light on this theme.[6] It argues that the activities included in underemployment are indeed a means of survival by obtaining and generating work and remuneration opportunities, and often renewing these opportunities, as the ones achieved previously run out. But, it also claims that in putting into practice and in the regular renewal of these survival strategies that constitute underemployment, large doses of creativity are expressed. Thus, the paper highlights and emphasizes that creativity is the basis of the achievement of material means of subsistence.[7]

However, it is not possible to disconnect the exercise of creativity from what is produced in other spheres of social activity. In this regard, it should be borne in mind that labor activities that involve underemployment are not carried out in a limbo of purely economic relationships. Like other labor activities, they occur in

6. These are the lecture notes of Carlos Lessa on "Formação do Brasil", delivered at the Institute of Economics, Federal University of Rio de Janeiro. The first versions are dated 1998 and 1999.

7. Note that the reabsorption of underemployment is favored by such creativity, but it does not depend only on it. It also depends on the implementation of policies aimed at raising the productivity among groups of workers, which involves various actors close to these groups: civil society organizations, public agencies with different degrees of decentralization, and so on. In the case of policies aimed at improved productivity of specific groups of workers, they can be called "policies of transformation of backwardness." They are indeed included and represent an essential part of structural adjustment policies, and for that reason, they differ from pure assistance policies, often tied to the vision of poverty as a syndrome and designed to prevent intergenerational transmission. Obviously, this does not imply denying the usefulness of welfare policies. It should be clarified that basic social policies - education, health, housing - may converge towards goals and policies aimed at transformation of backwardness, in turn, linked to changes in production. Note that there are already hands-on examples of wide and simultaneous implementation of these three types of policies (assistance, basic social and transformation of backwardness policies). Among them, attention is drawn to the policies implemented in the Brazilian case. The paper by V. Faria et al. (2000), entitled "*Preparando o Brasil para o século XXI*", explains and summarizes them.

a context of complex social relations. But in the case of underemployment, such relations have special characteristics: those based on wages are comparatively rare; in contrast, those that occur by means of belonging to a wide range of formally or informally structured institutions are comparatively broader: relations within the family, the neighborhood, community or neighborhood associations, sports and recreational organizations, churches and cults.

It should be noted that such belonging is in itself a manifestation of popular culture. Rather, it is within it and through it that various elements of that specific field of culture are expressed and enriched. As indicated above, underemployment consists of the implementation of survival strategies supported by creativity. But the creativity that is reflected in these strategies is part of the same creativity exercised simultaneously and inseparably in different areas of non-material culture. It can be understood, then, that this exercise bears the main sources of a flourishing popular culture that is becoming more visible in Latin America, and often surprising in its breadth and dynamism.[8]

Is it not possible, therefore, to think that the foundations of a cultural flourishing may have been accumulating? Is it not possible to imagine that this possibility, still unleashed, is expressed as a symptom and symbol in the renewed enrichment of popular culture? On the other hand, why should the enrichment of popular culture be seen as an expression of an emerging change, in times of massive foreign penetration in the various fields of non-material culture? The complexity of the issue does not allow a merely intuitive answer, certainly tentative and preliminary. It could be argued that popular culture preserves and recycles the deep roots of successive cultures, whose successive developments end up limited or interrupted. One might also think that these obstacles emerged in an environment where, nevertheless, the complexity and enrichment of different areas and aspects of culture as a whole have been present.

The long history of frustrated cultural developments in Latin America entails a specificity that needs to be expressed and emphasized: it was produced in parallel and in close connection with a strong process of miscegenation.[9]

This process is inseparable from the process of popular culture. Hence, this process - or better, the renewed wealth of popular cultures in different areas of the region - may be associated with the reemergence of cultural traits whose depth is related precisely with indigenous and Afro-American roots, and also their interaction with successive cultural penetrations from Europe, particularly of Iberian origin.

8. It is clear that the sources of this flourishing may be related not only to underemployment in the strict sense, but to a much broader range of "technical strata" with relatively low levels of productivity.

9. In this respect, these statements are relevant: "We were factory societies in which men were used to produce sugar, gold and coffee. Against the designs of the colonizer, unexpectedly, the system to produce goods, and through them, exportable wealth and profits, ended up producing a population of mixed-race people born on the plantations and mines, which one day began to organize themselves into nations seeking to define their own cultures" (Ribeiro, D., 1979:36).

In the origins of this double mix of cultures and races, there are strong acts of violence, based on which a sharp social differentiation is produced, either through slavery, or by regimes that, with some regional variations, evoke certain characteristics of "serfdom relations".

Over time, the original marked social differentiation underwent repeated changes in profile, thereby establishing the above-mentioned Latin American specificity: the ability to open a path and renew a mix of cultures definitely associated with a mix of races.

Presently, the degrees of breadth and complexity achieved by both mixes suggest that such specificity may well bear ethical meanings and contents of key importance. Their most direct expression seems to be the increasing acceptance of racial equality as a value (and its opposite, racial discrimination, as an anti-value). On the other hand, that acceptance is based on the equality of human beings in their capacity as such,[10] a notion that belongs to both the old and new ethical frameworks, as well as to higher religions and the way they have spread throughout the region for centuries.

As a reflection, the dissemination of such egalitarian position can be regarded as the resurgence of the ethical principle summarized by the phrase "love thy neighbor" and the like, the basic framework of moral conduct in human relations, complemented by the principle of "non-violence".

These lines argue that reaffirming key ethical principles, such as those mentioned, can become the primary force to unlock creativity, or even to induce a burst of creativity in the different fields of culture, enabling continued drive towards the development of a unique cultural identity.[11]

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10. In recent documents of international organizations (eg, ECLAC, 2000) it is highlighted that civil rights, political rights and the so-called ESCR - economic, social and cultural rights, are components of an ethical content related to equality, which is recognized as essential in any development process. This recognition, while undoubtedly positive, leaves open the question of which set of core values can sustain behaviors capable of inducing the strengthening of cultural identity. The brief consideration of this item is intended to highlight the crucial role, in this strengthening, of the emergence and dissemination of values related to the mixing of races, which begins to be seen and appreciated as an expression - not as a denial - of the essential equality that is provided by the human condition itself.

11. While referring to Latin America and their potential importance for its development, the principles just mentioned are compatible with those that have been established in the pursuit of global ethics. This pursuit has a particularly noteworthy sphere in the "Parliament of World Religions", whose last three meetings were held in 1993 (Chicago), 1999 (South Africa) and 2004 (Barcelona). The "Declaration of global ethics" issued in the first meeting, can be found in the book edited by Hans Küng (2002, pp. 25/44) with support from the "UNESCO Association for Interreligious Dialogue". It should be noted that this book contains articles by several authors, drawing on the perspectives of Judaism, Christianity, Islam and Eastern religions, and indicative of the possibility of accessing common ethical principles. Several works by Latin American authors also address this theme, including "Ethics of liberation in the age of globalization and exclusion" by Enrique Dussel (1998), and "Planetary ethics from the great South" by Leonardo Boff (2001). The concern over defining and disseminating common ethics is at the base of another two, in the scope of the United Nations. One is expressed in the frequent call to fight poverty with urgency and determination. The second concerns the search for an "Alliance of Civilizations", transformed into an explicit proposal at the 59th Session of the General Assembly, in sharp contrast to "The Clash of Civilizations", which S. Huntington (199) refers to in his book by the same title.

Therefore, the wealth fueled by the mixes in popular culture may well be perceived as an expression and symbol of "a long dawn":[12] like the first light that makes it discernible.

D) National development

As we know, globalization entails the implementation of the neoliberal ideology, which calls for trade liberalization, the action of transnational corporations and international financial transactions. Alongside, neoliberal principles induce the privatization of public enterprises and reduction of government intervention, deregulating market operations.

Since the eighties, there has been increased prevalence of these ideas in the implementation of economic policies in the region, albeit differentiated and with time lags. It seems that the crisis arising from this generic type of policy has been inspiring new visions of development processes, and with it, new strategic positions that drive "national projects" in the field of development.

As to their fundamental contents, and by way of summary of all the above considerations, three aspects should be distinguished. The first, which concerns the economic sphere (discussed in item A), is expressed in the necessarily self-centered strategies to be designed and implemented. The second, which is part of the socio-political context (addressed in item B), is increasingly recognized as crucial to build a "new partnership", conceived as the essential force required to initiate and continue such strategies. The third aims at achieving a "reaffirmation of ethics", i.e., the strengthening of certain ideas and values that belong to non-material culture (mentioned in item C), which in turn, are the seeds of creative skills and attitudes, key inducers of the reemergence of a cultural identity.

1. The "self-centered character" that has to be part of the development of peripheral economies (and/or strategies to achieve it) relates to what may be considered as the very heart of the "national issue", namely, ownership of the assets located in those economies. This sharply contrasts with neo-liberal approaches. The recurrent external risk, caused by the technology gap between center and periphery that affects trade relations and also the negative effects of financial liberalization on the balance of payments, hinders the unrestricted increase of foreign ownership of assets (either directly or indirectly through external borrowing). In contrast, the feasibility of peripheral development requires increased overall national ownership (direct and indirect).

This requirement complements another one, present in the background: In addition to the need to consider it from an asset ownership erspective, and without forgetting the need for an export effort to overcome external risk,

12. This expression mirrors the title of a recent book by Furtado (1999).

"national development" requires the implementation of a steady increase in the domestic market. The achievement of such endevour depends on the resolution of employment problems, partly through high levels of formal employment, but mainly through the absorption of underemployment. Since this is a difficult problem to solve, such reabsorption conceals the possibility of encouraging, and further, fostering development, while its full productive use involves the generation of surpluses, and in parallel, the necessary expansion of the domestic market. The new theories of technical progress are often incomplete neoliberal approaches to development. Treated cautiously, they suggest the implementation of carefully designed techno-productive policies, in particular the inclusion of such policies in a public effort focused on implementing and developing so-called "National Innovation Systems."

This effort, rather than the simplism of an alleged "technological autonomy", naturally allowing the surpassing of technology in some branches of the centers, is the real driver in achieving the requirements of continuing and internal technical progress that "national development" takes for granted.

2. The recent crisis revealed the reduction of the States' autonomy in the region. The most direct reason for this decline is the fact that their decisions became dependant on international organizations, partly because of the strict regulatory frameworks that support the measures adopted by international organizations, but especially because of the debt levels that accompanied the crisis, submitting several domestic policy decisions to the discretion and purposes of such organizations.

However, it should be noted that the limitation of public power by foreign forces goes hand in hand with a change in the State's supporting bases. In fact, there is a trend towards weakening such bases, while the classes and groups comprising them undergo sharp reduction in terms of ability to influence important decisions, and are left with a substantially weakened and secondary role.

Thus, the issue of State autonomy is critical to its role in the coordinated effort towards development in its various fields - economic, social, political, cultural – and involves paths that have undergone significant changes. It is no longer about asking how and until when certain stakeholders – such as transnational corporations and large national enterprises, both public and private - will continue to coordinate interests, so as to promote the expansion and continuity of production. Currently, the significant weakening of the internal bases of political power requires – using the terminology coined by Fajnzylber - designing and promoting a "new alliance", including internal stakeholders and particularly the majorities. Both are needed to expand the contents of democracy, and to strengthen the autonomy of the State, restoring its essential capacities to

conduct a process of development with national foundations, which are the only ones possible. Moreover, the "new alliance" and the empowerment of the State do not exclude, but rather imply, the preservation and/or return of public ownership of assets and companies that are relevant for the generation of technological external economies, and particularly for their potential role in the establishment of political power.

The efforts to deepen South American integration, which include those connected to the establishment of ALADI (1980), MERCOSUR (1991) and UNASUR (2009), suffer from the restrictions imposed to development by the crises of the 80s and 90s. The more recent crises have a special effect. New difficulties lead to an international and diplomatic movement, aiming to expand integration to the whole of Latin America and the Caribbean.[13]

3. Thus, in short, as a specific element of appropriate geopolitics, further integration efforts among South American countries, and the whole of Latin America, is proposed. However, it is worth noting that this does not imply denial of the desirability of encouraging the development of countries' own cultural identities, and considering them, as did Furtado, as the main mobilizing force of development, while the ideas and values in them serve as instigators and promoters of the positive actions of a "new alliance."

In this regard, one should insist on the possibility open to Latin America for the potential acceptance of racial equality as a key value, which involves the implementation of "appreciation of the other" and "mutually supportive" criteria that are part of long and widely accepted ethical frameworks, present in higher religions, and in the forms in which they have spread throughout the region for centuries. Such "ethical affirmation" can be decisive to enable the emergence of "cultural development" processes, where essential and recurring aspects of former cultures surface as basic driving forces.[14]

Moreover, accepting the strengthening and development of different cultural identities in each "national development" does not imply denying or ignoring the fact that integration and its deepening in various areas of non-material culture, especially in ethical content, could contribute to the mutual strengthening of such identities, perhaps inducing, in a collective awakening, a high and renewed expression of the Bolivarian ideal.

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13. In his book "*A integração sul-americana*" Celso Amorim very carefully examines its origins and evolution. He also reveals that a diplomatic effort is already underway to extend it to Latin America and the Caribbean as a whole (Celso Amorim, Minister of Foreign Affairs of Brazil, *Revista D.E.P.*, Brasilia).

14. The position implicit in those assertions emerges as an answer to the question, which contains some of Leonardo Boff's views: "...Under the hegemony of which dimension (or what value) are the elements (necessary) to create a new cultural unity structured?" ("San Francisco de Asis: ternura y vigor", Santander: Sal Terrae, 1982, p.33).

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LATIN AMERICA AND THE INTERNATIONAL CRISIS: SOME CONSIDERATIONS ON MACROECONOMIC POLICY*

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Rafael López-Monti***

The onset of the recent international crisis marked the end of a period of six consecutive years of economic growth in Latin America, from 2003 to 2008. Due to its uniqueness, this growth period is unprecedented in the economic history of the region. Thus, this article aims to analyze the main characteristics of such expansion period in Latin America, and to study the main transmission channels of the international crisis to Latin American countries. Finally, it discusses some challenges of the macroeconomic policy in the region over the long term.

A AMÉRICA LATINA E A CRISE INTERNACIONAL: ALGUMAS CONSIDERAÇÕES SOBRE A POLÍTICA MACROECONÔMICA

O início da recente crise internacional marcou o fim de um período de seis anos consecutivos de crescimento econômico na América latina, que durou de 2003 até o final de 2008. Devido às suas singularidades, tal período de crescimento não encontra precedentes na história econômica da região. Assim, este artigo tem por objetivo a análise das principais características de tal período de expansão na América Latina, bem como o estudo dos principais canais de transmissão da crise internacional para os países latino-americanos. Por fim, serão discutidos alguns desafios para a política macroeconômica da região em longo prazo.

1 INTRODUCTION

Latin America went through six years of consecutive growth, since 2003 until late 2008. The intensity, duration and characteristics of this phenomenon were unprecedented in the economic history of the region. During this expansion period, which reached almost all of the region's economies, the regional product grew at an average annual rate of 4.8%, accumulating a per capita GDP of 22.1%, equivalent to 3.4% a year.

The recent international crisis marked the end of this period of growth and underscored the need to take stock of the recent growth cycle, whose characteristics make it truly unique, and to assess how the crisis was transmitted across the region's economies and why the impact is different from previous crises faced by the region. Finally, some challenges faced by the macroeconomic policy, beyond the crisis, must be tackled.

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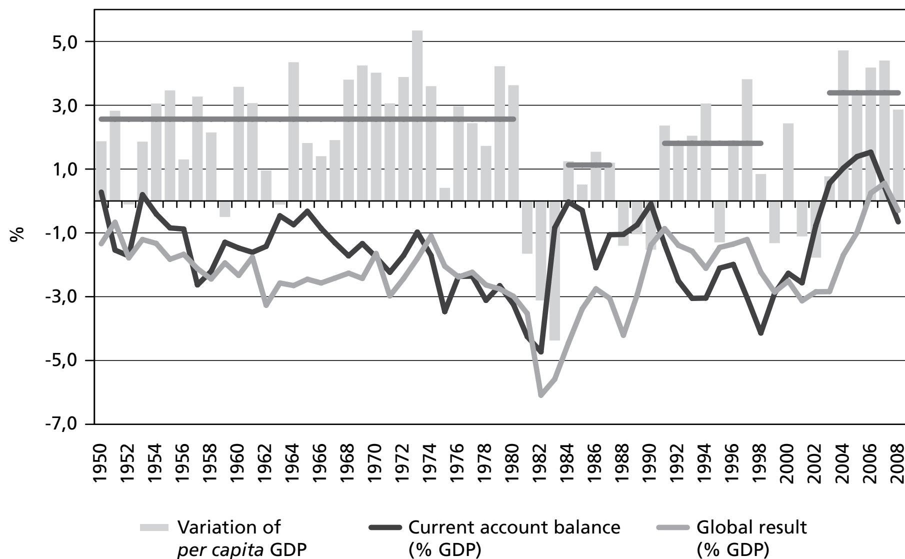
In order to address these issues, the article is structured as follows: Section II discusses the main features of the 2003-2008 growth period in Latin American countries, as well as the contribution of macroeconomic policy to reduce the region's vulnerability. Section III examines the main channels of transmission of the international crisis to Latin American economies, and finally, Section IV deals with some of the long-term challenges for macroeconomic policy.

2 LATIN AMERICAN ECONOMY BEFORE THE CRISIS: THE 2003-2008 GROWTH PHASE

As can be seen in Graph 1, in order to find a period when per capita GDP grew steadily over 3% a year, one would have to go back 40 years, when the region grew at comparable rates for 7 consecutive years, from the late sixties until the first oil price shock in the early seventies.

GRAPH 1
VARIATION OF PER CAPITA GROSS DOMESTIC PRODUCT, CURRENT ACCOUNT BALANCE AND GLOBAL RESULT



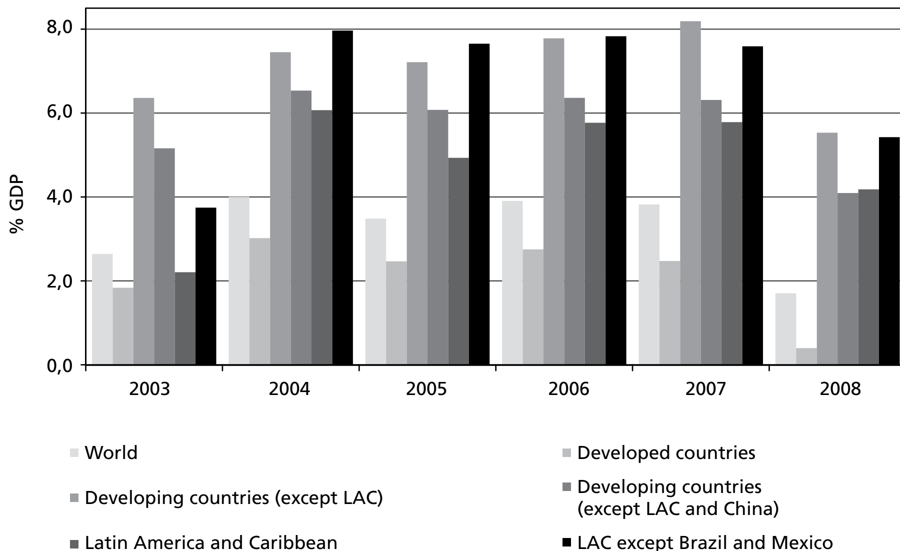
Source: Economic Commission for Latin America and the Caribbean (ECLAC), based on official figures.

However, as discussed in detail in this section, sustained growth was accompanied by a qualitative and quantitative improvement of key macroeconomic variables, which makes this period a phase of unprecedented expansion in the region's recent history. On the one hand, there was a surplus in the current account of the balance of payments, largely corresponding to the recovery of the terms of trade (especially in South America) and the growth

of remittances from migrant workers (in Mexico and especially in Central America). On the other hand, the evolution of public accounts during the expansion phase is characterized by an increase of the primary surplus, with near disappearance of the global deficit, which allowed a significant public debt reduction.

The good macroeconomic performance in Latin America during the 2003-2008 period took place in an international context characterized by growth in all regions of the world, and in particular by the good performance of emerging economies led by China and India. It should be noted that although growth rates in the region were high by historical standards, they were lower than those recorded on average in developing countries. However, it is evident that this comparison is influenced by the low growth observed in recent years in the two largest economies in the region, Brazil and Mexico, which together account for 60% of regional GDP. As shown in Graph 2, the performance of Latin American countries, without considering these two economies, is not very different from the performance of the developing world.

GRAPH 2
WORLD GROWTH BY REGIONS 2003-2008



Source: Prepared by the authors, based on United Nations and International Monetary Fund databases.

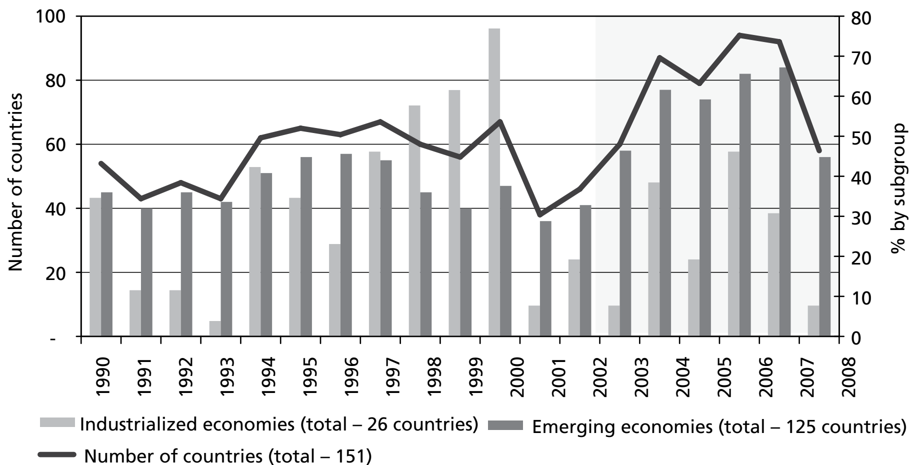
Overall, this period was characterized not only by current account improvements, but also by abundant liquidity in international capital markets and a decrease in country risk. In this context, international reserves increased and the net external debt dropped, led by the evolution of public accounts.

Moreover, better financial conditions allowed improvement of the debt profile, both in terms of deadlines and interest rates, as well as an increase of the share of debt denominated in local currency. As discussed in Section II.5, the expansion process resulted in improved labor market indicators, as demonstrated by the decline in unemployment rate at the regional level, which dropped from 11.0% in 2002 to 7.4% in 2008. Moreover, new and better quality jobs were created as a result of the growing share of formal paid jobs. The combination of economic growth, lower unemployment and better quality of jobs resulted in better social indicators.

2.1 The external context and the current account

As noted above, the good economic performance in Latin America in the 2003-2008 period occurred in a global context of rapid and widespread growth. Indeed, during the period there was an increase in the number of countries recording per capita GDP growth rates greater than 3% a year. This phenomenon is explained by the rapid growth in emerging economies, of which 57% had per capita GDP growth rates above 3% between 2003 and 2008, while only 25% of industrial economies grew at a comparable rate (see Graph 3). This pattern is remarkable when compared to the distribution of growth in the last decade, when on average only 38% of emerging economies and 33% of the industrial economies had a per capita growth above 3% a year, with marked acceleration of the pace of expansion in industrialized countries between 1998 and 2000.

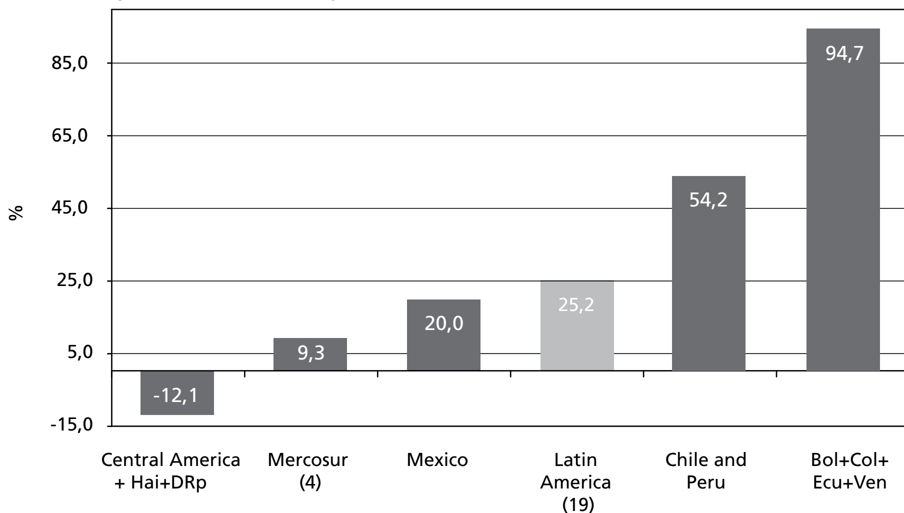
GRAPH 3
NUMBER OF COUNTRIES WITH PER CAPITA GDP GROWTH HIGHER THAN 3%



Source: Prepared by authors, based on United Nations and International Monetary Fund databases.

Other highlights in the context of the prolonged global economic expansion are the increasing participation of China and India in global demand and the ample liquidity that characterized international capital markets, at least until mid-2007. Favorable external conditions allowed growth to be accompanied by current account surplus, with the sole exception of 2008, in an unprecedented manner in the economic history of the region. Two main factors accounted for the evolution of the regional current account: terms of trade and remittances from migrant workers. However, both elements affected the region's countries differently. It is not surprising, therefore, that although on average the region achieved a surplus in current account during the 2003-2008 period, the surplus was concentrated in a minority of countries. Indeed, only 8 of the 19 Latin American countries had a surplus during the period of expansion, all of which are South American economies[1].

GRAPH 4
AVERAGE PERCENTAGE VARIATION OF TERMS OF TRADE 2003-2008
(Average 2003-2008 versus average in the nineties)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), based on official figures.
Note: The numbers in parentheses refer to the number of countries.

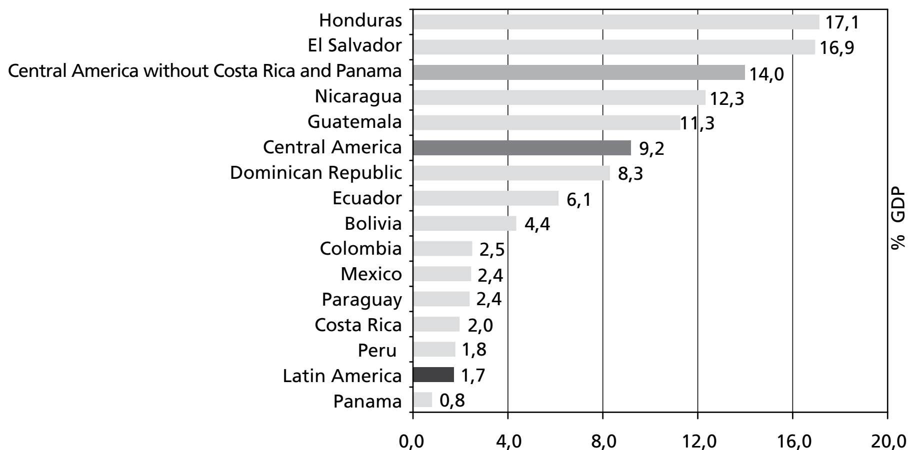
Not incidentally, South American countries account for the aggregate external surplus, since the region benefited most from the increase in terms of trade when compared with the average level of the nineties (Graph 4). In fact, countries specializing in oil and oil products exports, as well as metals and minerals had the largest increase in terms of trade during the growth period. MERCOSUR

1. In fact, four countries (Argentina, Brazil, Chile and Venezuela) account for the current account surplus in the region.

countries contributed through the increase in net export volumes, since the rise in relative prices of exports was modest (less than 10%). Mexico also experienced significant improvement in terms of trade, coupled with a rise in oil prices, although this was partially offset by the deterioration in net exportation of goods. As for Central American countries that are net oil importers and competitors of China in the U.S. market, the story is quite different. These countries not only suffered deterioration in their terms of trade during the period of regional growth, but also a reduction in foreign sales in real terms, both as compared to the average of the nineties.

On the other hand, Mexico and most Central American countries are recipients of significant resources in remittances from emigrant workers. The region as a whole received average remittances equivalent to 1.7% of GDP in the 2003-2008 period. However, Central America received the equivalent to 9.2% of GDP (although with the exclusion of Costa Rica and Panama, the average rises significantly, as seen in Graph 5), and Mexico received the equivalent to 2.4% of GDP, a figure comparable to what the country received in foreign direct investment in the period.

GRAPH 5
WORKERS' REMITTANCES, Average 2003-2008
(In percentage of GDP)

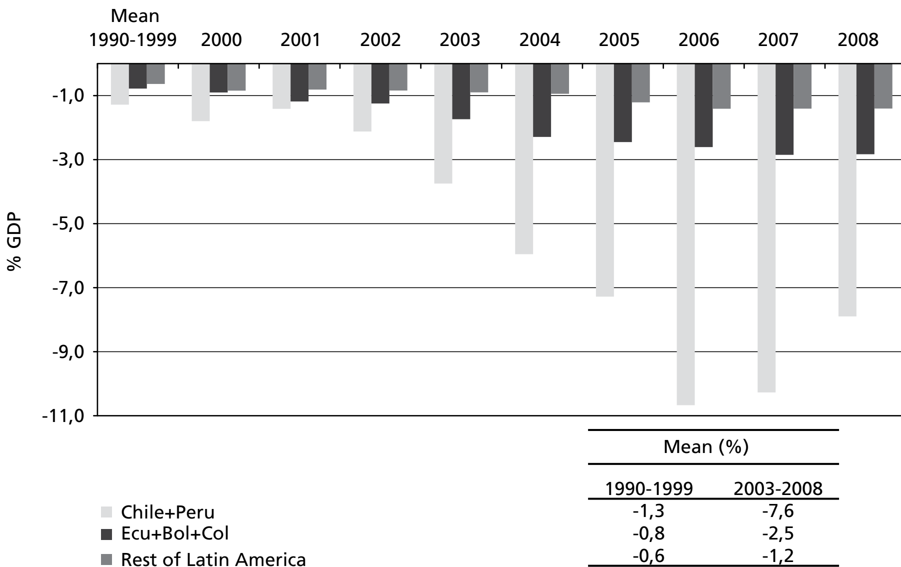


Source: Prepared by the authors, based on official figures.

Another feature of the evolution of current account in the balance of payments in the growth years was the significant increase in remittances of profits made by foreign companies to their parent companies. As can be seen in Graph 5, net profit flows in terms of GDP rose significantly in the economies linked to production and export of commodities in South America, mainly oil, metals and

minerals. This situation is in line with the improvement of international prices for these products and the fact that in many cases the exploitation of natural resources is in the hands of foreign companies. In this regard, it should be noted that Chile and Peru concentrated on average 33% of the net outflows of foreign exchange between 2003 and 2008, despite representing less than 8% of regional GDP measured in current dollars.

GRAPH 6
NET PROFIT REMITTANCES
(In percentage of GDP)



	Mean (%)	
	1990-1999	2003-2008
Chile+Peru	-1,3	-7,6
Ecu+Bol+Col	-0,8	-2,5
Rest of Latin America	-0,6	-1,2

Source: Prepared by the authors, based on official figures.

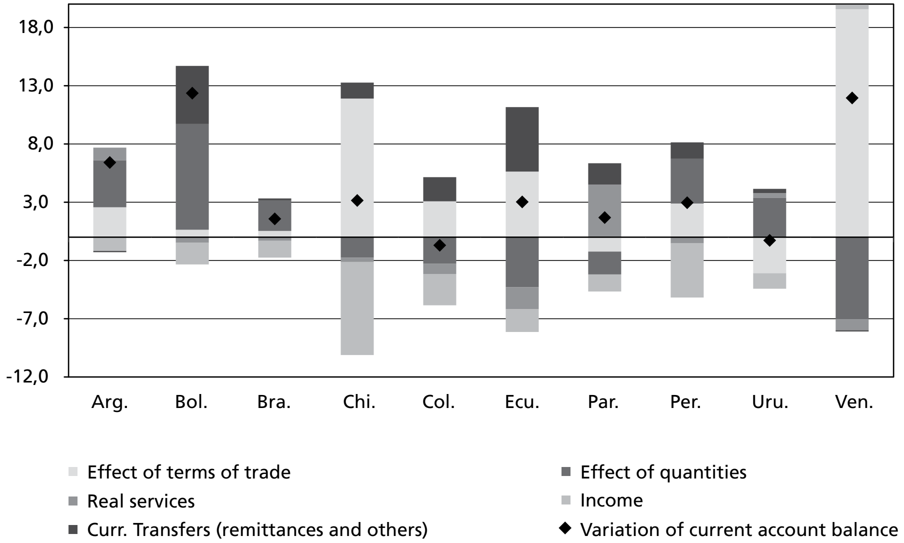
To illustrate the effects mentioned above and their impact on the current account balance, we will analyze the breakdown of average variations in current accounts by country during the expansion period (2003-2008), taking the nineties as benchmark. In South America, Graph 7(a), there was an improvement in the current account balance in most countries (with the exception of Colombia and Uruguay), mainly due to the effect of rising terms of trade, and in some countries, the improvement of the trade balance in real terms. The countries benefiting from improved terms of trade are Venezuela and Chile; in Peru and Chile this improvement was partially offset by the aforementioned remittance of profits abroad, mostly linked to mining. On the other hand, Argentina, Bolivia, Brazil, Peru and Uruguay recorded the largest increases in export volumes. It is interesting to note that in several South American countries (Bolivia, Colombia, Ecuador and Paraguay) remittances from emigrants began to rise, as compared with the average of the nineties.

GRAPH 7

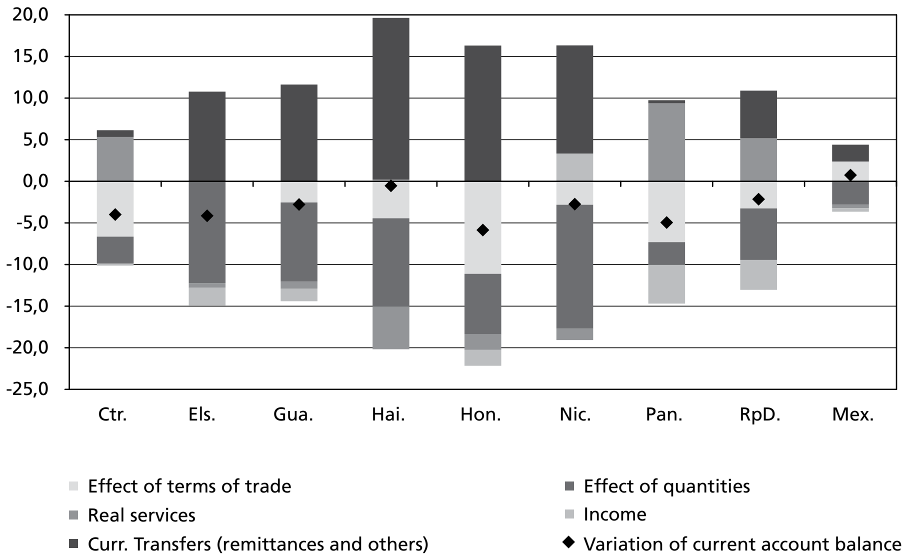
BREAKDOWN OF THE VARIATION OF CURRENT ACCOUNT BALANCE BETWEEN 2003-2008 AVERAGE AND 1990-1999 AVERAGE

(In percent of average 2003-2008 GDP)

(A) South America



(B) Central America, Haiti, Dominican Republic and Mexico



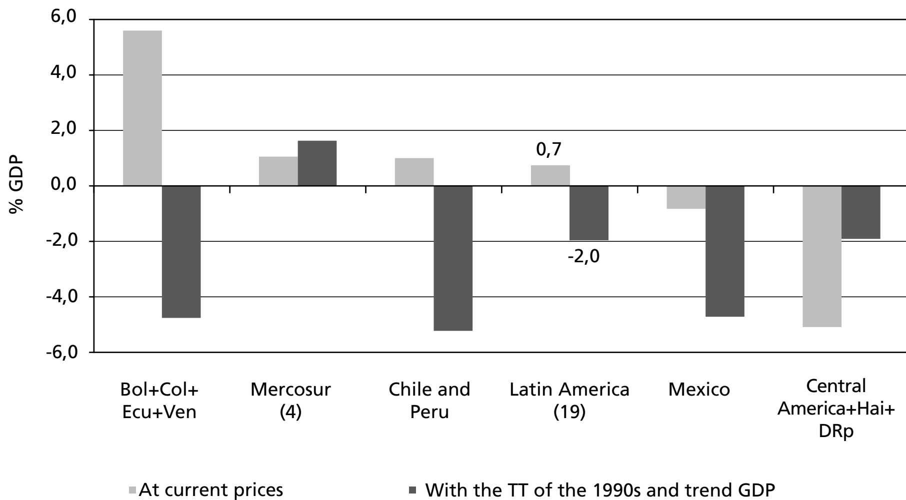
Source: Prepared by the authors, based on official figures.

Graph 7(b) shows the breakdown of current account variation for Mexico and Central America in the period analyzed. A common element in these countries is the deterioration of trade balance at constant prices and, with the exception of Mexico, the negative impact of changes in terms of trade. At the same time, there were significant foreign exchange earnings in remittances from migrant workers, with the exception of Costa Rica and Panama. These two countries, along with the Dominican Republic, experienced significant positive effects derived from the balance of services.

GRAPH 8

AVERAGE CURRENT ACCOUNT 2003-2008 AT CURRENT PRICES AND TERMS OF TRADE OF THE NINETIES

(In percentage of GDP)



Source: Prepared by the authors, based on official figures.
Note: The numbers in parentheses refer to the number of countries.

To assess the sensitivity of the external sector to the change in relative prices of foreign trade, we estimated what the current account balance would be if the terms of trade were equivalent to those of the nineties, also adjusting GDP growth, since it depends on the terms of trade (Graph 8)[2]. At the aggregate level, the region went from a surplus of 0.7% of GDP at current prices to a deficit of 2%, considering the terms of trade of the nineties and the

2 In order to arrive at the current account with the terms of trade of the nineties, real exports of goods and services were calculated with the price level of current imports, both of goods and services, adjusted by the average terms of trade of the nineties. The same procedure was used to calculate profit remittances sent abroad, since they are closely linked to changes in commodity prices. In turn, the growth of import volumes of goods and services each year was adjusted by the difference between actual GDP growth and the trend, the result of filtering the series with HP (λ = 6.25), and applying income elasticity of imports reported in Bello and Pineda (2007). In this exercise, the nominal GDP trend was also used for the calculation of the current account to GDP ratio.

rising trend over the 2003-2008 period. If the terms of trade were those of the nineties, the current account deficit in Mexico and Colombia would increase, while in Venezuela, Chile and Ecuador, the balance of current account deficit would drop, due to the decreased price of oil and metals in the nineties. In MERCOSUR countries, with the exception of Brazil, the current account surplus would increase, not as a result of changes in terms of trade, but because of lower demand for imports from less relative growth when considering the trend. On the other hand, the current account deficit in Central American countries would drop significantly, since the impact of their deteriorating terms of trade in the past six years would be eliminated.

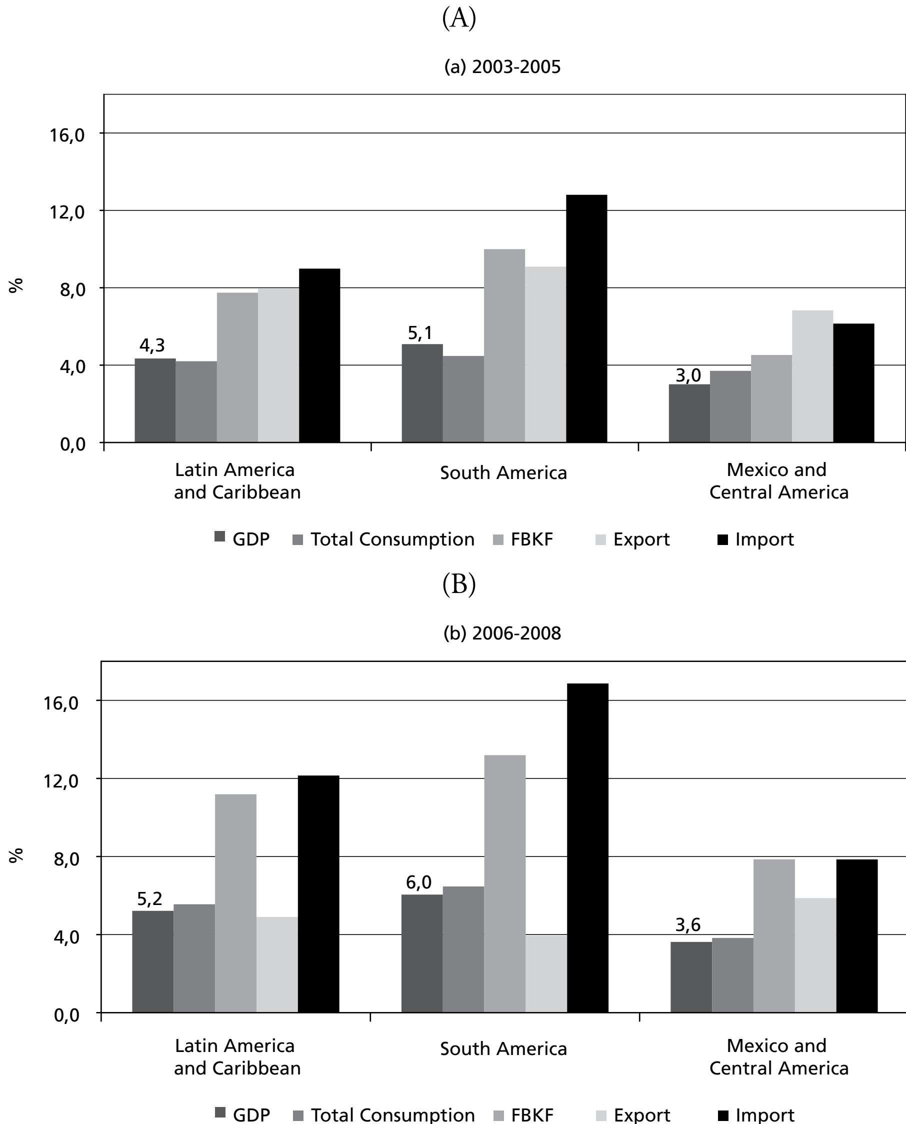
2.2 Product, income and demand components

In the 2003-2008 period, the available gross national income (GNI) of most countries in the region grew at a higher rate than GDP. While the region's GDP grew at an average yearly rate of 4.8%, the available GNI increased at an average rate of 5.7%. This phenomenon was stronger in metal, mineral and hydrocarbon exporting countries (Bolivia, Chile, Colombia, Ecuador, Peru and Venezuela) where there was a significant increase in available GNI in line with improved terms of trade, despite net payments of profits and dividends to the rest of the world (particularly in Chile and Peru, see Graph 5).[3] In other South American countries, the available GNI also rose higher than the GDP, although more moderately. In Central America, despite a decline in the purchasing power of exports, increased remittances allowed available GNI to grow at a faster rate than GDP in some countries (Guatemala and Honduras). In Mexico, the expansion of national income may be attributed both to improved terms of trade and increase in net current transfers received.

Given the increase of available GNI in the region, and despite the significant rise in consumption, domestic savings increased substantially in most countries and, at current prices, represented on average 22% of GDP between 2003 and 2008, the highest since the nineties. Unlike the last decade, foreign savings became negative (-0.7% of GDP), implying that regional investment was entirely financed by domestic savings for most of the growth period, with the exception of 2008.

3. A detailed analysis of these aspects can be found in Kacef and Manuelito (2008).

GRAPH 9
GROWTH OF SUPPLY AND DEMAND COMPONENTS
(Yearly average growth rates)

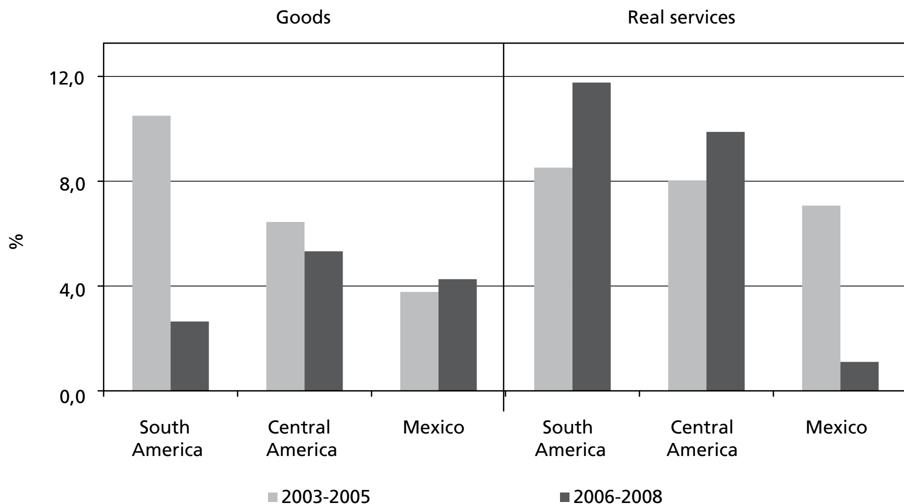


Source: Prepared by the authors, based on official figures.

The growth period can be divided into two phases: 2003-2005 and 2006-2008. In the first phase, Graph 9 (a), the regional aggregate demand grew at an average rate of 5.0% a year, with gross formation of fixed capital and exports of goods and services being the most active, particularly in South American

countries. In the second phase, Graph 9 (b), the expansion of domestic demand across the region accelerated to 6.6% a year, coupled with an increase in average investment growth rates from 7.7% to 11.2% a year between the two three-year periods, and lesser increase in total consumption (from 4.2% to 5.6% a year), following the performance of South American countries. This increased internal absorption together with increasing currency appreciation pushed imports in real terms throughout the region and especially in South America, which grew at an average yearly rate close to 17% in the last three years. As found in several studies, a feature common to most Latin American countries is that long-term income elasticity of imports is substantially greater than one.[4]

GRAPH 10
GROWTH OF EXPORTED VOLUME OF GOODS AND SERVICES
(Yearly average growth rates)



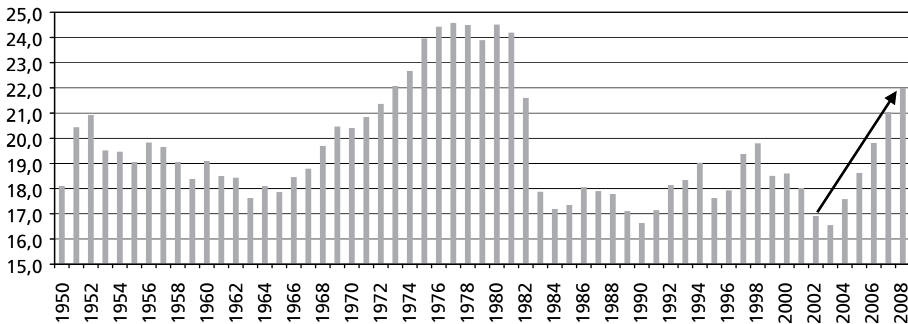
Source: Prepared by the authors, based on official figures.

At the same time, currency appreciation slowed the pace of growth in export volumes of goods and services throughout the region. However, this situation is mainly due to the sharp slowdown of real exports of goods in South America, which, after rising at 10.5% a year in the 2003-2005 period, grew at only 2.6% on average in the 2006-2008 period (Graph 10). By contrast, exports of real services in these countries maintained an upward trend, rising from an average

4. See, among others: Senhadji (1998) and Bello and Pineda (2007). In the latter work, using real GDP as income measure and prices as a measure of real exchange rate, income elasticity of imports ranges from 0.67 for Peru, to 2.54 for Uruguay, with a median of 2. When using the real GDP - exports as a measure of income, and again controlling for the real exchange rate, this elasticity ranges from 0.65 in Peru to 3.09 for Uruguay, with a median 1.4. In the first case, only one country reported an elasticity of less than one, while in the other case, two countries, Peru and Honduras, had an income elasticity of less than one.

yearly growth of 8.3% to 11.3% between both phases. Attention should be drawn to the significant growth recorded by real services in countries such as Argentina, Chile, Peru and Uruguay, with rates exceeding 10% a year. In Mexico and Central America, export performance took the opposite direction. While the volume of exports of goods slowed down in Central America in the last three years, its growth rate increased in Mexico. At the same time, real services exports slowed down sharply in Mexico (6 p.p.) while increasing in Central America, primarily in Costa Rica, Haiti and Panama.

GRAPH 11
GROSS FIXED CAPITAL FORMATION
(As% of GDP at 2000 prices)



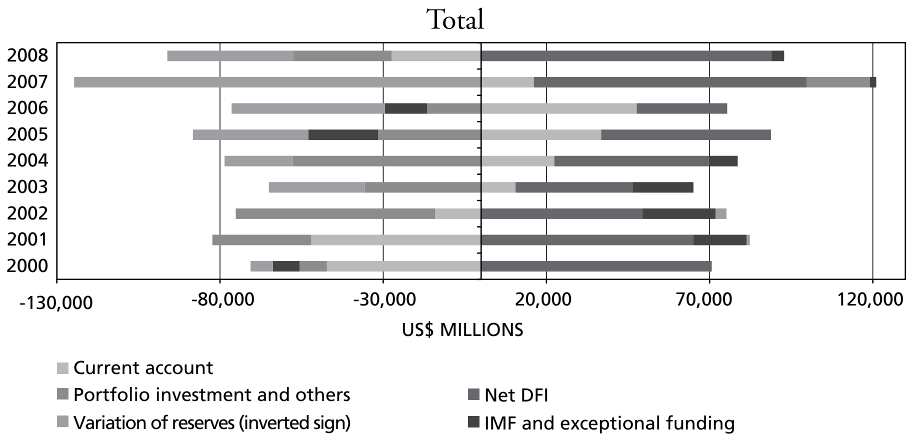
Source: Economic Commission for Latin America and the Caribbean (ECLAC), based on official figures.

Gross fixed capital formation was the most dynamic component of demand throughout the 2003-2008 period of expansion, growing at an annual rate of 9.5%, and is obviously greater in countries in South America, favored by improved terms of trade. This growth reflects not only the drive in construction but, above all, of investment in machinery and equipment, whose contribution represented about two thirds of the average increase in gross capital formation in the past six years. As a percentage of GDP, gross fixed capital formation grew by over five percentage points during this period, rising from 16.9% in 2002 to 22.0% in 2008, its highest level in more than twenty five years (see Graph 11). Despite this sustained recovery, the investment rate in 2008 was still lower than the levels recorded in the late seventies and early eighties.

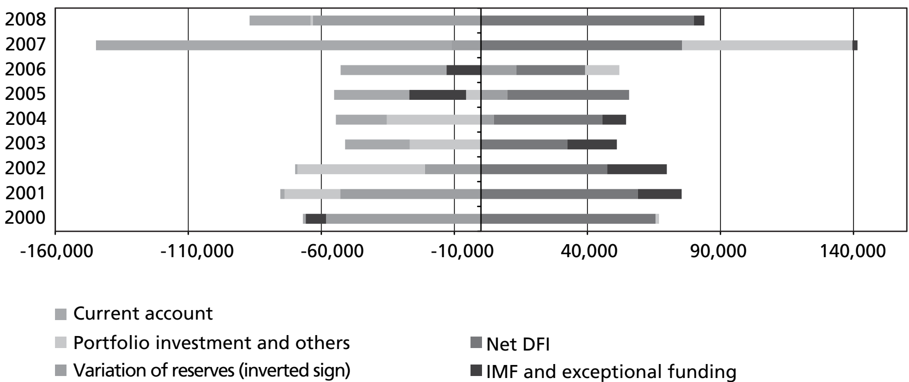
2.3 External vulnerability

Latin America recorded a surplus in its basic balance in the last six years, on average accounting for 2.7% of GDP, as a result of the positive balance on current account (0.7%) and the net inflow of foreign direct investment (FDI) (1.9%). As a result, many countries in the region strengthened their net external position, either by reducing foreign liabilities or through an increase in reserve assets.

GRAPH 12
SOURCES AND USES OF BALANCE OF PAYMENTS OF LATIN AMERICA
(in millions of dollars)



(B) Without Chile and Venezuela



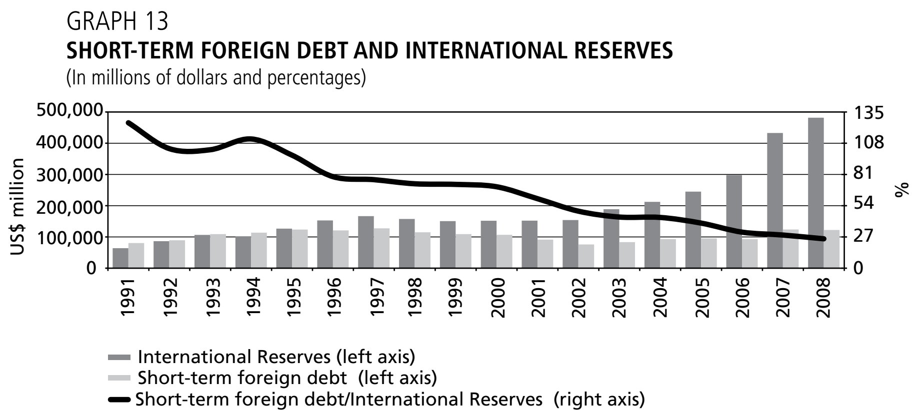
Source: Economic Commission for Latin America and the Caribbean (ECLAC), based on official figures.

The FDI inflows grew by a rate of 14.6% a year over the past six years, reaching a record high in 2008 (123,308 million dollars). However, as noted in Graph 12 (a), the region as a whole registered a net outflow of financial capital (portfolio and other investment) over recent years, with the exception of 2007, due to the solid inflow of financial capital in Brazil. This net outflow of capital decreased and even reversed in 2006, if not considering Venezuela and Chile in the regional aggregate (Graph 12 (b)). In the first case, there was a significant net outflow of capital, in both the private and public sectors, coupled with the surplus from oil exports. While in Chile, the net outflow of capital is explained by the creation by the government of a stabilization fund abroad associated with copper prices.

However, the total net outflow of capital in Latin America was much lower than the surplus recorded in the basic balance for the 2003-2008 period. This difference resulted in significant accumulation of international reserves, in a context where some central banks intervened in the currency exchange markets because of concerns regarding the level of real exchange rate. With the intervention in exchange markets, the stock of international reserves rose sharply in the last six years, serving as reinsurance against the subsequent international crisis (as discussed in Section. III)

The situation of external accounts in recent years favored a marked reduction in the external debt burden, both in relation to GDP and to exports.[5] Although external debt remains high in some countries, the external debt to exports of goods and services ratio decreased to less than half the level recorded ten years ago when calculated on the basis of total debt, and to about one-third if calculated as net debt to international reserves. The increased liquidity and improved debt profile reduced vulnerability in the region, which is seen in the sharp decline in the ratio of short-term external debt to international reserves, from 49.3% in 2002 to less than 25.4% in 2008 (Graph 13). In addition to lower external debt ratios, vulnerability to external shocks has declined due to decreased dollarization in several economies in the region, especially South America (including Bolivia and Peru).

GRAPH 13
SHORT-TERM FOREIGN DEBT AND INTERNATIONAL RESERVES
(In millions of dollars and percentages)



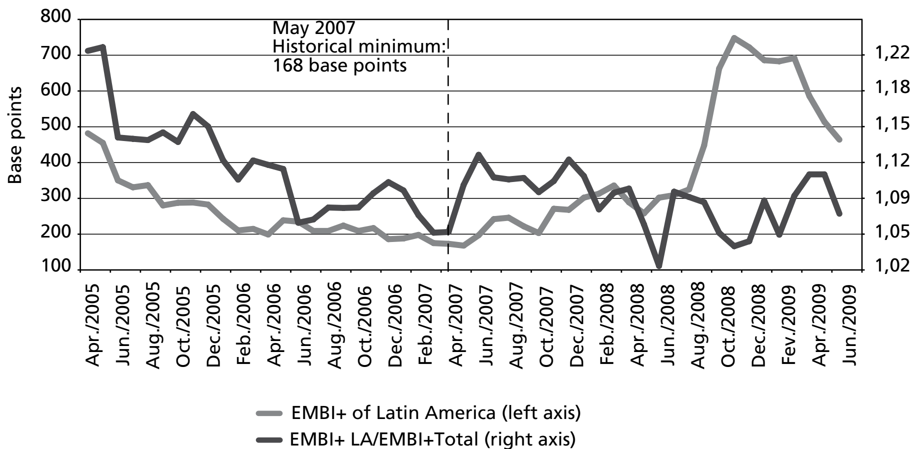
Source: Economic Commission for Latin America and the Caribbean (ECLAC), based on official figures.

The improved macroeconomic situation of Latin America during the 2003-2008 period reflected in the international financial markets, not only in the evolution of sovereign risk indicators but also in favorable debt ratings in several countries in the region. However, the international crisis that started in the U.S. mortgage market and quickly spread to all developed countries interrupted the

5. In both cases, attention should be drawn to the increase recorded in the variables of the denominator of these coefficients.

clear downward trend of sovereign risk in the region's countries. The increased volatility of international financial markets coincides with the deterioration of the subprime mortgage market in the United States in mid-2007. The EMBI+ of Latin America reached its historic low of 168 basis points at the end of May 2007 (only 17% of that recorded in late 2002), from which point it began to escalate. As shown in Graph 14, this rise increased Latin America's relative EMBI+ (as compared to emerging markets in general).[6]

GRAPH 14
EMBI+ OF LATIN AMERICA AND ITS RELATION TO TOTAL EMBI+



Source: Economic Commission for Latin America and the Caribbean (ECLAC), based on official figures.

2.4 The contribution of macroeconomic policy

2.4.1 Fiscal policy

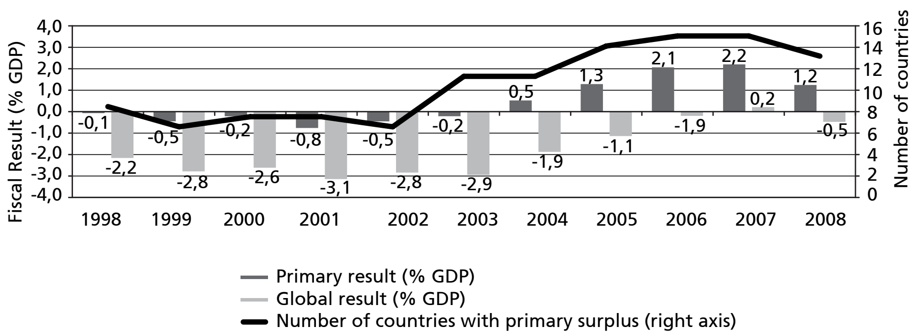
In recent years, central government fiscal accounts of Latin American countries showed a significant improvement both with regard to the overall deficit reduction and the primary surplus generated as of 2004, both calculated as a simple average (Graph 15). This average primary surplus reflects a general good performance of fiscal accounts of the countries in the region. Of the nineteen countries surveyed in 2008, 14 recorded a primary surplus (only Guatemala, Haiti and Honduras maintain a primary deficit), which contrasts significantly with 2002, when only seven countries had a surplus.

6. This increased relative risk of the region, however, is explained by the evolution in the price of bonds that took place in Argentina and Venezuela, even before the outbreak of the international crisis.

In turn, the positive evolution of fiscal accounts in a context of rapid economic growth allowed the reduction of public debt to GDP ratio, which at the regional level increased from an average of 58.4% in 2002 to 28% in 2008. In addition, countries in the region have taken advantage of macroeconomic conditions in recent years to implement active liability management policies that have helped reduce their financial vulnerability.

GRAPH 15

PRIMARY AND OVERALL RESULT OF CENTRAL GOVERNMENT AND NUMBER OF COUNTRIES WITH PRIMARY SURPLUS



Source: Prepared by authors, based on official figures.

The good performance of public accounts in the last six years differs from that occurred in other recent growth episodes, as shown in Graph 16 (a). During the 2002-2008 period, the primary surplus rose 1.8 points of GDP as a result of significant increase in total revenue equivalent to 3.4 percentage points of GDP, while spending increased 1.6 percentage points. On the other hand, in the two growth periods of the nineties (1991-94 and 1995-98), fiscal revenue did not grow as strongly and in both instances it was exceeded by the rise in primary spending in GDP terms, resulting in a worsening of the region's average primary surplus.

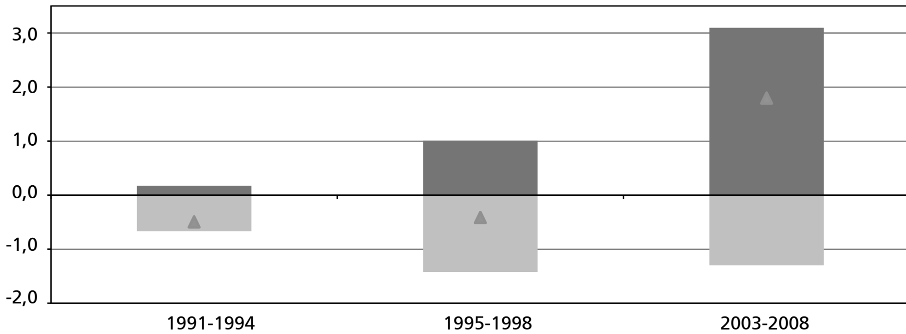
Attention should also be drawn to the evolution of the main fiscal indicators along the 2003-2008 expansion period. While the improved primary surplus in 2003 and 2004 corresponded to an increase in fiscal revenue, and at the same time expenses grew less than the region's product, in 2005 and 2006 the rise in the primary surplus corresponds to a significant increase in resources, which more than offset an increase in public spending in GDP terms (see Graph 16 (b)). Since 2007, primary spending has been accelerating while the rate of increase of total revenues in relation to the product has been dropping. This situation led to a deterioration of public accounts in 2007, which became worse in 2008.

GRAPH 16

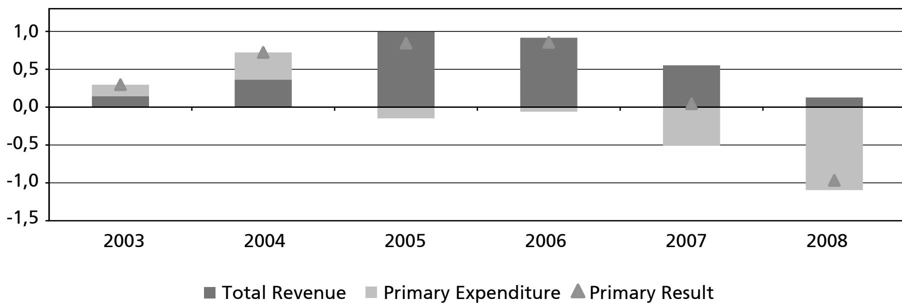
FISCAL INDICATORS: Evolution of primary result and contribution of income and spending

(Variations in GDP points)

(A) Comparison of periods: 1991-1994, 1995-1998 and 2003-2008



(B) 2003-2008

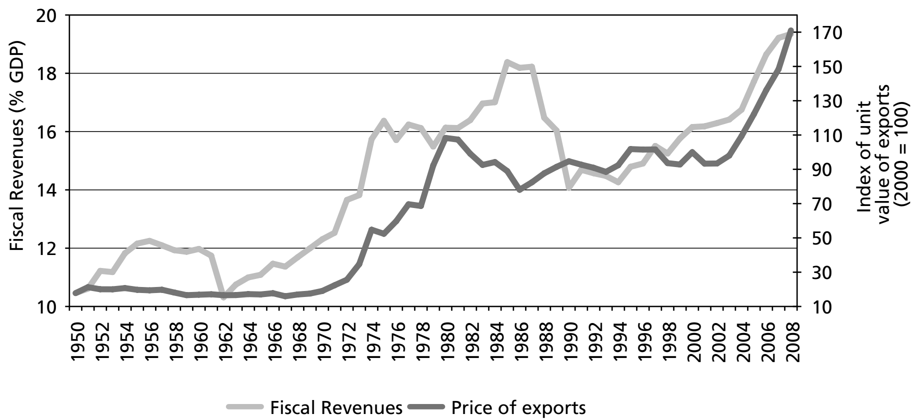


Source: Prepared by the authors, based on official figures.

As follows from the above analysis, the increasing fiscal revenue, coupled with a more controlled spending policy during the 2003-2006 period, accounts for much of the improvement in the primary surplus in GDP terms during the period of growth. The countries with more growth of fiscal revenues are those that recorded the highest increase in the prices of their export products. As shown in Graph 17, due to the region's high specialization and high proportion of commodity exports, fiscal revenues are very sensitive to changes in export prices[7].

7. For an analysis of the impact of changes in export prices on tax revenues, see Jiménez and Tromben (2006).

GRAPH 17
LATIN AMERICA: FISCAL REVENUE AND PRICE OF EXPORTS



Source: Economic Commission for Latin America and the Caribbean (ECLAC), based on official figures.

Within fiscal revenues, tax revenues which, together with social security contributions, represent on average more than 80% of fiscal revenues (with differences between countries) grew steadily in terms of GDP until 2007, reaching the highest levels of the series. The item that increased most was general tax on goods and services, reflecting the fact that the tax structure has concentrated more on such taxes, emphasizing the regressive bias that characterizes the tax structure of Latin American countries.

The effects of the boom experienced by the region with regard to fiscal indicators depend on the origin of the extraordinary resources received by countries. In Central America, the national income increased primarily due to remittances from migrant workers received by the private sector. However, in almost all countries in South America and Mexico, most of the improvement is due to the effects of terms of trade, although Mexico is the largest recipient of remittances in absolute amounts. In countries where exports are carried out largely by state enterprises, a high proportion of the resources generated by improved terms of trade was received by the public sector. Generally, this is the case with oil exports and certain metals, including copper. When exports are carried out by public companies, resources are channeled to private companies and the state receives only a share of them through taxes.

Regarding the fiscal impact of rising remittances and export prices, it is possible to identify three situations with different impacts on public accounts. Remittances and better export prices when production is private have positive impacts on public accounts through increased tax revenues, directly in the case of higher prices of exports (by means taxes on benefits or exports) and indirectly

through the impact of increased remittances and rising export prices on domestic demand. An important difference is that remittances tend to increase consumption, while private companies can invest some of the benefits or increase profits sent abroad.

When it comes to state enterprises that produce and export, the impact on fiscal revenues is greater, while the impact on demand will depend on the public policy decisions to either save the surplus or increase spending. This choice confers to fiscal policy a greater stabilizing capacity and the ability to channel resources to higher investment spending, whether in infrastructure or human capital.

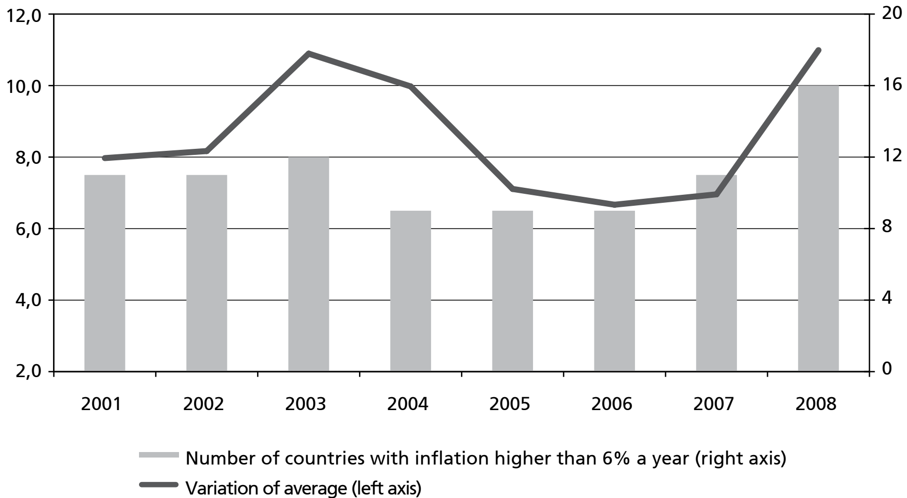
On the other hand, as mentioned earlier, the evolution of fiscal indicators in the past two years shows a marked acceleration of the primary spending to GDP ratio. While in 2007 capital expenditure accounted for a greater share in the increase in expenditures, in 2008 current primary expenditures grew more than capital spending. This increase in primary spending can be analyzed as the result of the considerable drop in public spending during the stabilization programs launched in the beginning of the decade, as well as increased social spending, following an upward trend that began in the early nineties[8]. From this perspective, the increase in social spending may be considered appropriate and even necessary, given the high levels of poverty and inequality. Moreover, unlike in the past, increased spending in recent years occurred in a context of fiscal consolidation that, with varying degrees according to the country, has been widespread in the region. This consolidation, as pointed out, is explained largely by the surge in fiscal revenues and is reflected in lower fiscal deficit and the generation of increasing primary surpluses, at least until 2007.

2.4.2 Monetary and exchange rate policy

In general, an element that characterized most of the period of growth in Latin America was the expectations of increase in inflation resulting from the sustained expansion of activity levels and the in commodity prices, particularly energy and some food products. After a slowdown of the region's average levels during the 2003-2006 period, inflation accelerated in 2007 until reaching double digits in 2008 (see Graph 18).

8. Social spending, following the sharp decline in the eighties, increased 40% in real terms between 1991-1992 and 2002-2003.

GRAPH 18
LATIN AMERICA AND THE CARIBBEAN: SIMPLE AVERAGE INFLATION AND NUMBER OF COUNTRIES WITH RATES HIGHER THAN 6% A YEAR

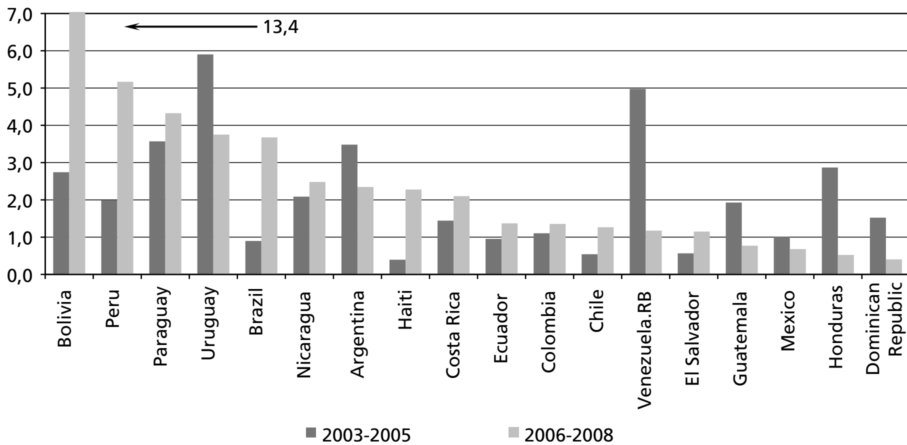


Source: Prepared by the authors, based on United Nations and International Monetary Fund databases.

Between 2004 and 2006, nine countries out of nineteen had inflation rates above 6% a year, while in 2008 sixteen countries exceeded this benchmark. This rise in prices is not a phenomenon unique to Latin America; it took place in a context of increased global inflation fueled by the same causes as those found in the region: greater activity and commodity price increases.

In turn, after an initial period of sharp depreciation in the real exchange rate of the region's countries, in recent years there was an appreciation of the real exchange rate, particularly in South American countries. This situation prompted many central banks in the region to increase the level of intervention in currency markets, accumulating large amounts of international reserves (Graph 19).

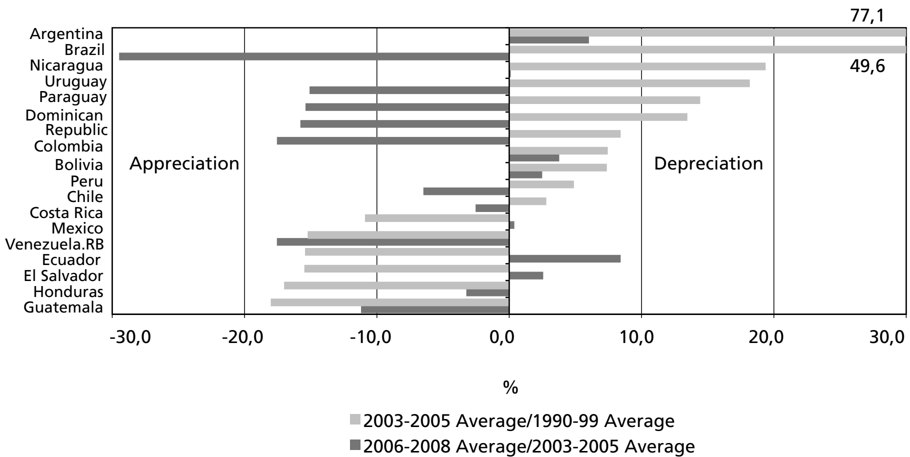
GRAPH 19
VARIATION OF AVERAGE INTERNATIONAL RESERVES IN 2003-2005 AND 2006-2008.
(In percentage of GDP)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), based on official figures.

Alongside the pursuit of policies based on inflation targets in Brazil, Colombia and Peru, monetary authorities were concerned about the level of real exchange rate, which led them to intervene in currency markets. Also in Chile, the Central Bank decided to intervene in the market in April 2008 with the aim of strengthening the liquidity position of the Chilean economy against the expectation of a deteriorating external environment. This was seen as consistent with the assessment that the type of real exchange rate in Chile was below its long-term level. On the other hand, extensive interventions in currency markets were also observed in Argentina, Bolivia, Costa Rica and Paraguay. If the increase in reserves in recent years is added to the increase recorded during the initial 2003-2005 phase, the total accumulation of six years of reserve assets exceeded US$327.5 billion in the region, equivalent to 11.3% of average GDP.

GRAPH 20
REAL EFFECTIVE EXCHANGE RATE



Source: Economic Commission for Latin America and the Caribbean (ECLAC), based on official figures.

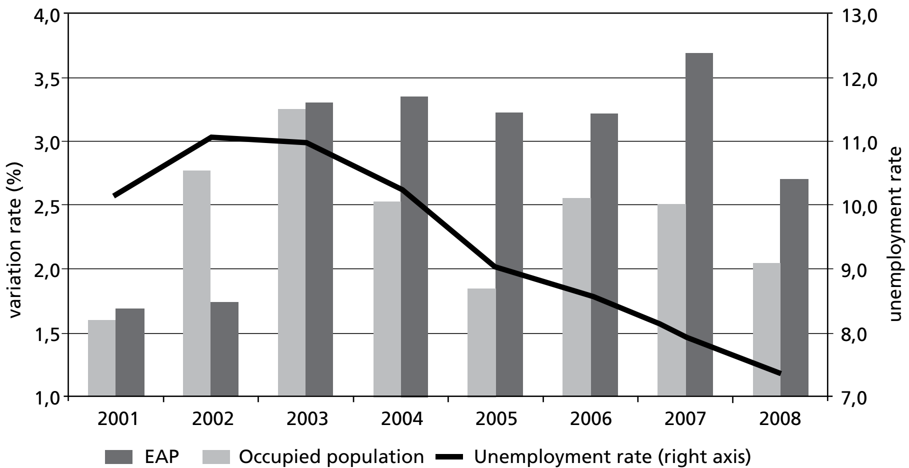
Despite the efforts by central banks, when the dollar was depreciating in relation to other currencies, there was an appreciation of the region's real effective exchange rate as compared to their 2003-2005 average in most countries of the region (see Graph 20). Improved terms of trade, increased demand for certain products exported by the region and increased resources from migrant workers' remittances constitute a set of factors behind this downward trend of real exchange rates. To a lesser extent, unlike in the nineties, the effect of increased external liquidity may be added. In short, excess supply in the foreign exchange market led to decreased exchange rates in the region in recent years, with varying intensity from one country to another, and regardless of the efforts of monetary authorities to intervene in currency markets to support parity.

The counterpart of the intervention in exchange markets has been a growing effort to sterilize monetary issuance in a context marked by increasing inflation expectations. The region's countries have been adopting absorption policies through open market operations, incurring costs of various types with different results. To mention just a few examples, Brazil's central bank intervened by purchasing foreign currency to maintain the exchange rate, paying a high cost in terms of interest rate of the absorption instruments, with a view to protecting its monetary program, but as we have seen, these efforts did not prevent the Real's appreciation. Something similar happened in Colombia. By contrast, Argentina's central bank has also bought foreign currency, with a better outcome in terms of exchange rate stability, but high cost in terms of capacity to manage the monetary policy. The common element in all three cases is that the costs associated with the strategy of intervention in the foreign exchange market (and the outcome thereof) were strongly influenced by the general economic policy, which included characteristics that contradicted the decision to maintain the real exchange rate.

2.5 Labor market and social indicators

Economic growth resulted in an increase in labor demand with significant generation of formal employment. Thus, after 2003 the employment rate began to recover, accumulating an increase of 3 percentage points until 2008, which corresponds to an increase in the number of employed workers of 3.3% a year on average for the 2003-2008 period, despite a sharp slowdown in the last year (see Graph 21). At the same time, the unemployment rate in the region as a whole declined from a peak of 11% in 2002 and 2003 to 7.4% in 2008. Thus, the unemployment rate returned to the levels of the early nineties, while real wages in the formal sector, because of the high levels of unemployment, showed moderate increases below the growth in labor productivity.

GRAPH 21
LATIN AMERICA AND THE CARIBBEAN: THE EVOLUTION OF THE ECONOMICALLY ACTIVE POPULATION, OCCUPATION AND UNEMPLOYMENT RATE

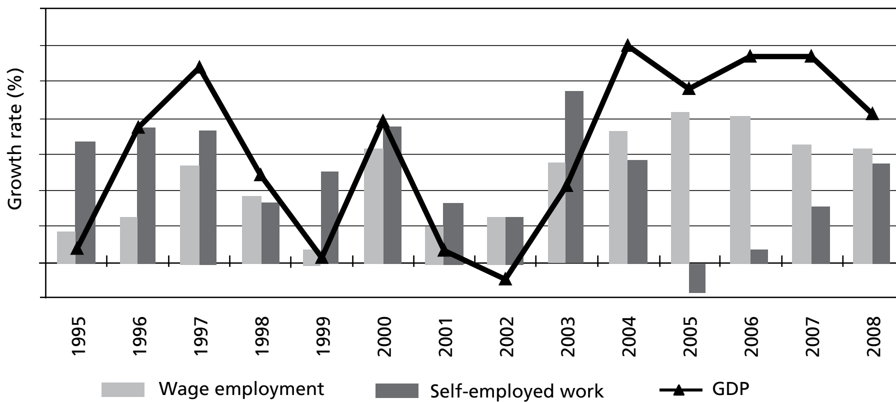


Source: Economic Commission for Latin America and the Caribbean (ECLAC), based on official figures.

Since the beginning of this decade, the urban economically active population has expanded at a pace of 2.4% a year. During the first years, the number of employed workers grew by less than 2%, resulting in a sharp increase in unemployment in 2002. However, economic growth led to accelerated growth of employment, causing a drop of the unemployment rate. The supply of labor has been growing in recent decades, due to the sharp increase in the participation of women, both in urban and rural areas where it was traditionally low[9].

9. At the regional level, there has generally been a pro-cyclical behavior of the participation rate. By comparing the cyclical component of the participation rate and the product in different countries of the region, procyclical behavior of the participation rate was found in Argentina, Brazil and Uruguay, acyclic behavior was found in Chile, Costa Rica, Mexico and Peru, while in Colombia and Venezuela behavior was counter-cyclical. These results are obtained from regressions performed by the OLS method over the logarithms of the participation rate and GDP, both filtered by Hodrick-Prescott, to obtain the cyclical component of both series, in the period from 1985 to 2006 [Machinea and others (2008)]

GRAPH 22
ECONOMIC GROWTH AND EMPLOYMENT GENERATION, 1995-2008



Source: Economic Commission for Latin America and the Caribbean (ECLAC), based on official figures.

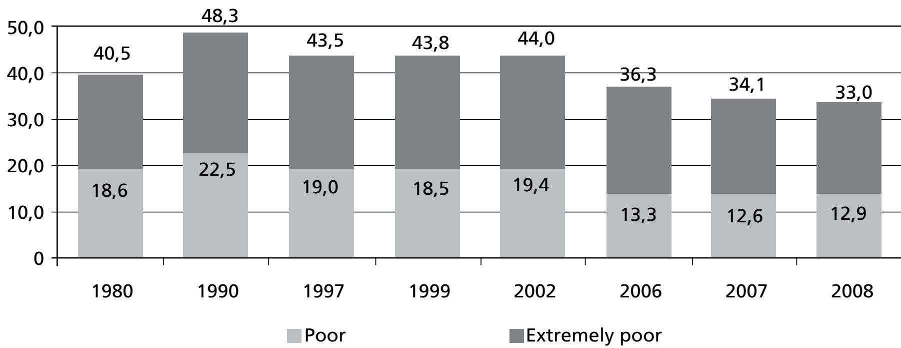
As of 2003, employment generation accelerated alongside the growth of the economy and, in particular during the 2005-2007period, the expansion of informal employment slowed down, in a context of rates of economic growth and generation of formal jobs unprecedented in the region as a whole, taking into account the past 25 years[10]. It should be noted that while there was an acceleration of informal employment in2008, its growth rate was still lower than that of formal employment, a fact that characterized five of the six years of economic expansion.

Economic growth and improvement in labor indicators that accompanied the 2003-2008 expansion period had a positive impact in reducing poverty. In the beginning of this decade, 44% of the population of Latin America was considered poor, i.e., did not have the necessary income to meet their basic needs. Within this group, 19.4% of the population were extremely poor, i.e., could not even meet their need for food. With the sustained growth and improvement in the labor market of the last six years, poverty and extreme poverty rates of the beginning of the decade dropped 10.4 and 6.4 percentage points respectively (see Graph 23)[11]. In 2006, for the first time, the levels of poverty and extreme poverty in relation to the population were lower than those recorded in the early eighties. However, in absolute terms, they were higher due to population growth.

10. This shows that much of the increase in informality observed in the nineties is not due to a preference for this type of employment, but a forced option in face of the weak demand for labor of formal sector enterprises.

11. In 2008 there was a slight increase in poverty, although poverty continued to fall. This divergence is due to the significant increase in food prices recorded in the first half of 2008.

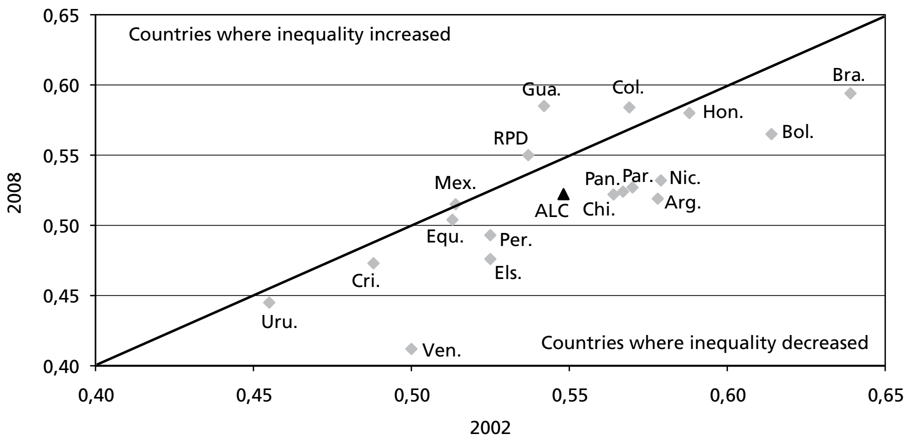
GRAPH 23
LATIN AMERICA: POVERTY AND EXTREME POVERTY
(Percentage of population)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), based on official figures.

During the 2003-2008 growth period, not only did poverty and extreme poverty drop in Latin American countries, but there was also an improvement in income distribution in the region. As shown in Graph 24, inequality indicators for 2007, the lowest since the early nineties, revealed better income distribution in most of the countries of the region as compared to 2002.

GRAPH 24
EVOLUTION OF INCOME DISTRIBUTION MEASURED BY THE GINI INDEX: 2007 vs. 2002

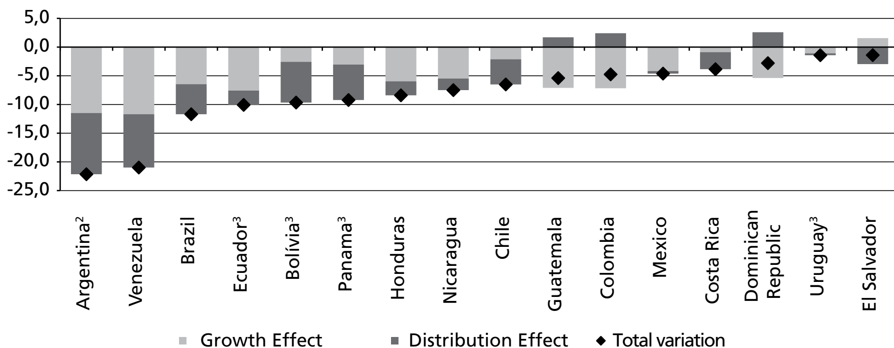


Source: Economic Commission for Latin America and the Caribbean (ECLAC).

The main cause behind the reduced rates of poverty and extreme poverty between 2002 and 2007 is the increase in average household income, although in almost all cases this effect was strengthened by improvements

in income distribution.[12, 13] In turn, in the cases of Colombia, Guatemala and the Dominican Republic, the increase in inequality during the period tended to increase poverty, although this effect was more than offset by stronger growth in household income. On the other hand, in 9 countries of the region both effects simultaneously contributed to the decline in poverty, although with different intensity (see Graph 25). Interestingly, the increase in average income in lower income households can be explained largely by the improvement of their labor income when compared with other non-labor sources (public and private transfers, income from capital and other incomes). Of the seven countries where poverty dropped more sharply (Argentina, Brazil, Chile, Ecuador, Mexico, Panama and Venezuela) the increase of labor income on average accounts for 77% of the increase in total income of poor households and 69% of the income of extremely poor households. This phenomenon took place in the context of general quantitative and qualitative improvement in labor indicators in the region, analyzed previously.

GRAPH 25
"GROWTH" AND "DISTRIBUTION" EFFECTS OF CHANGES IN THE POVERTY RATE, 2002 - 2008[1]



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of special tabulations of surveys OF households in their respective countries
Notes: [1] In some countries, it corresponds to the last available estimate.
[2] Metropolitan areas.
[3] Urban areas

12. See ECLAC (2008).
13. This analysis is based on the Datt-Ravallion (1992) breakdown of variations in poverty and extreme poverty rates, averaging the effects calculated with different base years (as suggested by Kakwani (1997)) to prevent residue and dependence on a base year. For further details on the methodology, see ECLAC (2008, Box I.7)

3 THE IMPACT OF THE CRISIS ON LATIN AMERICAN MACROECONOMICS[14]

The global economic crisis marked the end of the longest and most intense phase of regional economic growth since the seventies. As mentioned in the previous section, this growth took place in the context of widespread international economic expansion, whose heyday spanned from 2003 to mid 2007, when the problems in the high risk mortgage segment of the United States began to spread. The impact reflected in the financial systems around the world and significantly affected the goods and labor markets, even more strongly since September 2008. Thus, an unusually severe global economic downturn gradually formed, which, given the similarities, has even been compared with the thirties Great Depression.

Indeed, there is more than one element in common: both started in the U.S. financial system and from there spread to other regions and sectors, and both were the result a bubble in asset prices leading to a problem of solvency in the financial system. This time, however, the size of the financial system and the international interconnections were much greater, and the degree of opacity of the financial system reached unprecedented levels.

On the other hand, this time the economic policy response was faster and more accurate. The thirties crisis left the lesson that it is necessary to limit the impact of the crisis as quickly as possible and implement expansionary fiscal and monetary policies to avoid the risk of an economic depression. That is what countries have generally been doing since 2008, despite huge differences determined by the different capacities and particularities of each case. Another major difference in relation to the thirties is that currently there are several instances of international coordination, both regionally and multilaterally, many of which were created after the Great Depression and World War II, while others were more recently established, such as the Group of Twenty (G20). Even with their limitations, these institutions have some capacity to support the policies that countries are implementing in isolation and to avoid, or at least limit, predatory practices - through trade policies or exchange rate policies - that can damage international trade, which has already been sufficiently hit by the crisis.

For the reasons stated in the previous paragraph, this episode was limited to a sharp and severe economic contraction, but for the global economy it did not reach the intensity of the Great Depression, in terms of levels of unemployment, contractual default, and underutilization of productive resources.

The financial crisis moved quickly to real variables and was internationalized mainly because of four factors[15]:

14. This section is based on Kacef (2009).

15. On the analysis of the international crisis from a Latin American perspective, see Machinea (2009) and Lopes (2008).

- The credit crunch resulting from the weakness of the financial system led banks to require greater liquidity, given the uncertainty regarding renewal of their liabilities and the need to rebuild their capital, on one hand, and doubts about the creditworthiness of potential borrowers, on the other.
- The destruction of both financial and non-financial wealth resulting from the depreciation of real estate, stocks, and other assets.
- The deterioration of expectations on the evolution of economic activity, which affected the decisions of household consumption and business investments.
- The decrease in world trade, which reached 21% in volume and 38% in value between July 2008 and January 2009, even though the decline began to reverse in the first half of 2009.

3.1 The crisis' transmission channels

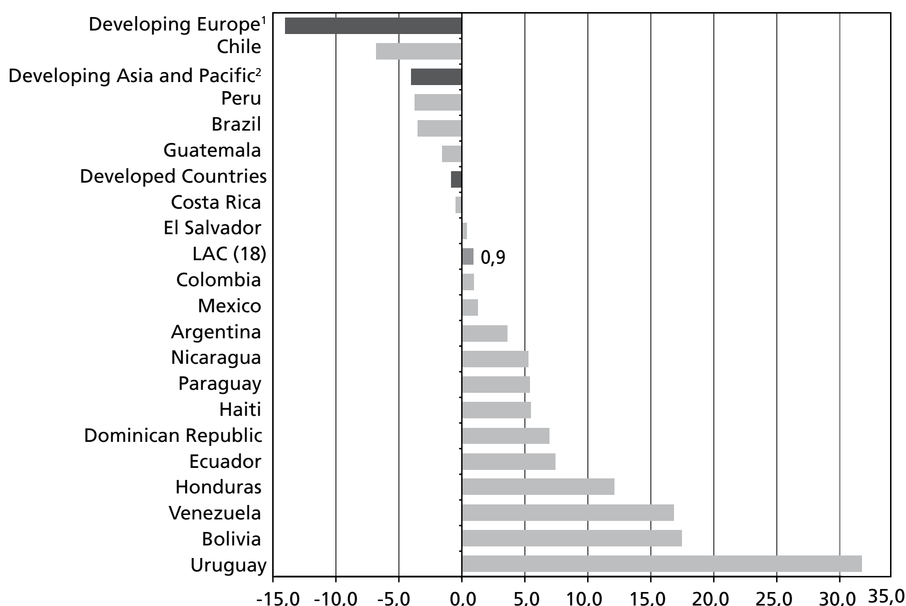
One characteristic that distinguishes this crisis from previous ones relates to the transmission channels through which it affected the economies of Latin America. Unlike similar events, the strongest impacts have taken place through real channels. As further discussed below, export volumes and prices, remittances and other items directly linked to economic activity, together with the deterioration of consumer and producer expectations, were the factors that explain the sudden halt of growth observed in the fourth quarter of 2008.

Indeed, only three countries (Brazil, Chile and Peru) showed signs of a sudden stop in capital flows associated with the effects of the crisis.[16] As shown in Graph 26, these are the three countries in the region whose financial systems remain at a net debtor position of greater relative scale.[17] Meanwhile, in seven cases analyzed (Argentina, Brazil, Chile, Ecuador, Mexico, Peru and Venezuela), information suggests the existence of commercial turbulence due to reduction in exports considerably higher than would have been typical in a common cyclical movement. These disturbances, however, are largely related to the behavior of commodity prices, as they cannot be dissociated - in origin and effects – from a shock of a financial nature.

16. In order to estimate these effects, two different methodologies were used. The first focused on the reversal of Latin American countries' exports as a result of changes in global demand. This exercise used the deviation of the series of exports with seasonally adjusted long-term trend, calculated through the Hodrick-Prescott filter. Trade reversion was defined as any reduction of over one and a half standard deviation of exports. The second methodology was applied to episodes that markedly reduce capital flows. This series includes seasonally adjusted investment flows obtained from the difference between accumulation of reserves and basic balance. An episode of decline in capital flow is considered to occur when investment flows suffer a reversion of more than one and a half standard deviation as compared to the average for the whole period.

17. The fact that these countries maintain a net debtor position in foreign markets does not imply a negative assessment of their financial systems. On the contrary, this may be due to the fact that their markets are more developed and involve a larger scale of operations, which requires institutions to use international financial markets. In addition, it should be clarified that Chile shows a reversal of capital flows when the analysis discounts public sector flows. In the case of Venezuela, it is possible to identify a reversal of the capital account of balance of payments in the first quarter of 2009, but also during some moments in 2008, prior to the worsening of the crisis, so it cannot be associated to it.

GRAPH 26
NET EXTERNAL POSITION OF THE FINANCIAL SYSTEM, December 2008
(In % of GDP)



Source: Prepared by the authors, based on figures by BIS and ECLAC

3.1.1 The financial channel.

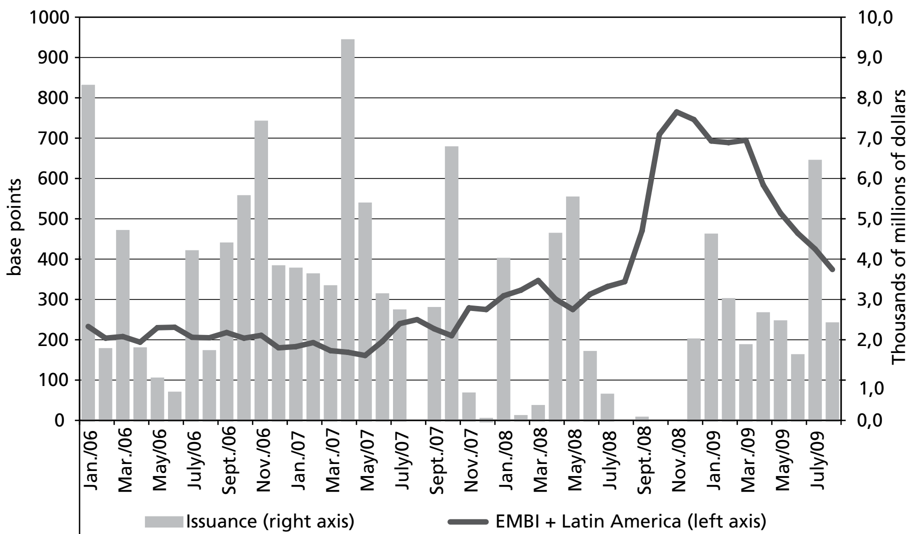
The fact that Latin American countries have reduced their debt levels and accumulated international reserves (see Section II.3) helps explain why, unlike other times, the region has not been hit by a financial crisis . Another important element in this regard is that the degree of external exposure of the region's financial systems is relatively low, so that the maintenance of domestic credit is not as sensitive to external conditions, especially when compared to other emerging economies.

Major difficulties in access to external credit were observed in the last quarter of 2008. In response, as discussed in the next section, central banks of several countries in the region took steps to ensure liquidity in domestic and foreign currencies to support their banks, and the United States' Federal Reserve established agreements with the central banks of Brazil and Mexico with the same purpose.[18] Furthermore, the placements of corporate and sovereign bonds by countries in the region in world markets disappeared completely during the increase in risk premiums, as shown in Graph 27. These factors led to a reduction in international reserves in the region between late 2008 and early 2009. However, as of the second quarter, the reserves resumed growth until reaching a new historical high of over 530 billion dollars.

18. See ECLAC (2009b).

During the first months of 2009, the setting for the operation of financial markets began to change slowly. The programs implemented in the United States and, to a lesser extent, in Europe contributed to strengthen the expectation that, except for isolated cases, everything would be done to avoid bankruptcy of institutions with systemic reach. Similarly, the monetary policy in several developed countries aimed at restoring liquidity, reducing interest rates to near-zero levels, while seeking to restore the credit flow, with the offer of certain collaterals for interbank lending. This contributed for the perception of risk regarding emerging countries to begin to decline gradually, even though it remained at levels higher than during the three previous years and allowed countries in the region to re-access international capital markets, thus resuming the placement of sovereign and corporate bonds.[19]

GRAPH 27
LATIN AMERICA: PLACEMENT OF SOVEREIGN AND CORPORATE BONDS IN GLOBAL MARKETS
(In billions of dollars and base points)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), based on official figures

3.1.2 The real channel

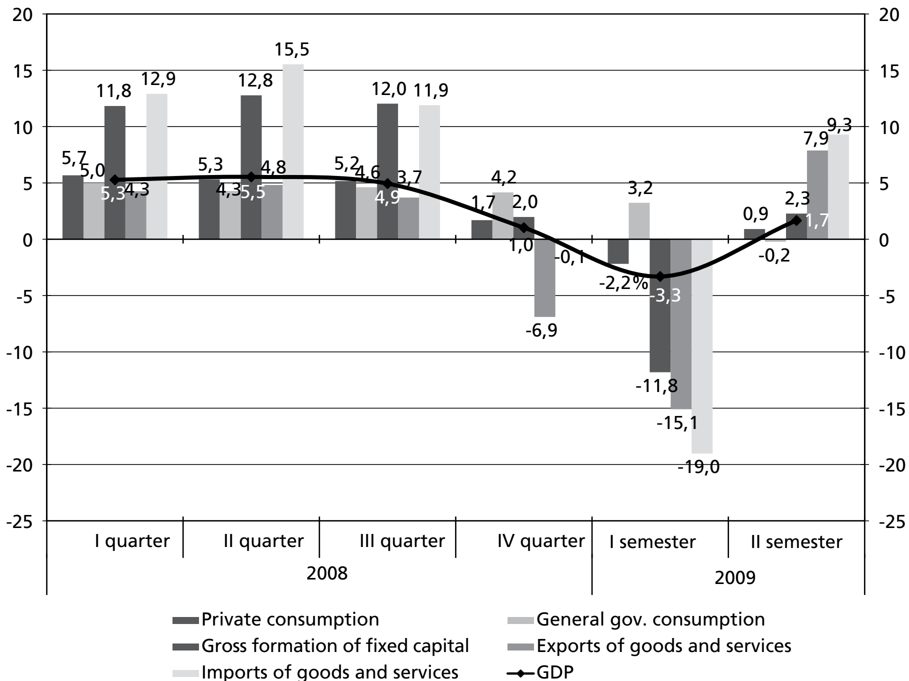
The impact was strongest in the trade transmission channel. On the one hand, there was a substantial reduction in export volumes of real goods and services, as shown in Graph 28, exceeding 15% in early 2009, although estimates show marked recovery in the second semester.

19. It should be noted that even at the peak of the crisis (September-October 2008), the increase in risk premiums implicit in sovereign debt yields was significantly lower than that found in other crises.

GRAPH 28

LATIN AMERICA: INTERANNUAL PERCENTAGE VARIATION IN AGGREGATE DEMAND, 2008-2009

(In constant 2000 U.S. dollars)

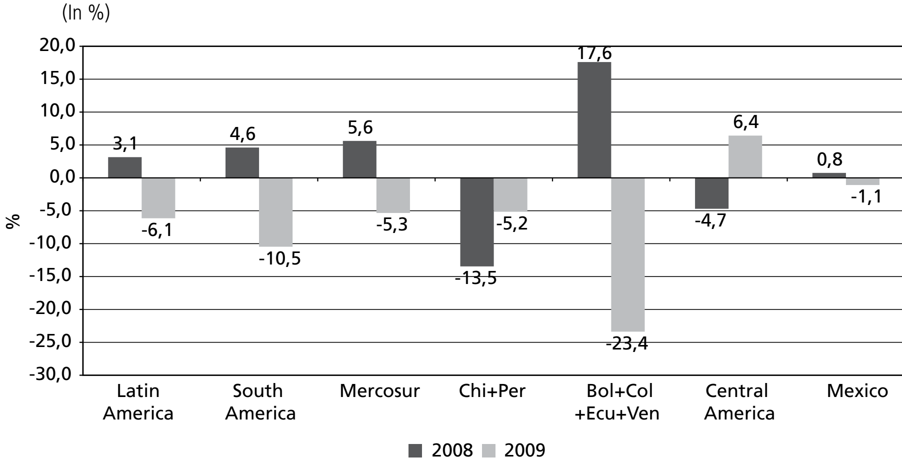


Source: Economic Commission for Latin America and the Caribbean (ECLAC), based on official figures

Moreover, the global recession and declining international trade adversely affected commodity prices, which decreased significantly from the high levels observed early 2008 impacting the evolution of regional terms of trade (Graph 29). Although this negative trend was partly reversed in the last months of the year, it is estimated that the drop in terms of trade for Latin America was of 6% in 2009, after rising 37% from the average in the nineties to 2008.

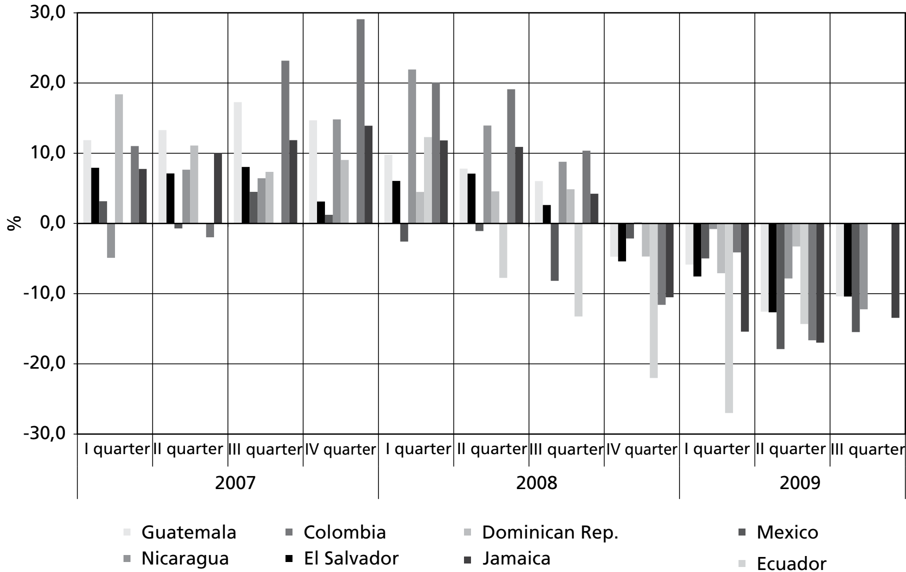
In addition to the international repercussions of the U.S. crisis throughout financial and foreign trade markets, there were other relevant factors, although more difficult to quantify, such as the destruction of wealth resulting from falling asset prices (financial and property) and the effects of deteriorating expectations of families and businesses in the demand for goods and services. These factors are especially important in countries with larger domestic markets that have greater weight in economic activity, and have led to reductions in investment and significant deceleration in private consumption. Conversely, as shown in Graph 28, public consumption shows greater growth, a fact that may be related to active fiscal policies which will be discussed further on.

GRAPH 29
ESTIMATED VARIATION OF TERMS OF TRADE, 2008-2009
(In %)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), based on official figures

GRAPH 30
LATIN AMERICA (8 COUNTRIES): INTERANNUAL VARIATION OF REMITTANCES
(In millions of dollars and percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), based on official figures

In some countries, the evolution of private consumption has also been affected by reduced remittances from migrants (Graph 30). Reductions started as of the third quarter of 2008, worsened in the first quarter of 2009, and tended to ease up towards the end of the year.

In turn, the reduction of foreign direct investment flows also reduced investment, which showed an estimated decline between 35% to 45% for 2009.[20] This had especially relevant effects in Central American countries, where these flows have a considerable weight in terms of GDP, even though they are not the main recipients.

3.2 The macroeconomic and political space to tackle the crisis

Although there are differences from one country to another, a change in macroeconomic behavior in the region has been observed in recent years, in contrast with previous episodes of boom, as discussed in detail in Section II. In the period before the crisis, increases in saving rates were promoted in the region, resulting in less reliance on external financial resources and, in many cases, reductions in external liabilities of governments, which fully compensated greater use of international credit by the private sector. This process was accompanied by the already mentioned significant accumulation of international reserves, in order to reduce dependence on external financing vis-à-vis potential liquidity problems.[21] This self-insurance behavior reflected the decision to pay a price equivalent to the opportunity cost of accumulated external resources, as a result of the recognition of pro-cyclicality of the international credit supply and the desire to avoid financing-related conditionalities from multilateral sources.

This not only made a remarkable difference with respect to the financial difficulties usually faced by the countries of the region in similar episodes, but also enabled better implementation of public policies. However, recent developments marked by the impact of the crisis have narrowed the macroeconomic space available for implementation of policies aimed at increasing domestic demand, and have fueled competition for tools and resources available to governments. [22]

Graph 31 shows the parallel development of two basic elements for the definition of space for economic policy, analyzed from the perspective of flows: current account balance and public accounts balance. As mentioned in the previous section, the boom period from 2003 until at least 2007 was accompanied by improvements in both balances, an unprecedented endeavor which allowed Latin America to record on average twin surpluses in 2006 and 2007.

However, most of the recent improvement in the fiscal situation followed the steady increase in commodity prices between 2002 and early 2008, and the deterioration observed as of mid-2008 imposed strict conditions to the fiscal space

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20. See ECLAC (2009c).

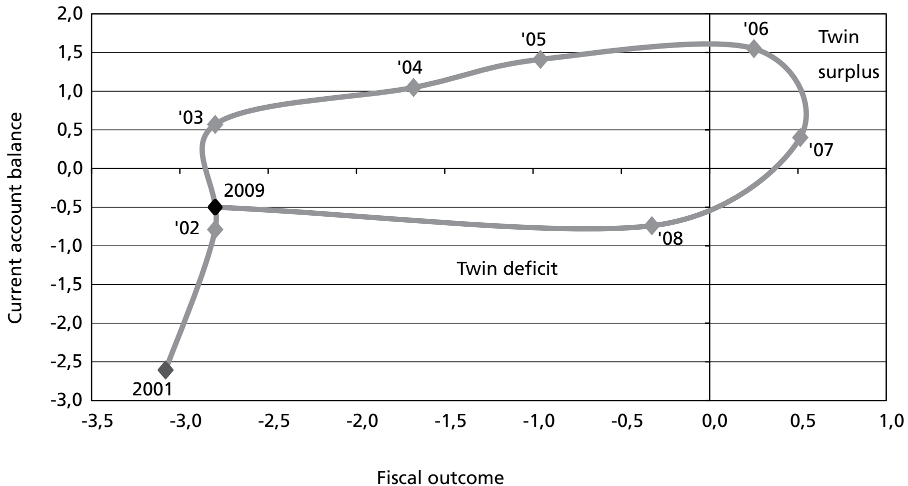
21. The perception of the efforts of countries in the region would be even greater if the calculation of international reserves included what was saved by several countries in sovereign funds fed by fiscal surpluses. Of course, it was quite a costly effort in terms of opportunity cost of resources that the countries of the region and emerging economies in general had to incur to offset international financial market failures, against which they had been helpless in other crises.

22. See Fanelli and Jimenez (2009).

achieved. The decrease in tax revenues is estimated at around 1.4% of GDP (simple average), while the region's average overall deficit reached 2.8% of GDP in 2009.

The drop in internal demand, and in turn that of imports, offset the reductions in exports and remittances, generating a decrease in the deficit, which reached approximately 0.5%. Reduced consumption and investment generated a marked reduction in imports, almost 25% in current values, which offset the 23% drop in external sales in the region.

GRAPH 31
LATIN AMERICA: EVOLUTION OF THE CURRENT ACCOUNT AND FISCAL OUTCOME, 2001-2009
(Percentages of GDP)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), based on official figures

In addition to the limits imposed by the dynamics of public and external accounts on the resources available for counter-cyclical measures, some features of the region's economies raise additional issues that affect macroeconomic policy. In particular, apart from the importance of maintaining liquidity levels that allow smooth operation of financial systems, the effectiveness of monetary policies might be restricted in countries with low levels of monetization and financial soundness. Moreover, situations of high uncertainty may affect the transmission mechanisms between monetary policy expansionary measures and increases in credit supply, and between them and the effective use of available funding to raise the demand for goods.

In crisis situations, when credit markets tend to become segmented, fiscal policy could play a leading role in maintaining aggregate spending flows.[23] However,

23. On the effectiveness of fiscal policy against a financial crisis, see Baldacci, E, S. Gupta, and C. Mulas-Granados (2009).

the countries of the region sometimes face institutional constraints and restrictions concerning the public sector's implementation capacity, which set the limits for the flexible use of fiscal policy for the purposes of macroeconomic stabilization goals. In particular, while tax cuts are decisions whose implementation is relatively simple, the scale of their effect may be limited in countries where taxation levels are low and, in periods of uncertainty, where increases in income available are not necessarily translated into larger volumes of demand, particularly if the groups favored by tax cuts are in the higher strata of the distribution. In turn, increases in public spending bring about more institutional and administrative requirements. Increasing public investment takes time, especially since countries generally do not have projects evaluated and ready to implement. Similarly, the provision of targeted subsidies can be highly effective, but not all countries have developed mechanisms to identify and reach potential beneficiaries of social programs.

3.2.1 Monetary and Exchange Rate Policy

In face of the change in the international scenario late 2008, which brought about significant credit constraints in developed countries and less inflationary pressures than had characterized recent years (see Section. II.4.b), central banks of the region sought to ensure adequate liquidity levels in order to facilitate the functioning of domestic financial markets.[24] To this effect, the measures adopted included reduction in reserve requirements, cutting the maturity of liquidity operations, and the establishment or expansion of special lines for discount operations and reporting.

In the early months of 2009, central banks of most countries in the region lowered their policy rates to help economic recovery, in coordination with fiscal measures, although in some countries it could be expected that rates continued to fall, since they remained high in real terms. Reduced inflationary pressures and expectations of a fall in the pace of price increases led to this change in orientation of the monetary policy.[25]

24. The acceleration of inflation observed in 2007 and early 2008 complicated the management of the monetary policy and imposed compliance with inflation targets set by central banks. In that period, inflation remained above the established target in Chile, Colombia, Mexico, Paraguay and Peru. Brazil was the only country where inflation remained within the target range, wider than in other countries, but the pace of price increases also accelerated and remained one step higher than the average level of the range. Although the observed acceleration of inflation was due largely to supply shocks associated with the prices of food and energy, most central banks increased their monetary policy rates, aiming to anchor inflation expectations. As inflationary pressures dropped in late 2008, in many cases very high real rates were observed by the end of the year.

25. Brazilian Central Bank reduced the benchmark interest rate of the Special System of Clearance and Custody (SELIC) on four occasions between December 2008 and April 2009, from 13.66% to 11.66%, and a similar trend was observed in the period in the central banks of Colombia, Guatemala, Mexico and Peru. Chile's central bank reduced interest rates drastically - 7 percentage points – going from 8.25% in December 2008 to 1.25% in May 2009. Considerable decline also occurred in central bank rates in Honduras, from 9% to 4.5% from November 2008 to March 2009. One exception was Argentina, where the evolution of the exchange market limited the ability of the monetary authority to lower interest rates.

However, the expansionary monetary policy could not prevent the slowdown of the credit market, especially after the aggravation of the international crisis. The slowdown in the growth rate of total credit in real terms continued in the first half of 2009 in Argentina, Brazil, Colombia, Mexico, Peru and Venezuela, although in several countries greater activity as observed on the part of public banks, which contributed at least to slow the fall in financing supply. This instrument was especially relevant in Brazil, where credit offered by public institutions represents around one third of the total credit to the private sector.

On the other hand, as of the worsening of the crisis towards the end of 2008, and despite the loss of reserves, the currencies of several countries in the region depreciated significantly, after considerable appreciation in the last three years (see Section II.4.b, Graph 18). Authorities intervened in different ways, including both cash market transactions and future markets. These movements partially reversed in early 2009 when, despite a general drop in interest rates by central banks in the region, currencies tended to appreciate in nominal terms, as a result of the improved environment in international financial markets. During this period, selling interventions in currency markets were progressively phased out.

3.2.2 Fiscal Policy

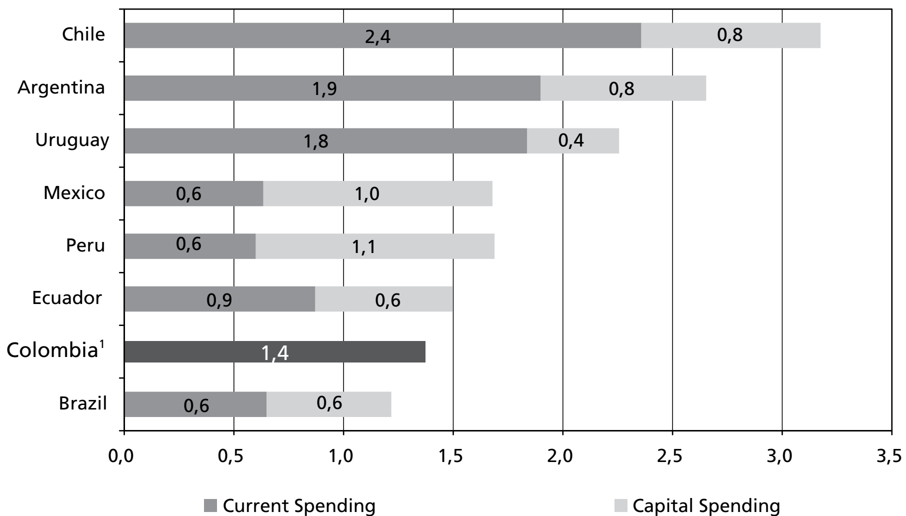
The challenge of a counter-cyclical fiscal policy takes place in a context of revenue reduction, at the same time protecting certain expenses - education, social protection and infrastructure - which are vital to prevent increasing poverty and lay the foundation for future growth. Although the governments in the region have some capacity to support the economy with fiscal measures, in practice, the room for maneuvering the fiscal sphere varies greatly from one country to another and depends on the availability of savings accumulated in times of boom, the degree of rigidity of expenditure, the duration of the crisis and the possibility to borrow safely.

The crisis placed public finances of Latin American economies in a complex situation. On the one hand, tax revenues showed a significant reduction, as a result of lower levels of activity and falling commodity prices. At the same time, countries adopted measures of fiscal stimulus and to offset the distributional costs of the crisis, which led to further deterioration of fiscal performance. Moreover, in many cases, this deterioration occurred as part of significant external financing contraction that limited the adoption of counter-cyclical fiscal policies.

Also, the effects of international crises on tax revenues differ from one country to another depending on the tax structure, the level of collection and the sources of revenue-generating activities. In this sense, the degree of exposure to the crisis

was greater in countries with low tax burdens, or those with a high proportion of resources that are non-tax-related or derived from natural resources, and in those with a high level of trade liberalization, especially if they export mainly to developed countries. In contrast, it seems to have been lower in countries with high tax burdens and greater share of income tax and VAT productivity.

GRAPH 32
LATIN AMERICA (SELECTED COUNTRIES) PUBLIC SPENDING, NINE MONTHS IN 2008 – NINE MONTHS IN 2009
(Percentages of GDP)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), based on official figures

Increasing expenditure is explained by greater current spending and infrastructure investment costs, especially in housing construction. In the first nine months of 2009, there was a significant increase in current spending, and less capital spending, whose increase is usually slower (see Graph 32).

Even though the measures to increase spending prevailed over those related to tax reduction or increasing tax revenues, several countries in the region resorted to authoritative measures. Indeed, eleven countries implemented tax cuts on income tax for individuals, through changes in deduction regimes, reductions of rates, or greater exemptions - two of which are transitory. In addition, an equal number of countries announced changes in companies' income tax, through new exemptions, deductions and accelerated depreciation systems - four of which are transitory. It is worth mentioning the case of Brazil, where, although the increase in total spending was lower than in other countries, measures were adopted for reduction of tax rates over industrialized products

(temporarily on vehicles, appliances and building material), reduction of tax rates over financial transactions, and changes were made to the tax rates paid by low-income individuals.

The breakdown of social measures by sub-region reveals significant differences in the approaches to their composition. In South America and Mexico, three quarters of the measures announced are associated with support to poor families, while in Central America distribution is more balanced, and half of the measures announced are consumer subsidies, while the other half provide support to low-income families. As noted above, this shows a discrepancy in relation to institutional capacity to carry out these policies, since the measures in question, although more effective, require greater institutional efforts. Although consumer subsidies are relatively simple to implement, they reach a larger number of people, which can generate a regressive bias in favor of those who consume most.

Concerning the effect of the measures adopted, the difficulties involved in authoritative incentives and deductions in the region are well known - usually called "tax expenditures" - both in terms of quantification and measurement of their effects. On the other hand, it raises a question about the duration of the measures and the ability of some governments to sustain the level of spending entailed by these policies. It should also be noted that although measures were taken by central governments, many of them have required resources from subnational governments, which requires greater intergovernment coordination and adds an additional fiscal policy vulnerability vis-à-vis the crisis.

4 FINAL THOUGHTS: MACROECONOMIC POLICY BEYOND THE CRISIS

Although not as dramatically as in the past, the region was affected by the crisis, interrupting a process of six consecutive years of growth and improvement of social indicators. Regional GDP is expected to fall in 2009, mainly due to the sharp decline expected in the Mexican economy, with negative impacts on employment and poverty. As noted in the previous two sections, the growth of the 2003-2008 period was accompanied by increased employment and improvement in employment quality, factors that led to reduced poverty and inequality. In 2009, it was the opposite: low or even negative growth rates were accompanied by a rise in unemployment and informality, a weakening of employment with social protection and reduction of full-time employment.[26] The combination of these elements will result in increased poverty and inequality in a region with over 180 million poor and 70 million extremely poor people.

26. ECLAC / ILO Bulletin (2009).

It is hoped that the tentative recovery observed towards the end of 2009 will consolidate in 2010 and that Latin America will resume growth, although it is likely to do so at rates lower than those of the boom period cut short by the crisis. The expected growth may be insufficient in terms of employment demand, which may hinder rapid recovery of the amount and quality of jobs and, therefore, of social indicators.

On the other hand, reduced investment has an immediate negative impact not only on the demand for goods and the level of activity, but on the region's growth capacity in the long run. It is often argued that the region took 14 years to recover the per capita GDP in place before the eighties' debt crisis, and 25 years to recover the poverty rate observed before the crisis. As noted in Section II, the investment to GDP ratios observed in the region back in the seventies did not occur again. In recent years, Latin American countries were managing to increase their rates of investment, but this path was interrupted before they could recover the amount necessary to grow steadily at a rate higher.[27]

On the other hand, it is highly likely that the crisis will bring about deep changes in the international arena that will generate an environment less conducive to growth than that experienced in the region between 2003 and 2008. First, it is likely that the post-crisis world will be characterized by lower global growth, due to less intense aggregate demand in developed countries, partially offset by increases in aggregate demand in developing countries. [28]

As a result, it is expected that emerging economies will play a more prominent role in global growth, but in the context of a slowdown in trade flows. Reduced demand for imports in developed economies will narrow the space for emerging economies to introduce new products in these markets, boosting competition and encouraging the adoption of growth-oriented strategies directed to domestic markets, at least in the relatively larger economies.

On the other hand, the global financial crisis highlighted the need for deep reforms in the international financial architecture, especially in regulatory and supervisory systems, so as to ensure greater global financial stability. The crisis made it clear that institutional mechanisms for the control of systemic risks did not evolve hand in hand with the process of globalization and financial liberalization. Thus, it would be necessary to change the approach and scope of regulation and supervision of domestic financial systems, accompanied by a greater effort to coordinate global regulation. These changes will probably result in more comprehensive regulation and supervision over various financial instruments and market participants. The

27. It is estimated that in order to grow steadily at 6% a year, the average investment rate in the region should be between 24% and 27% of GDP. See ECLAC (2006)
28. See Rogoff (2009).

change in the banking model is expected to lead towards a more transparent banking system, with less incentive to risk-taking and lower levels of leverage, which will mean a reduction in international financial flows and, thus, a partial reversal in the process of financial integration observed until the onset of the crisis.

To recapitulate, Latin America faces the renewed challenge of increasing its growth rate in order to respond to the needs arising from a complex social situation that must be addressed urgently. But such growth requires more investment and, in our region, it implies an increased demand for currency to purchase capital goods which are mostly imported. One wonders then, how the region will fit into a world characterized, first, by lower growth in developed countries and greater participation of developing countries in global growth and, secondly, by financial systems subject to stricter regulation and supervision, with less buoyant credit markets and higher interest rates.

It is not our objective to provide an exhaustive answer to these questions, which ultimately entail the need for sustained economic growth supported by increased productivity and more equitable distribution. We simply intend to raise some contributions, which - based on the design of macroeconomic policy - can contribute to strengthening the link between growth and equity, which is quite weak in the Latin American experience.

Macroeconomic stability is a necessary condition for the region to grow more and to distribute better, but stabilization must be understood broadly, as an objective that goes beyond ensuring low and stable inflation. Undoubtedly, this is a central objective of macroeconomic policy, but the economic history of Latin America has given numerous examples of the major costs generated by real instability. This highlights the importance of sustainable macroeconomic management, defined in terms of expected trends of the main variables, to serve as a reference for decision-making that goes beyond the short term.

It is crucial for macroeconomic policy design to allow tackling the fluctuations associated with economic cycles, but this capability must be forged in times of economic boom to be used in times of recession, thus avoiding excessive fluctuations in public service provision and in real exchange and interest rates. This is an important lesson emerging from the crisis, as it highlighted the benefits originated from counter-cyclical policies implemented, in varying degrees, by different countries.

However, this was not always the case. On the contrary, a comparative view of the past thirty years shows that most Latin American countries' fiscal policy behaved pro-cyclically, in contrast to that observed in developed countries, where it has been counter-cyclical or at least acyclical.[29] Despite

29. See Lopez-Monti (2009b) for a comparative analysis of the cyclicality of fiscal policy in Latin America and developed countries.

recent improvement, Latin America still records very high levels of real volatility, which carry significant costs in terms of welfare.[30]

Of course, the implementation of counter-cyclical policies is a task that is not free of tensions and conflicts, largely associated with the difficulty in identifying the long-term trend in many of our economies, but may also result from differences in preferences of different operators in specific situations. In this case it is highly probable that sectors with savings capacity or access to financing differ in their interests from those of the poorest strata, who face severe spending restrictions, since they lack savings capacity and have very limited access to financial markets.[31] In this sense, counter-cyclical macroeconomic management is particularly relevant to lower income groups, and policy actions during booms to build capacity to cope with the downturn cycle are particularly important from the distribution perspective.

In general, macroeconomic policy affects growth and distribution through the way it combines the handling of variables that are, at least partly, under the control of economic authorities, such as the amount and type of tax collected, the level and composition of public spending, interest rates and the type of exchange rate. The way these instruments are used strongly affects decisions over production, accumulation, and income of different groups or sectors. The set of instruments available and the nature and intensity of their effects depend on the structure of the economy, their institutional framework (such as ownership of natural resources) and history (for example, experiences affecting the demand for domestic assets and the soundness of financial systems).

In Latin America, the tax burden of most countries is insufficient to guarantee the spending needs of States. But tax collection in the region is not only insufficient, but ineffective.[32] In particular, the low participation of income tax and the fact that the tax structure is sustained mainly by indirect taxes of a regressive nature should be noted.[33] These tax systems are among the factors that contribute to the maintenance of an unequal income distribution framework and, therefore, to poverty and extreme poverty, given that the tax policy has relegated the goal of improving distribution in detriment of other purposes. The main challenge is not only to increase collection, but also improve its impact over income distribution, by increasing the burden of well-off sectors.

30. For an estimate of the cost, in terms of welfare, of the cycle fluctuations in Latin America based on different models, see Lopez-Monti (2009a)

31. See Krusell and Smith (2002)

32. See Cetrangolo and Gomez Sabaini (2007) on this subject.

33. This could also affect the effectiveness of automatic stabilizers. On this point, see Sescún (2007).

As regards spending, all areas of the public budget should be submitted to some kind of reformulation, in response to the dissatisfaction of society concerning the extent and form of government intervention.[34] In particular, with regard to social spending, reforms are expected to play a central role in building more cohesive societies, in allowing greater legitimacy of public policies and, therefore, the payment of taxes to finance them. However, the demands for increased public spending are not limited to the social area. They include, for example, public investment in infrastructure, which impacts activities of other sectors, plays a role in boosting the economy, has a significant impact on competitiveness, and on the definition of productive profiles[35].

In short, it is necessary to ensure sustainable financing of a number of services the States should provide to help achieve higher and more inclusive growth. Although this requirement directly involves different aspects of the fiscal policy, it far exceeds its scope, to become the basis for a new social pact, an issue that would require a whole new article to be addressed in detail.

Finally, the monetary policy should seek to achieve the lowest and most stable inflation rate possible. This consensus has been widely reached in a region that has gone through very difficult times associated with high inflation processes. However, it should not be forgotten that the choice of the monetary and exchange regimes determines a variable as important as the exchange model. The real volatility characteristic of Latin American economies is closely linked to the excessive fluctuation of real exchange rate, which has a negative impact on investment, especially in tradable goods. Therefore, macroeconomic policy should seek to avoid large and sudden real exchange rate fluctuations, regardless of whether nominal currency prices fluctuate according to market conditions or to what is set by economic authorities.[36]

The difficulties associated with reducing the exchange volatility in a region exposed to strong external shocks are not minor, but it is clear that low prices of tradable goods resulting from excessive appreciation tend to induce a configuration of production and investments that hinders growth and diversification of exports.[37] Moreover, these relative prices lead to misperceptions of spending capacity (measured in foreign currency), which end up generating high external imbalances and unsustainable debt levels.

Therefore, the economic policy, and particularly central banks, should have the "second objective" of maintaining an exchange model that is real, stable and competitive. To that end the tools available range from direct interventions and

34. An assessment of the perception of social programs in Argentina can be seen in Cruces et al (2007). One interesting finding of this study is the need to include aspects of the flow of information relating to program content and evaluation as a way to improve their legitimacy.

35. See Lucioni (2009).

36. Bastourre and Carrera (2004) found a negative association between the degree of flexibility of exchange rate policy and real volatility.

37. Aghion et al (2006) show that exchange rate volatility adversely affects growth in economies, such as Latin-American, that have poorly developed financial systems.

actions of "deterrence", to restrictions on short-term capital inflows, as relevant. Of course, a more active monetary policy to try to sustain a model of real exchange rate requires fiscal discipline as a counterpart. However, maintaining the real exchange rate at any cost may, in certain circumstances, lead to inflationary pressures, which goes against the main objective of the monetary policy.

The difficulties it may bring about should be addressed by strengthening coordination, so as to enable comprehensive and explicit evaluation of the costs of any relevant variable moving away from the target value in relation to the benefits of avoiding possible deviations of other variables which are also given weight in decisions. However, taking into account the importance of a real exchange rate model as a macroeconomic signal on decisions about production, investment, demand and financing, it seems inadvisable to treat it as a "residual" variable for the economic policy.[38]

These paragraphs have attempted to identify some factors that should be taken into account in the design of macroeconomic policies aimed at mitigating volatility. The multiplicity of objectives involved calls for independent instruments. In turn, this requires acting over structural constraints that limit policy autonomy: institutions, the availability of tax resources and the quality of the state apparatus.

Economic development is a complex construction, which goes far beyond mere quantitative changes and leaps of scale, and should be seen as a process of continuous transformation of productive and social structures. The difficulty faced by Latin American economies in this regard is associated to the lack of some markets (such as long-term credit in local currency), imperfect competition of other markets, asymmetric distribution of information (e.g., credit markets or technology, and investment opportunities), and coordination failures. All this stresses the importance of the State's presence, since the generation and expansion of public policy space, through the development of instruments and the strengthening of different spheres of coordination, are critical tasks to ensure growth and development.

The need to achieve sustained growth based on increased productivity and equity highlights the importance of reducing volatility to encourage growth, to generate more jobs, and to reduce the susceptibility of the most vulnerable segments of the population. Ultimately, as noted Prebisch 60 years ago: "If, for social purposes, one seeks to maximize real income, counter-cyclical considerations cannot be absent from the economic development program. The dissemination of cyclicality from the great centers to the Latin American periphery entails considerable losses of income. If these losses could be avoided, the problem of capital formation would be less difficult. There have been attempts of counter-cyclical policy, but we must recognize that the elucidation of this matter is still incipient."[39]

38. On the importance of the exchange rate instrument for emerging economies, see Eichengreen (2008), and Rodrik (2007), or, from a Latin American perspective, see Barbosa (2005) and Frenkel (2008).

39. Prebisch, Raúl (1949).

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THE GLOBAL CRISIS AND ITS IMPACT OVER LATIN AMERICA*

Ricardo Ffrench-Davis**

The current crisis is part of a process that began in recent years and may be explained largely by the boom and volatility of financial flows. One can already feel its impact over Latin America and, although the region is in a better situation than in the past, predictions indicate a 2% drop in gross domestic product (GDP) in 2009. This article aims to analyze the origins of the current crisis and its effects on Latin America. In addition, it reviews the steps taken to remedy the most serious deficiencies in financial markets and redirect them to development financing, starting at the 2002 Monterrey Summit, and in the last episode with the G-20 agreement on 2nd April, 2009. Finally, the document analyzes the challenges to be faced in moving towards sustainable development.

O IMPACTO DA CRISE GLOBAL NA AMÉRICA LATINA

A crise atual faz parte de um processo que teve início nos últimos anos e que se explica em grande parte pelo auge e pela volatilidade dos fluxos financeiros. Já é possível sentir seu impacto na América Latina e, ainda que a região se encontre em melhor situação que no passado, os prognósticos indicam uma queda de 2% no produto interno bruto (PIB) de 2009. O presente artigo tem por objetivo analisar as origens da atual crise e os seus efeitos na América Latina e, em seguida, rever os esforços empreendidos para sanar as deficiências mais graves dos mercados financeiros e redirecioná-los para o financiamento do desenvolvimento, que tiveram início na Cúpula de Monterrey, de 2002, e em seu último episódio com o acordo do G-20 de 2 de abril de 2009. Por fim, serão analisados os desafios a serem enfrentados para avançar rumo ao desenvolvimento sustentável.

INTRODUCTION

The current crisis is part of a process that was put in motion in recent years. Current globalization is characterized by a huge boom in financial flows that are remarkably volatile. These fluctuations are expressed in intense cycles that last long periods of time and affect the quality of resource allocation and equity, in addition to generating growing imbalance, ultimately bringing about costly recessions in the real economy. Latin America has been a favorite, recurrent target of these crises. Indeed, the region has endured deep recessions during the eighties, in 1995, in 1998-2003, and currently.

As known, this time the epicenter of the crisis originated in the major global economy, the one that intensely promoted the liberalization of financial markets. Currently, most of the world is caught in the crisis resulting from the globalization of financial volatility. The severe consequences at the global level should ultimately lead to urgent correction of the international financial architecture.

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* Materials developed by Ffrench-Davis (2005) and (2009) will be partially used.

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Section 1 of this paper provides a brief account of financial globalization and the current global crisis. Section 2 examines the impact of financial crises on Latin America. Section 3 considers the major international effort in recent decades to correct serious failures in financial markets and redirect them towards funding for development. The United Nations Summit held in Monterrey in 2002 is also addressed, culminating with a brief summary of the Doha Summit and the G-20 Agreement on 2nd April. Section 4 concludes with the challenges to be tackled in the current crisis to ensure a shift towards sustainable development.

1 VOLATILITY OF FINANCIAL GLOBALIZATION AND THE CRISIS

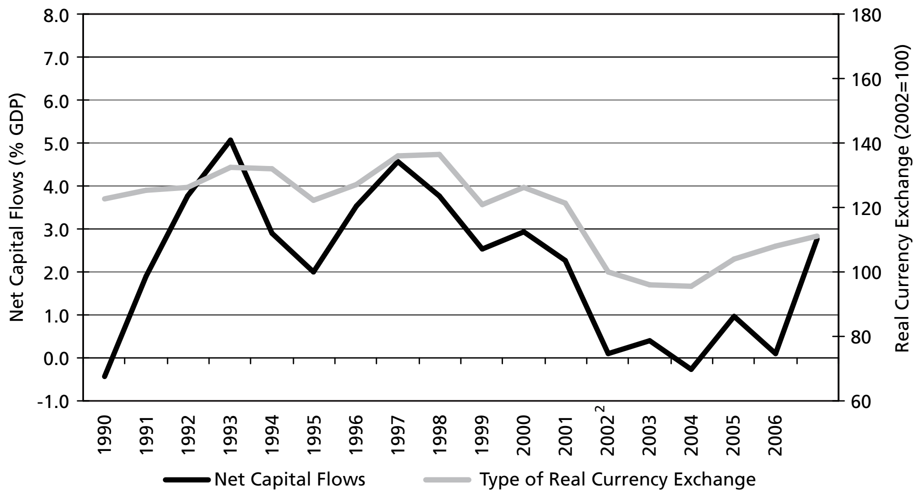
The current global crisis was gradually generated in the preceding five-year periods. The growing short-termism and speculative bias of international financial markets was at the core of its origins. Capital markets have expanded dramatically in recent years with large diversification across segments that are increasingly shady and prone to speculation and high leverage. The growing presence of international financial offshore centers and tax havens with little or no regulation at all encouraged dodging of national financial regulation, capital controls and taxes. This phenomenon, together with the revolutionary breakthrough developments in information and telecommunications technologies, as well as the use of increasingly sophisticated financial techniques (many of which allow excessive leverage via off-balance sheet operations), contributed to a remarkable boom in international flows. Pro-cyclical macroeconomic policies completed a scenario prone to explosive imbalances, given the magnitude of resources involved and the volatility that characterized them.

It is estimated, based on data by the Bank for International Settlements, that for every dollar of transactions in international trade of goods and services, as much as US$40 are transacted in currency exchange markets. Such an unequal ratio results from funds that are transacted several times per day, apart from real trade and productive investment. This complicates the macroeconomic environment for the real economy, where the overwhelming majority of enterprises and workers operate. In financial markets there are frequent "mood swings", which affect price expectations, for example, of the dollar and stock markets. This, in turn, enables net funds, unlike those invested in productive activities ("irreversible" investments), to migrate suddenly to another geographic market. These mood swings of financial and foreign exchange markets affect the real economy very strongly, i.e., in production, employment, utilities, and also tax revenues.

In general, the financial boom took place in a context of loose or partial regulation and supervision. It should be pointed out that the lack of regulation has not been uniform. In fact, for example, banking systems regulation persisted, particularly in developed economies. As we know, however, this regulation generally has a pro-cyclical bias, aggravated by Basel II (see Griffith-Jones and Persaud, 2005; Ocampo, 2007).

However, the main problem consisted of three very marked characteristics. (i) Growing or new segments (e.g., stock markets, international investment funds and derivatives markets) - which became the dominant share of financial markets - had weak or no regulation at all. These financial "innovations" involved intense shadiness. In a context of prolonged boom in these markets, the perception of the accumulating risks was undermined, including the significant cases of fraud detected later. (ii) Agents in these markets generally allocate resources with a short-term bias, exacerbated by the prevailing incentive systems (see Williamson, 2003). Also, they do so with net resources and at the international level, which creates enormous volatility for national macro-economies. (iii) In addition, a markedly pro-cyclical neo-liberal macroeconomic approach prevails (see Ffrench-Davis, 2005, chap. V, Ocampo, 2007), with strong currency exchange and monetary cycles. Two of its expressions were the huge foreign deficit in the United States, and the exchange delays that have occurred throughout Latin America on several occasions since 2004 (see graph 1).

GRAPH 1
Latin America 19[1] – 1990-2007



Source: Data by Eclac.
Prepared by the author.
Notes: [1] Data based on types of real exchange of 19 countries.
[2] Rate 2002 = 100.

It is hard to predict the precise moment when a crisis will break out, but it is possible to identify when the circumstances leading up to it are brewing. It has often been observed that emerging economies (EEs) have been driven by massive capital inflows to enter ***vulnerability zones***. They include: (i) large current account deficit; (ii) high foreign liabilities, with a significant net component, greater than foreign reserves; (iii) high real exchange rates and currency devaluation; (iv) domestic assets at high prices (stock exchange, bonuses, and real estate assets); (v) high household indebtedness vis-à-vis wages and profits; and (vi) decreasing interest rates with significant increases in monetary supply.

The longer and deeper the entry into these *vulnerability zones*, the stronger the *financierist trap* authorities may fall into, and the less likely to escape from it without experiencing a crisis with major economic and social costs.

Several combinations of these variables were present in the Latin American crises of 1982, 1995 and 1999, with gradual worsening of vulnerabilities. However, since the processes involved continuous increases in asset prices, they have provided increasing returns to financial operators, despite generating macroeconomic imbalances. Herein lies a serious contradiction between the "rationale" of financial operators and that of macroeconomists, who should focus on sustainable stability without the distortions that undermine productive development.

The U.S crisis shares many of these sources of vulnerability with EEs: for example, very low interest rates, bubble in real estate prices, incentives to provide increasingly risky loans driven by high liquidity, high leverage, and rating agencies behaving pro-cyclically. On the other hand, the U.S. crisis differs substantively from that of EEs, in that the United States is the issuer of the leading international currency and it was in US markets that the channels of expansion were created, with a large amount of financial engineering, which is then globally exported. It should be noted that these channels involve highly veiled risks, with intense leverage.

The area of sub-prime mortgages only triggered the crisis, but if it had been the major source of vulnerabilities, the scope would have been limited to one sector of the U.S. economy. Clearly, this sector experienced an unsustainable boom, based on the misperception that prices would continue to rise permanently (a feature shared by many situations leading to the crisis in LACs). However, in parallel, numerous other imbalances of a financierist origin were generated.

(i) On the one hand, the U.S. mortgage market bubbles spread across the globe[1], but with a rather "micro" scope worldwide: it was not possible to trigger a crisis in a world with GDP amounting to over US$ 60 billion. (ii) "Financial innovations" also spread worldwide, in the absence of effective

1. In addition, housing booms occurred simultaneously in many other countries.

regulation, facilitating massive cases of fraud, with real impact, but also with pro-cyclical impact on expectations. (iii) Many of these investors were operating with significant leverage, which could be justified in the case of actual producers and users of products, as they are backed by real activity; however, it could not be justified in the case of speculators, who operate with minimum capital. (iv) There were major stock market booms, inconsistent with the increase in the support base for stock prices, which are actual flows of net profits.

At the macroeconomic level, the U.S. economy incubated a growing current account deficit during the nineties. In the first phase, until 2000, rising external deficit was explained by the private sector. With the 2001 recession, the private sector adjusted, but the government initiated a process of increased fiscal deficit, which lasted until 2003, reaching almost 5% of GDP. Between 2003 and 2006, the public sector began to readjust, at the same time that the private sector boom worsened the already high current account deficit, which reached 6% of GDP in 2006.

Along the same lines, for several years, long-term interest rates fell in the U.S., reaching historically low levels; this trend was intensified after 2002, associated with a significant increase in demand for U.S. Treasury bonds. A similar trend occurred in real estate assets, whose prices nearly tripled (191%) between 1996 and peaked in mid-2006, growing at a 2-digit yearly rate between late 1999 and 2006 (see Table 1).

TABLE 1
United States – Home price index S&P Case-Shiller

	Level (Jan.)	Rate (Dec./Dec.)
1989	81	6.1
1990	82	-3.6
1991	78	-1.8
1992	78	-1.7
1993	76	-1.3
1994	77	1.7
1995	77	-0.4
1996	78	1.9
1997	80	5.4
1998	87	9.1
1999	95	10.8
2000[1]	107	14.1
2001	120	8.9
2002	133	15

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(Continued)

	Level (Jan.)	Rate (Dec./Dec.)
2003	151	13.4
2004	179	18.7
2005	209	15.9
2006	225	0.2
2007	215	-9.7
2008	182	-19.1

Source: Standard & Poors (S&P).
Note: [1] Jan./2000 = 100.

The stock markets of many nations played a central role in the bubbles, since they were also on increasingly unsustainable paths. In turn, the price of natural resources skyrockets. Over time it became evident that derivative markets for these products were invaded by speculators, which is clearly confirmed by the rapid collapse in the downward cycle (see Table 2). There were obvious signs of bubbles, not only in the U.S. housing sector, but on a global scale.

TABLE 2
Basic goods price index

	2003[1]	2004	2005	2006	2007	2008
General index	100	120	134	175	197	250
Food	100	114	122	145	158	228
Oilseeds	100	113	102	108	165	225
Agricultural raw material	100	113	118	136	151	185
Minerals and metals	100	141	178	285	321	352
Oil	100	131	185	222	246	353

Source: United Nations Conference on Trade and Development (UNCTAD).
Note: [1] = 100.

The pro-cyclical behavior of rating agencies worsened the imbalance by influencing the expectations of agents. It is amazing that those who should safeguard sustainability and foster transparent assessment of agents and markets - rating agencies - in general, fueled imbalances with their assessments. In fact, their assessments continued to be highly pro-cyclical, as occurred in the beginning of the Asian crisis (see Reisen, 2003).

Today, the world faces the urgency of resolving the largest crisis since the thirties. It has been possible to avoid widespread and destructive panic, with more pragmatic and effective policies than those of the thirties. Paradoxically, this may discourage the correction of current globalization failures. However, the reality of the real economy shows that correction is essential. Indeed, in 2009 most of the

world's production capacity is undergoing recession, well below capacity. Indeed, even if a chaotic situation has been avoided, the total losses in production, employment, profits and tax revenues are remarkable.

Thus, one should not miss this opportunity and introduce reforms to correct the speculative bias and the current lack of clarity, as they have clear regressive implications. No doubt, there is a substantial shortage of macroeconomic and financial regulation at the current stage of an unbalanced globalization, as well as a significant imbalance among the voices, opinions and interests that are taken into account in the design and implementation of public policies. "Productivism" has to replace "financierism" (Ffrench-Davis, 2005), so as to bring into being a market that fosters the financing of development and growth with equity, as discussed in Section 3. Beforehand, Section 2 examines the impact of the crisis over Latin America.

2 GLOBAL CRISIS AND ITS IMPACT IN LATIN AMERICA

Countries in Latin America have gone through frequent crises associated with financial volatility. The most severe in recent times was the eighties' crisis. But later on, the region was affected by the contagion of the Asian crisis for a period of six years.

The scale of purely financial flows far exceeds all other international transactions, whether by way of foreign direct investment, trade credits, official development assistance, or remittances by migrant workers.

After the brief 1995 crisis (the so-called "tequila crisis"), the return of capital flows to Latin America in 1996-97 once again allowed for improvements both in economic activity and price stability, but at the expense of exchange rate appreciation and rising external deficits. The result was the subsequent entry into vulnerability zones. Consequently, in 1998, when the Asian crisis contagion hit Latin America, it brought about widespread recessionary adjustment in the region, especially in South America, with massive capital outflows and strong currency depreciation. Subsequently, recessive gaps lasting around six years led to reduction in total real productivity factors and GDP losses, as well as stifling of investment in physical and human capital. That is, with the deterioration of the present and the future, development is undermined and the achievement of productive development and equity is hindered.

Thus, between 1998 and 2003, regional GDP growth plummeted to 1.4% a year, i.e., less than the increase of the population. This, in turn, had an impact on employment: for example, the average unemployment rate in Latin America after the in East Asian crisis increased by 3-4 percentage points in between 1999 and 2003, as compared with 1997. This is one of the most glaring failures in

resource allocation: the allocation of resources to unemployment benefit. And correction requires reforms in national macroeconomic policy making and in international architecture.

In the following years, vigorous recovery was observed, with 5.5% GDP growth in the region in the 2004-07 period. The change was quite abrupt, and in 2004 GDP growth shot up to 6.1%, a major contrast with the 1.4% slump of the previous period. There was no preliminary step in productive investment or sharp technological revolution. The driving force of such hasty leap was the positive external shock, especially as regards the terms of trade in the region. But the latter, even if national economies were macroeconomically balanced, could not have responded so positively. An irrefutable proof of the intense imbalance was the large gap between real GDP and potential GDP in the period[2]. The abundance of external funds, based on an improvement of 25% of the terms of trade, generated strong surpluses in external balances, debt reduction, and significant accumulation of international reserves. All these strengths contribute to reducing vulnerability vis-à-vis eventual negative external shocks. There was widespread rumor that Latin America was able to detach from external shocks.

The last external crisis emerged in mid-2007. A year later, the theory of detachment seemed to be confirmed, as the region maintained the pace of growth experienced in recent years. Similar to the Asian crisis contagion, this crisis arrived with a lag. But it did arrive, despite the region's strengths. Undoubtedly, the strengths are a valuable asset once contagion hits. In effect, they allowed for the implementation of counter-cyclical fiscal policies and for the moderation of exchange rate depreciations.

However, the region has been affected by substantial recessive and regressive impacts.

3 FROM THE MONTERREY CONSENSUS TO APRIL 2009 G-20

In 2002, the international community held a summit in Monterrey aimed at agreeing on measures to correct the path of financial globalization. At that time, a threatening globalization of volatility was brewing, and the boom in financial flows was contributing little to financing for development (Ffrench-Davis and Ocampo, 2001, Rodrik 1998, Stiglitz, 2000). The trends at that time indicated that the world's pace was to slow to achieve the Millennium Development Goals (MDGs).

2. In the 2004-2007 period, driven by vibrant global economic activity and marked improvement in the terms of trade, there was major reduction in the GDP gap. While potential GDP grew around 3%, real GDP grew by 5.5% during the four-year period.

The Consensus represented a shift towards a pragmatic approach, as it stressed the need for "adequate" level of productive investment. Greater productive investment required financial development, with considerable strengthening of long-term capital market segments and the creation or promotion of segments focused on financing small and medium enterprises (SMEs) in domestic markets. This represents an essential link between economic growth and equity, as it extends to low and medium income agents - major suppliers of productive jobs - the ability to access markets more effectively.

The text in the Consensus stresses the importance of "sound macroeconomic policies." In addition to concern with price stability and fiscal balances, it highlights the need to also consider the achievement of full employment, poverty eradication and sustainable external balances, which, in turn, require an "appropriate exchange rate system."

The Monterrey Consensus confers priority to the prevention of potential crises, with particular attention to short-term capital flows. It underscores that international financial institutions, including the International Monetary Fund, should strengthen compensatory financing in order to avoid or mitigate the deepening of crises.

The United Nations has prepared comprehensive yearly monitoring reports on compliance to the commitments undertaken in 2002, and made recommendations on how to achieve the agreed goals.[3] Similarly, the General Assembly has organized high-level dialogues on financing for development. The dialogues culminated with the Doha Summit, held in late 2008, amidst full-blown global financial crisis.

Such documents show that the United Nations were anticipating the worsening of the international financial environment, which culminated in the ongoing global crisis. Meanwhile, international financial institutions had a complacent attitude, oblivious to the global imbalances being generated and expanding. In different ways, they even encouraged the liberalization of speculation markets and financial market-oriented policies. It was the prevailing, widespread trend.

UN reports, especially the 2007 Report, address many aspects of the Consensus and suggest a coherent policy-making approach aimed at the achievement of the goals established by signatory countries. Four main points are highlighted here: styles of conducting macroeconomic policy; intensity and coverage of counter-cyclical regulation and supervision; formal compensation mechanisms for external shocks and international liquidity; and the role of the quality of domestic capital markets in developing countries.

3. The United Nations Secretariat has made excellent assessments of implementation progress and setbacks. See details and references in Ffrench-Davis (2009, section 2).

The progress recorded in the report, regarding the understanding of macroeconomic issues, is of great importance, as the approach adopted seeks to reduce the gap between real production and potential GDP, an approach termed *macroeconomics for development*.[4]

It underlines the need to strengthen regulation, supervision and transparency of financial markets, including hedge funds and derivatives. It should be pointed out that the position taken in the report precedes the explosion of the mortgage lending crisis in the United States and the intensification of the speculative ingredients related to rising prices of several commodities. It addresses several issues related to the international financial architecture and its backwardness as compared with other forces in globalization.[5]

One of the most prominent topics is that the international community has not created a compensation tool to offset reduced liquidity in developing countries. In this regard, the report suggests urgent resumption of the issuance of Special Drawing Rights, as an essential part of a new international financial architecture.

It should be noted that the effects of capital inflows on economic growth also depend on the quality of domestic intermediation and foreign exchange policy. Fashionable approaches have failed miserably: intermediation has focused on consumer finance and overvaluation of existing assets and has been lacking or weak with respect to investment projects, while at the same time inflows in general have led to quotations outside a sustainable balance (outlier prices). Latin America has been an example of such failure: a boom in "financial savings" associated with stagnant national savings and minimal rate of productive investment (see Ffrench-Davis, 2005, chap. II). Consequently, it generates the need - in developing economies – for active exchange rate policies that are consistent with the evolution of internal productivity, as well as the need to concentrate financial reforms on the development of long-term and non-traditional segments within the national capital market.

Issues relating to illicitly acquired funds and tax evasion are addressed. In fact, a common feature in many developing countries is an extremely low tax burden combined with high tax evasion and avoidance. As a result, the ability to finance investments in infrastructure and human capital to ensure the efficiency of public spending is limited. Therefore, it is essential to strengthen international cooperation to fight tax evasion, money laundering, illegally acquired funds, funding of terrorism and corruption.

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4. The proposals are consistent with the recommendations we have repeatedly made on the need to change the predominant macroeconomic approach in Latin America, which features a neo-liberal bias or a financially-oriented macroeconomics, rather than concentrating on sustainable development. For an analysis of approaches to "financially-oriented and real" macroeconomics, see Ffrench-Davis (2005, Chapter I). The texts in quotes are from the UN report (2007).

5. Among other issues, the 2007 UN Report highlights environmental taxes, which contribute to mitigate environmental degradation and provide funding for research, mitigation and adaptation, and taxes or royalties over the use of natural resources.

The approval of the Doha Summit Declaration, which comprises an assessment of the progress made and obstacles faced in the implementation of commitments under the Monterrey Consensus, faced strong opposition, led by the U.S. government delegation, just ending its term of office. The final text reiterated the ideas of the Consensus and the purpose of strengthening the monitoring of compliance with the commitments undertaken; however, it was subject to intense negotiations, which ended up weakening it.

The most significant progress is related to three topics. (i) The agreement that a conference on the international financial crisis should be held in 2009. This implies the acceptance that the United Nations and its Member States are entitled to a say on an issue that some countries wish to limit to the IMF and World Bank spheres.[6] (ii) The recognition that the international economic system architecture also requires adjustments to meet the needs of middle-income countries. (iii) The explicit recognition, after lengthy discussions among delegations, that there should be space for so-called "innovative financing", with special recognition of the Action Against Hunger and Poverty Initiative, described below.

b) Action against Hunger and Poverty Initiative

In 2004, determined to contribute to the fulfillment of the Millennium Development Goals and the Monterrey Consensus, a group of countries in the North and South launched an initiative to identify innovative sources of funding to promote public goods, foster solidarity-based economic development, and finance the fight against public evils, such as hunger and poverty.

The presidents of Brazil, Chile and France and the United Nations Secretary General - later joined by the Heads of State of Spain and Germany - created the Action against Hunger and Poverty Initiative. The funds raised by innovative sources would be used to implement projects aimed at attaining the Millennium Development Goals (see Action against Hunger and Poverty, 2004, 2005).

In 2006, the Leading Group on Innovative Financing for Development was established. Currently, the group comprises 58 countries from the North and South, including the five mentioned above, whose representatives expressed their willingness to levy taxes for development and contribute to fundraising to fight "public evils", such as tax evasion and financial crises.[7]

6. The meeting was held in June, but with participation of few delegations, and reduced impact.

7. The Pilot Group addressed various issues besides those covered by the Initiative for Action against Hunger and Poverty. The Group's work includes an assessment of solidarity levies on air travel, issuing of Special Drawing Rights, such as financing counter-cyclical mechanisms to address trade and financial instability in developing countries, introduction of a modest tax on currency exchange transactions, repatriation of illicitly acquired funds, improving the role of the carbon market, linking migrant workers' remittances to microcredit in recipient households, the increasing efforts to fight fraud and tax evasion, and implementation of a digital solidarity contribution.

Concrete progress has been made. In 2006, it launched the pilot project for a solidarity levy on international airline tickets, earmarked for the fight against HIV/AIDS, tuberculosis and malaria. Currently, 34 countries contribute to financing the activities of UNITAID, the mechanism created to allocate funds, in collaboration with national health services in poor countries.

c) Fighting international tax evasion

Hunger and poverty are also associated with weak tax systems, mainly because of tax evasion through tax havens, among other reasons. Thus, curbing tax evasion can become a major innovative source of financing for development. This topic has sparked renewed interest, with the disclosure of significant cases of tax evasion in developed economies, sheltered by the secrecy of tax havens.

Permissive policies vis-à-vis the expansion of financial flows with little or no restrictions have accentuated this failure of globalization. It is well known that a considerable part of the resources that leak out of the tax systems of countries in the North and South are sheltered in tax havens.

Tax evasion is extremely unfair to honest taxpayers. Tax havens are one of the means by which this inequality is perpetuated. Tax evasion is also related to money laundering, corruption and terrorist financing, three global "public evils".

Given the precarious fiscal systems often found in developing countries, it is essential to strengthen their ability to raise revenues through the implementation of measures to prevent evasion through tax havens. The United Nations Committee of Experts on International Cooperation in Tax Matters can play an important role in this regard. The Organization for Economic Cooperation and Development (OECD) has also addressed the issue of tax evasion and tax havens. Collaboration between the two institutions could contribute to the adoption of concrete measures to fight international tax evasion and improve tax systems in developing countries.

4 CONCLUSIONS

The Action against Hunger and Poverty Initiative and the Leading Group on Innovative Financing for Development have drawn up proposals to strengthen anti-cyclical mechanisms and their funding with counter-cyclical issuances of Special Drawing Rights (SDRs) by the IMF . The United Nations Committee for Development Policy made convergent proposals in its 2008 and 2009 reports.

External crises, whose effects are transmitted through trade and capital accounts, usually have considerable negative economic and social impacts on developing economies. Installed economic capacity is used inadequately and resources are wasted. Therefore, economic crises may also prevent or delay the achievement of the Millennium Development Goals.

It is therefore necessary to establish an international financial architecture favorable to development, with comprehensive regulation and supervision of financial markets, that includes major reform of official counter-cyclical financing for developing economies affected by financial and trade shocks, supports the fight against tax evasion, and includes gradual release of an international reserve currency, like SDRs.

Given the deterioration of global economic prospects, its implications for developing countries, and the absence of effective compensation mechanisms, it is urgent to reform the compensatory financing architecture, in order to provide official liquidity and assistance to developing countries affected by the negative effects of external crises. In order to be effective, liquidity must "be adequate, of speedy disbursement, at a scale proportionate to the shock, and impose few conditions."[8] The G-20, on 2nd April 2009, agreed upon reforms in line with these approaches, taken up strongly and comprehensively by the Stiglitz Commission in its June report.

To fund a considerable increase in the volume and quality of compensatory financing, and taking into account the arguments in favor of a gradual transition into a global currency for reserves, the issuance of Special Drawing Rights (SDRs) should be resumed. A new reform should allow the IMF to allocate them to finance a significant increase in the availability of compensatory financing. The current prospects of downward adjustments in economic and financial turbulence constitute an appropriate context for a new allocation of SDRs, with an anti-cyclical function, so as to ensure a gradual shift towards a truly international reserve currency.

Considering the growing imbalances resulting from globalization, the restructuring of the international financial architecture to respond to deep changes in the global economy is an urgent task. Instability is a harmful feature of the current global financial architecture. The voice of developing countries should be taken into account and prevention and management of financial crises (including the proposed reform of anti-cyclical mechanisms) should be seriously addressed. Firstly, international finance generally pays little in taxes at the expense of the real economy, particularly immobile factors of production. The currency transaction tax could help improve financial equity, and generate a substantial amount of funds to stimulate equitable growth (see Williamson, 2006). Secondly, fashionable approaches advocating complete opening of capital accounts are markedly biased toward high-income producers and short-termist

8. The IMF approved a new mechanism in late 2008. It is the Short-Term Liquidity Facility, SLF. The arrival of the new IMF Managing Director, Dominique Strauss-Kahn, has been a positive shift toward pragmatism, with some valuable achievements away from the extreme neo-liberalism of previous years.

speculative agents. The latter are the new rent-seeking actors. It is necessary to reform the rules and institutions to redirect funding to typically excluded sectors such as small and medium enterprises and micro-producers. Thirdly, there is increasingly strong evidence that flows of foreign direct investment to completely new areas or sectors contribute directly to productive investment and promote development, while, on the contrary, short-term financial flows have a weak link with capital formation in periods of economic boom, are a common cause of deep economic depression, and deter productive investment.

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HOW TO IMPROVE REGULATORY AND FINANCIAL INSTITUTIONS

Stephany Griffith-Jones*

Since the 1980s, deep financial crises have become frequent in both developed and developing countries. Although crises have complex causes, it is clear that the liberalization of financial markets, especially when not accompanied by adequate regulation, seems to always lead to serious crises. This implies that financial crises are not preventable, but can be attenuated by appropriate public policies, and especially through regulation. Thus, this article sets out key principles for the reform of financial regulation, and presents institutional arrangements necessary for the proper functioning of the global financial system.

COMO MELHORAR A REGULAÇÃO E AS INSTITUIÇÕES FINANCEIRAS

Desde a década de 1980, profundas crises financeiras se tornaram frequentes, tanto em países desenvolvidos quanto em desenvolvimento. Embora as crises tenham causas complexas, é evidente que a liberalização de mercados financeiros, especialmente se não acompanhada de regulação adequada, parece sempre conduzir a graves crises. Isto implica que crises financeiras não são evitáveis, mas podem ser amenizadas pelas políticas públicas adequadas e, especialmente, por meio da regulação. Assim, o presente artigo estabelece princípios fundamentais para a reforma da regulação financeira, além de apresentar arranjos institucionais necessários para o bom funcionamento do sistema financeiro global.

1 INTRODUCTION

It is useful to put crises and responses to them into a historical context. Firstly, it is important to stress that after the Great Depression, the financial sector – particularly, but not only, in the US – was re-regulated carefully, most notably by the Glass-Steagall Act of 1933. During the next 40 years, the financial sector was closely regulated, capital accounts were essentially closed, and there were practically no financial crises.

Since the 1970's, and especially during the 1980's and 1990's, there has been far-reaching deregulation, both at national and international levels. Since the 1980's, there have also been frequent and deep financial crises, both in the developing and developed world. These crises have been extremely costly in terms of growth and development. Barry Eichengreen (2004) gives the staggering estimate that over the last quarter of a century, currency and banking crises have reduced the incomes of developing countries by 25 percent.

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The fact that even Japan's GDP fell 12% over the last three months of 2008 shows how serious the impact of the current global crisis is on the real economy. Though crises have complex causes, it is evident that the liberalization of financial markets, especially if not accompanied by appropriate regulation, seem almost always to lead to costly and damaging crises. This implies that financial crises are not inevitable, but rather, may be prevented or ameliorated by appropriate public policy, and especially by regulation.

The only silver lining that appears during these costly crises — such as the current one — is that they provide a political opportunity to carry out desirable regulatory reforms. The task of improving regulation is urgent because the political window of opportunity is narrow and can close quickly, once the crisis diminishes. This was, for example, an important lesson learned in the wake of the East Asian crisis. Even though there was a major debate both during and after the crisis about reforming the international financial architecture, including its regulatory structures, in practice very little progress was actually made once the crisis was contained, especially in thedeveloped economies (Griffith-Jones and Ocampo, 2003).

However, the current crisis originated — and is extremely deep — in the developed economies, and particularly in the United States. It has led to massive bailouts and costly public recapitalizations of many financial institutions in those countries, at great cost to their taxpayers. The crisis threatens to lead to a serious and long recession in developed countries and globally. As a consequence, there is a political appetite for more and better regulation. It is increasingly clear that effective regulation is not only in the interest of the real economy, but also safeguards the stability of the financial system itself — as well as its individual financial institutions. Moreover, for a country to have a competitive financial system, it must be well regulated. Indeed, steps are beginning to be taken to improve regulation, for example, by making it more comprehensive.

The key question in policy circles at present is therefore not whether to regulate, but how best to do it. In thinking about the future shape of the financial system and its regulation, it is important to be clear about its purpose. The financial sector should be seen as a means to an end; it should serve the real economy, and thus the needs of households and enterprises to consume and invest. Governments should encourage the financial sector to create financial innovations and instruments that support growth and development in a sustainable way. It is particularly important that governments utilize regulation to avoid the generation of systemic risk, so that future crises — which can be profoundly negative for the real economy — can also be avoided.

Inherent flaws in the way that banking and capital markets operate leads to a boom-bust pattern that is linked — as market participants themselves describe it — to cycles of greed and fear. These pro-cyclical processes lead in turn to the main kind of failure in these markets. The second major cause of crises — as briefly mentioned above — is rapid liberalization within and across countries, a process accompanied by insufficient, incomplete and inappropriate financial regulation. Indeed, the excesses of financial liberalization, coupled with major mistakes of regulation, as well as incomplete regulation, have led to a historic policy failure.

2.1 PRINCIPLES OF REGULATION

To overcome the failures — of both markets and policy — that have been major factors contributing to the crisis, two key principles of regulation need to be followed. The first principle is comprehensiveness: the domain of regulation needs to be the same as the domain of the market. The second is counter-cyclicality, which must be placed at the heart of regulation.

2.2 COMPREHENSIVENESS

Financial systems — both nationally and internationally — have undergone very large changes in the past ten years. Regulation has clearly not kept up. In the United States, and also in other developed countries like the UK, there has been a huge shift of savings from banks to capital markets. As noted in d'Arista and Griffith-Jones (2008), only 25% of the US financial systems' assets belonged to commercial banks in 2007.

Worsening matters, commercial banks are the only part of the financial system that has been regulated for capital requirements, and even that regulation is partial, as off-balance sheet instruments such as structured-investment vehicles have been practically unregulated. Investment banks have been very lightly regulated, while other financial actors — like the powerful rating agencies, mortgage lenders, and hedge funds[1] — have been subject to no regulation at all. For some of the financial instruments, like over-the-counter (OTC) derivatives, which grew to astronomical levels — more than any other instrument in the last decade — there was no transparency and even less regulation. In addition, off-shore centers remain subject to extremely light or no regulation at all.

As a consequence of this hands-off regulatory system, a massive "shadow financial system," seriously deficient in both transparency and regulation, was allowed to emerge. Indeed, regulatory arbitrage – a practice designed to get around

1. Germany raised the issue of regulating hedge funds even before the global crisis. This discussion became more intense, for example in the European Parliament and the European Commission, after the crisis started.

regulations – encouraged the growth of financial activity and risk taking. In fact, many of the very problems that caused the financial crisis arose in institutions (e.g. mortgage lenders) and instruments (e.g. credit default swaps) that were unregulated. This is a lesson that should have been learned from previous financial crises in developing countries, where the most liberalized and unregulated parts of the financial system were the source of crisis.

In capital markets, there has been practically no formal regulation. Private actors, such as insurance companies, boldly acted as though they were entitled to sell systemic risk insurance, like credit default swaps (CDS). Some of those major insurance companies, like AIG in the US, had to be rescued and effectively nationalized, as they became bankrupt during the crisis. This came about because they did not have sufficient capital and reserves to fulfil credit swap insurance contracts that carried enormous systemic risk. Indeed, no entity — except the government — was capable of credibly fulfilling such a contract once the crisis spread. Thus, the government not only became lender of last resort, but also insurer of last resort, since it had not previously exercised regulation to limit the risk that afterwards it had to assume.

To summarize, regulation has to be comprehensive so that the domain of the regulator will be the same as the domain of the market; otherwise, regulatory arbitrage is inevitable. Another reason for comprehensive regulation — as illustrated by recent events, when bailouts and rescues have become extensive — is the need to avoid moral hazard, in other words, placing the appropriate consequences for risky behavior upon those who cause the risk.

It is perhaps obvious that a necessary pre- condition for effective comprehensive regulation is comprehensive transparency. Thus, over-the- counter derivatives should all be brought onto the exchanges (even if this produces certain microeconomic costs). Off-balance sheet instruments, like structured-investment vehicles, should be brought onto the balance sheets, and on-site inspection of banks and other financial institutions should be expanded. This process should be facilitated by the fact that, in developed countries, governments own capital.

Comprehensive regulation should relate both to liquidity and solvency. Regarding solvency, equivalent regulation of different actors, instruments and activities should aim at uniform limits on leverage, as excessive leverage has been a major source of systemic risk. However, as the longevity of funding is an important variable, it may be desirable to restrict leverage (and require more capital) for assets funded by short-term liabilities. This will not only protect the solvency of financial institutions but also encourage them to seek more long term funding. Separate minimum liquidity requirements should be an essential part of regulation, an aspect that has been neglected in recent years.

2.3 COUNTER-CYCLICALITY

Historically, the most significant financial market failure comes when these markets operate with pro-cyclicality. In fact, risk is generated mainly in the booms, even though it becomes apparent in the busts. Therefore, the time for regulators to act — to prevent excessive risk taking — is precisely in the boom. Indeed, one of their key functions is to take away the "punch-bowl" when the party is at its best.

As a consequence, financial regulation needs to follow the principle of counter-cyclicality, which implies "leaning against the wind." This should be facilitated by simple rules that cannot be easily changed by regulators so that they themselves will not become captured by "boom-time" enthusiasm and thereby relax regulatory standards. In fact, under Basel II, bank regulation does exactly the opposite, particularly in the set of credit risk measurement techniques known as the "Advanced Internal Rating Based" (A-IRB) approach, in which required capital is calculated based on the banks' own models. This perversely incorporates the inherent pro-cyclicality of bank lending into bank regulation, thus accentuating boom-bust patterns.

Counter-cyclical bank regulation — of provisions and/or capital — can be easily introduced, either through banks' provisions or via their capital. Counter-cyclical bank provisions have already been used for some time in Spain and Portugal, which shows the feasibility of the strategy. The Spanish system requires higher provisions when credit grows more than the historical average, thus linking provisioning to the credit and business cycle. This both discourages (though does not eliminate) excessive lending in booms and strengthens the banks for bad times. The introduction of counter-cyclical provisions in Spain was facilitated by the fact that the design of accounting rules falls under the authority of the Central Bank of Spain. Unfortunately, accountants in many other countries do not readily accept the concept of "latent" or expected losses, on which the Spanish system is based, preferring instead to focus on actual losses, information that is more relevant for short-term investors. However, accounting principles should be designed in ways that balance the short-term needs of investors with those of individual-bank and systemic banking-sector stability.

An alternative approach for counter-cyclical bank regulation is through capital. Here, Goodhart and Persaud (2008) have presented a specific proposal: increase Basel II capital requirements by a ratio linked to the recent growth of total banks' assets. This provides a clear and simple rule for introducing counter-cyclicality into the regulation of banks. Another virtue of this proposal is that it can be fairly easily implemented, since it builds directly on Basel II. It also has the advantage that it does not face the accounting

difficulties outlined above for provisioning. In this proposal, each bank would have a basic allowance of asset growth, linked to macroeconomic variables such as inflation and the long-run economic growth rate. It would measure the actual growth of bank assets as a weighted average of annual growth (with higher weights for recent growth).

Two issues then arise. Should the focus be just on the increase in total bank assets, or should there also be some weighting for the excessive growth of bank lending in specific sectors that have themselves grown particularly rapidly (such as recently to real estate)? Often crises have arisen due to excessive lending to particular sectors or countries (e.g. emerging economies) during boom times. However, most systemic bank failures have also been preceded by the excessive growth of total bank assets.

Finally, there is the crucial issue of timing. It is important to approve such changes soon, while the appetite for regulatory reform remains high. However, reforms should be introduced with a lag, so as to avoid increased capital requirements (especially linked to the weighting given to growth in recent years in the Goodhart-Persaud formula, which would be high) thereby putting pressure on currently weak banks and accentuating the credit crunch. Make no mistake, leverage has to be reduced when it builds up, but this should be done gradually and in a controlled fashion, to avoid disasterous social consequences.

Some of the least regulated parts of the financial system may have some of the strongest pro- cyclical impacts, including on emerging economies. One such example is the role that hedge funds and derivatives play in the carry trade; there is increasing empirical evidence that such carry trade has very pro-cyclical effects (on over- or under- shooting) of the exchange rates of both developed and developing economies, with frequent negative effects on the real economy. For regulation to be comprehensive, as argued above, there should be minimum capital requirements for all derivatives dealers and minimum collateral requirements for all derivatives transactions, so as to reduce leverage and lower systemic risk. Collateral requirements for financial transactions function much like capital requirements for banks.

Another important issue to explore is whether the regulation of derivatives' collateral and capital requirements should also have counter-cyclical elements. This would seem desirable and would imply that when derivative positions, either long or short, are growing excessively (for example, well beyond historical averages), collateral and capital requirements would be increased.

3 REGULATING BANKERS' COMPENSATION

Another way to discourage counter-cyclicality is to regulate the compensation of bankers and other market actors. As Stiglitz (2008) points out, incentives are at the heart of the boom-bust behaviour of financial and banking markets. A large part of bonuses are tied to short term profits: they are positive in good times but never negative, even when big losses occur. This encourages bankers and fund managers to take a lot of risk in boom times which results in high bonuses for them. However, they will not lose money if heavy losses are incurred later due to their excessive risk- taking in good times, even though systemic risk also increases, as is recognized even by the Institute of International Finance (an organization that represents the major banks).

There is another negative effect of short term bonuses that is less often highlighted. In good times, a large part of profit is paid out as bonuses. Because this profit is taken out of the banks, it is therefore not used to increase their capital, such that when crises come, banks are recapitalized by bailouts ultimately paid by tax-payers. It can be argued that taxpayers are paying after the fact for excessive bonuses.

The political point can be made that high bonuses and high remunerations contribute to the concentration of great wealth in the financial sector. As a consequence, financial actors gain political influence, for example by financing political campaigns. The increased wealth and influence of the financial industry may thus increase the risk that their regulators become captured, or hired at greater salaries into higher- paying sector jobs. The simple solution to this problem is that bankers and fund managers receive a fixed salary. Bonuses could either be abolished (a more radical solution) or accumulated into an escrow account, in which case they could be cashed only after a period equal to an average full cycle of economic activity, if the activity it is compensating remains profitable. Such a change would reduce existing incentives towards short- termism.

Either individual firms or the financial industry as a whole could introduce such changes, as stability is in their own long term interest. However, collective action and principal agency problems makes this highly unlikely. As a consequence, the outside regulation of compensation schemes may be the best way forward, even from the perspective of the stability of individual financial institutions. This would be particularly beneficial for systemic financial and macroeconomic stability. It is encouraging that the Financial Stability Forum is studying the introduction of a code of conduct on compensation schemes and requiring higher capital from banks that do not confirm with it.

4 INSTITUTIONAL ARRANGEMENTS

In terms of new institutional arrangements for regulation, there are necessary changes at both national and international levels. Part of a new regulatory structure in the US at the national level should be a financial products safety commission. (Stiglitz, 2008). This commission would assess the benefits and risks of particular products and determine their suitability in general and for particular users. In so doing, it would have strong parallels with the Food and Drug Administration, which evaluates the risks and benefits of new medications. There is a clear rationale for this in financial markets as well. Financial markets have innovated, but often these innovations have been damaging for individuals, financial institutions and the whole economy. Clearly, the financial sector has not done a good job at analyzing the consequences of the products they produce. Defective products can have disastrous effects both on those who buy them and on the economy, as they can create systemic risk.

A financial products safety commission could evaluate products, especially those being produced and invested in by regulated entities. Each product would have to have a stated objective (e.g. In what ways does it help manage and mitigate risk? What is the risk profile for whom the product is intended?). Its risk characteristics would be identified using conservative models that paid due attention to the failures that characterize financial markets. Such a commission would determine whether individual products provided significant risk mitigation benefits of the kind purported by the product. There would be a presumption that there is "no free lunch", in other words, higher returns can be obtained only at the expense of greater risk. There would also be a strong presumption against complex products, the full impact of which are hard to analyze. A financial products safety commission would establish transparency standards that all those dealing with regulated financial entities (including hedge funds) would have to satisfy. It would have the power to ban certain products from the balance sheets of regulated entities and would also look at the pricing of those products.

A well designed regulatory system needs to be comprehensive, otherwise funds will flow through to the least regulated part. That is why there is a need, within individual countries, for a financial markets stability commission which would have oversight of the entire financial system and would provide integrated regulation of each of the parts of the system. (See Stiglitz, 2008). Such a commission would also look carefully at the interrelations among the parts of the system.

Modern financial markets are complex, with many and often unexpected interrelations among different institutions of different kinds, as shown in the current crisis. A financial market stability commission could assess over-all risks, looking at the functioning of the entire financial system and how it would respond to various kinds of shocks. In a complementary fashion, a financial products safety

commission would look at individual products and judge their appropriateness for particular classes of purchasers. A financial market stability commission would have been charged with identifying macroeconomic risks, for instance, the risk posed by the breaking of the housing bubble. All of the regulatory authorities (those regulating securities, insurance, and banking) would then report to the commission. With oversight over the entire system a financial market stability commission would help to avoid regulatory arbitrage.

At the international level, there is also a need for designing an institutional structure consistent with the fact that capital and banking markets have very large parts that operate globally. For the domain of the market to be with the same as the domain of the regulator — to thus avoid regulatory arbitrage between countries and financial centres — it would be desirable to have a global financial regulator. Both academics (Eatwell and Taylor, 2002) and some market actors have long called for such an institution, but the recent crisis — and the way contagion has spread throughout the globe, affecting even countries with sound financial systems — has made a global regulatory institution more necessary and politically more feasible.

A global financial regulator would design standards to be applied by all countries and jurisdictions, including offshore centres. Parts of the financial system with no global connections, e.g. small banks that lend only to farmers in a particular region, could be still regulated nationally. However, financial institutions with any international connections should be regulated by the global regulator and the standards it designs.

A key question is whether a new institution should be created to fulfil this function. Given the difficulty of achieving the necessary consensus to create new international institutions, it may be desirable to adapt an existing one, namely, the Bank for International Settlements (BIS). The BIS is the leading candidate for at least three reasons: its concern with regulating systemic risk in financial markets, the high quality of its analysis, and its close links with central banks and regulatory bodies.

However, an absolutely necessary pre-condition for the BIS to provide a basis for a global financial institution is that its membership become more universal and that developing countries be duly represented in its Board, management, and staff. Accountability of government representatives of the BIS to their Parliaments would also be important. Developing countries should be adequately represented to appropriately reflect their weight in the world economy, as indicated by the magnitude of their financial assets, their contribution to world savings and their level of foreign exchange reserves. Such an expansion of membership — providing for representatives of regions that in turn represent smaller and poorer countries — is key to establishing multilateral credibility.

Furthermore, important elements from the Financial Stability Forum (FSF), to which the BIS provides a secretariat, should be incorporated into a global regulator. There should naturally be close interaction with the IMF on the macroeconomic aspects of risks, both globally and at a country level, (a subject also studied by the BIS). However, the IMF should not become the global regulator, as the institution already has many important functions to fulfil — which it needs to do more fully than at present — and it has limited expertise in the design of regulatory standards, regulation and supervision, especially at a global and developed country level. Furthermore, the IMF has been — at least in the past — too closely wedded to excessive enthusiasm for the deregulation of financial markets to give it credibility at present.

It is encouraging that the G-20, in their November 15, 2008 Declaration, called urgently for an expansion of the Financial Stability Forum to a include a "broader membership of emerging economies, and other major standard setting bodies should promptly review their membership". The urgency of such an expansion cannot be underestimated, as developing countries are not at all represented in these bodies (which are therefore extremely undemocratic at present). Ultimately, such reforms would ensure not only greater legitimacy but also greater efficiency. Last, but not least, some representation of the non- financial part of the economy could be valuable, for example with some representation by business and trade unions.

Finally the importance of conferring a global regulator with real power to influence the decisions of national regulators, especially in all the large economies whose financial systems have a systemic impact on the world economy cannot be underestimated. Such centrality will be difficult to achieve, given that countries are loathe to concede sovereignty to international bodies. Nevertheless, the case can be increasingly made that countries would also gain sovereignty by increasing their control over the global financial system, over which they have limited control at present.

In conclusion, the design and creation of a global financial regulator is one of the main institutional challenges that the international community faces in the wake of the current financial crisis. Such a body would allow regulatory reforms to be implemented globally, thus curtailing regulatory arbitrage. It would also help to prevent future crises. The other option — to make capital and banking markets less global by introducing capital controls — is a less attractive strategy at present. However, the segmentation of global markets, for example by introducing capital controls, may take place on its own if effective global regulation is not introduced. Thus, those who favour financial globalization should be strong supporters of a global financial regulator.

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THE FINANCIAL CRISIS BEYOND FINANCE

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The global economy has reached the peak of a cycle of expansion, fueled mainly by the appreciation of residential properties in the United States. In Europe, with the exception of Germany, the collapse of real estate prices in 2007 led the economy into recession due to the cumulative nature of the process of wealth and income adjustment. Thus, this article aims to analyze the structural causes and changes in the global economic scenario which led to the crisis triggered in 2007, in addition to analyzing the crisis that now grips Europe with the decline of the euro against the dollar, with Portugal, Ireland, Italy, Greece and Spain (PIIGS) sinking into external and fiscal deficits in high public debt close to or above 100% of gross domestic product (GDP).

A CRISE FINANCEIRA ALÉM DA FINANÇA

A economia global atingiu o auge de um ciclo expansivo, turbinada, sobretudo, pela valorização dos imóveis residenciais nos Estados Unidos e na Europa, à exceção da Alemanha, o colapso do preço dos imóveis em 2007 levou a economia à recessão, devido ao caráter cumulativo do processo de ajustamento da riqueza e da renda. Assim, este artigo tem por objetivo analisar as causas estruturais e as mudanças no cenário econômico global que levaram à crise deflagrada em 2007, além de analisar a crise que, hoje, assola a Europa com o declínio do euro perante o dólar, em que Portugal, Irlanda, Itália, Grécia e Espanha (PIIGS, na sigla em inglês) se afundam em déficits externos e fiscais elevados em endividamento público próximo ou superior a 100% do produto interno bruto (PIB).

Few deny the unique character of the capitalist expansion occurred between the postwar and the mid-seventies. Studies of the economist Angus Maddison, in The World Economy: a Millennial Perspective, demonstrate that no other stage of capitalist development presented such favorable results as regards product growth rate, real wages, inflation, and stability of interest and exchange rates.

The international economic space in the aftermath of the Second World War was built on the basis of the project of integration among national economies proposed by U.S. State and its economy. At the same time that the United State's economic leadership promoted the expansion of large American corporations and its banks, it made room in its domestic market to shelter European and Japanese exports. After Europe's economic recovery and the competitive response of large European companies, the rivalry between the business systems brought about productive investment across the U.S. and Europe and the first round of Fordist industrialization in the periphery.

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After the Chinese revolution and the Korean war, Japan, and later Korea and Taiwan, also came into play with their business systems. The "development-oriented" Latin America was integrated to this expansion outbreak. Brazil, like others, drew upon national industrialization policies promoting the "internationalization" of the economy, namely, the division of tasks among multinational corporations, state companies, and national private enterprises, the latter two in charge of producing intermediate goods and semi-processed raw materials.

This stage ended with the 1971 dollar crisis and the unilateral enactment of the inconvertibility of the dollar, hitherto fixed at 35 dollars per troy ounce of gold. The game turned. The fateful combination of inflation and low growth emerged. The ideological bloc that opposed "interventionist" policies and the welfare state attributed the breakdown to the decrepitude of policies and practices that sought to control the instability of capitalism and prevented citizens to be at the mercy of market uncertainty. After thirty years of brilliant performance - capitalist economies were sending signals of structural fatigue. The Golden Age was agonizing.

After the seventies' hegemony and "productivity" crisis, the "American expansion" resumed. Not only it imposed financial liberalization to the world, but pushed the production metastasis to the Pacific of small tigers and new dragons. As of then, the world has witnessed a cataclysm in the international division of labor. Asia became a huge producer and processor of cheap parts and components (without excluding final consumer and capital goods). A major raw materials importer and manufacturing area was shaped around China, and reintegrated to the capitalist circuit since the late seventies reforms.

Technological changes in the forms of competition, in the organization and strategy of large businesses, and in the operation of financial markets occurred as of the seventies paved the way for major changes.

The process of globalization of competition triggered a new wave of centralization of capital and encouraged the spatial dispersion of productive functions, as well as the outsourcing of ancillary functions to the production process. This movement was accompanied by strong "ownership" of decisions and circulation of information by the "brain" of finance. Capital markets became, at the same time, more powerful in shaping decisions and, contrary to that expected by apologists, less "efficient" in the establishment of risk assessment criteria.

The terms of trade in world commerce no longer lean towards manufacturing and against primary products. New manufactured goods are produced in the Asian economic space, built around the "great Chinese carmakers." The huge reserves of manpower, currency devaluations and plenty of foreign direct investment allow China to establish a virtuous division of labor with its neighbors.

At the same time, the movement of American, European and Japanese companies in search of global-sourcing requires the U.S. national economy to expand its degree of trade liberalization and generate a growing trade deficit. It becomes unavoidable to accommodate the expansion of new manufacturing and commercial partners, produced largely but not exclusively, by the displacement of the large U.S. capital in search of greater competitiveness.

Since the eighties, these transformations in the productive sphere were accompanied, in the financial scope, by the progress of financial globalization and securitization. Direct debt placement and capitalization of stock exchanges helped stronger and better reputed companies to extend their scope of action. These markets, in the version of optimists would have the virtue of combining the benefits of better circulation of information, reduced transaction costs and more rational risk distribution. The success of securitization left deposit banks with high-risk customers, vulnerable businesses and dubious credibility consumers. However, compelled by the forces of competition, deposit banks went into the promising business of securitization of receivables.

I will enumerate some trends, not an exhaustive list, which have since defined the transformations of global finance: 1) the greater weight of financial wealth in total wealth, 2) the growing power of active securities (mutual funds, pension funds, insurance) managers in the definition of ways to use "savings" and credit, 3) the free movement of capital among financial markets and the adoption of floating rate regimes and inflation targeting in national economies 4) rating agencies take on the role of courts, under the pretense of judging the quality of assets and national policies, 5) the expansion of futures markets and the widespread use of derivatives provide greater elasticity to credit.

As mentioned, the dominance of the financial sphere was associated to the constant search for new "competitive" areas by the bloc of leading companies and their suppliers. This alliance imposed on the global economy a dramatic increase of the wage-productivity ratio in the manufacturing sector of emerging Asian economies, and, at the same time, favored poor risk assessment in markets trading property rights and securities.

The synergy of low inflation and distorted asset pricing in financial markets allowed the United States and consumerist countries in the euro area to adopt expansionary fiscal and monetary policies, sources of high growth rates and the extraordinary asset appreciation, conducive to the wealth-effect. The appreciation of assets - stimulated by permissive leveraging sanctioned by cheap credit - sustained indebtedness and hyper consumer spending.

Therefore, the chronic imbalance of current account balances of China and the United States was not an "anomaly" of Chinese-American model, but part of the dynamism of the Third Millennium global economy. The current account

surpluses and reserve accumulation of emerging economies "funded" the deficit of the planet's most powerful economy. Traditional views maintained that capital should flow from developed to emerging markets. But, in the Chinese-American arrangement, trade surpluses and mercantilist policies of reserve accumulation of the periphery inverted capital accounts. The so-called emerging economies become funding providers for financial markets of consumerist chronic deficit countries. Over the last decade, the Asians' strategy, more than Greenspan's exploits, ensured low inflation and sustained the dollar as reserve currency.

The global economy reached the peak of an expansion cycle, fueled mainly by the appreciation of residential properties in the United States and Europe, except Germany. The collapse of house prices in 2007 led the economy into recession, due to the cumulative nature of the process of wealth and income adjustment. Families - pinned between plummeting house prices and rising debt services - desperately sought to reduce their debt ratio. Families' attempts to contract joint consumer spending (this also applies to firms) negatively affected income and employment. It is the paradox of deleveraging. If everyone tries to get rid of excessive borrowing the same time, assets and debts depreciate and no one can accomplish their purpose. The peculiarity of the recent business cycle, led by "securitized" finance, is that spending decisions of firms and households are highly sensitive to asset price fluctuations. The transmission mechanisms are fast, varied and powerful.

As for the National State, the "brain" of the Golden Age virtuous expansion, no one doubts that its coordinating activity was suffocated by strategies for localization and internal division of labor by large companies, and was at the mercy of tensions generated in financial markets, which submitted monetary, fiscal and exchange rate policies to their whims. Rather than by its global character, the new finance and its logic became crucial due to their ability to impose restrictions on macroeconomic policies.

The requirements of the global competition process caused the deterioration of the fiscal base of the welfare state: long-term unemployment increased in core countries, especially in Europe. In the United States precarious employment is widespread, source of the fall in earnings of the poorest 40%. Rising inequality and falling incomes undermined wage-workers' ability to pay, while the wealthier escaped to tax havens.

State and society could not respond to these negative forces with the compensatory actions of other times, because in globalized markets, there is increased resistance by wealth holders to the use of fiscal and social security transfers. While neoliberal globalization freed the space for the movement of wealth and income of integrated groups, it also dismantled the old tax basis of Keynesian policies, built on solidarity and the prevalence of direct taxes on income and wealth.

However, during the crisis, the material relations among money, public finance, and private financial markets in contemporary capitalism became apparent, By creating deposits, i.e., money supply - whose unit of account is defined by the State – the modern credit system operates as a private central of monetary management. In this role, banks (and, today, other financial intermediaries who indebt themselves in wholesale money markets) are market infrastructure providers, as they define the rules for access to liquidity, credit and the payment system. Such rules impose constraints to enterprises production and competitiveness. Private managers of mainstream wealth, banks manage liquidity and credit according to the greater or lesser confidence in the possibility of non-financial companies and governments to control their streams of revenue and expenditures and to the evolution of the indebtedness stock.

In this currency regime denominated by the State and issued by the banking system, economic stability cannot be guaranteed by private criteria of maximizing gains, such as fully demonstrated by the historical experience of deregulated banking systems, in practice, devoid of central public authority. In the boom period that preceded the crisis, commercial banks, investment banks, pension fund managers, mutual funds, private equity funds, not to mention the sophisticated hedge funds, escaped rationality and risk assessment standards proclaimed by the Efficient Markets Hypothesis. As a matter of fact, they succumbed to the impersonal forces of competitive mimicry, referred to in the vulgar language of marketism as the "herd behavior". All were convinced they were shielded from market, liquidity and payment risks. The climate of trust, as usual, spread systemic risk that the know-it-alls thought they had ruled out with the use of derivatives.

In recent years, reduced volatility of asset and currency prices combined with greater liquidity led to exasperated "leverage", from frenzied consumers to hedge funds backed by bank credit. This is the crucial paradox of modern finance: "private centralization" of currency and credit in institutions "too big to crash" spreads – following global integration of financial markets - the competitive process of generation and distribution of assets with enigmatic pricing in different currencies, subject to a floating exchange rate regime. When the wheel of fortune turns sour, with the collapse of prices and wide currency fluctuations, the remedy is to resort to state centralization, under penalty of credit and currency obliteration, i.e., the market infrastructure.

The "flight to quality" movement denounces the political-legal nature of currency and the "collectivist" and hierarchical nature of the credit system, whose inevitably public function is, in "normal" times, delegated to private institutions. Therefore, the stability of the monetary economy depends on the complex relationships between the collective funds managed by private credit appraisal

committees and the state's ability to guide behavior and expectations of private agents engaged in the struggle of abstract wealth accumulation. Such work on the part of the State is carried out by the Central Bank's monetary policy together with the management of public debt by the Treasury. In a financial crisis such as the current one, public securities of dominant countries reveal their nature of "last resort assets", a shelter for the anxiety of owners and controllers of private wealth.

With a damaged credibility, due to their own deeds, "markets" were invigorated by formidable cash injections, a spectacular "inflation" of monetary liabilities of central banks. The money was distributed generously through an "atypical" cooperation between central banks, once independent, and national treasuries, once austere. The former sheltered under their balance sheets the subprime financial scum and the like, and established programs to exchange toxic assets for liabilities they issued themselves, i.e., money, while treasuries issued public bonds to protect private wealth that was in perilous state. At the height of the crisis, central banks of the capitalist cusp accomplished their mission. Besides their traditional role as a last resort lender, central banks promoted the transfer of property implicit in the debit-credit relationship, without allowing the violation of private wealth ownership principles, even though some individual owners suffered.

As soon as the panic subsided, the lords of finance, with lots of money generously provided by the State, did not hesitate to demand more rewarding risk premiums to roll the sovereign debt. The governments of Greece, Ireland, Italy, Spain and Portugal were the first victims. In a high-risk maneuver, Europeans created the euro, the single currency, without building a common fiscal space and, thus, faced with the financial crisis of the weakest members, were limited to contingency actions that fail to instill confidence in public debt markets.

Beneficiaries of the turmoil and entrenched in hedge funds, the so-called investors bet on the collapse of Greek, Portuguese and Spanish securities, i.e., they took on a short-term position and speculated in CDS markets - derivatives supposed to guarantee buyers in case of debtors' default. These creatures brought about by creative bankers can be purchased in over-the-counter markets by anyone, people who have nothing to do with the Greek, Spanish, and Italian debts, or any other debt of whatever nationality.

Martin Wolf, Financial Times columnist, is concerned with the evolution of public debt and fiscal deficits in developing countries, particularly in England. He says: "In the United Kingdom (as elsewhere) fiscal deficits are mirror images of private sector surpluses. Furthermore, the causality is from the second to the first. The necessary conditions to reestablish fiscal and economic health are recovery of consumption (and private investment), a huge increase in net exports, or ideally both. It is not enough to reduce the fiscal deficit, it is necessary to reduce the fiscal deficit and sustain growth."(2010)

In a crisis like the present one, wealth assessment (long-term expectations) and radical uncertainty (not only risk) paralyze and contradict the new spending flows. The breaking of the state of conventions that used to govern the movement of the economy means that producers and private consumers paralyze their decisions - production, consumption and investment - in the face of radical uncertainty in which they are immersed. This is the state that contrasts with that of "conventional expectations": in it, players behave as if uncertainty did not exist and as if this would constitute the best assessment of the future. Keynes (1936) sought to demonstrate that in a situation of collapse of the conventional state of expectations, a strong contradiction arises between private enrichment and the creation of new wealth for society (growth of investment in real capital). The crisis leads to restriction of the private enrichment momentum, resulting in a preference for liquidity, which in turn leads to paralysis of investment and consumption. In a situation of drastic reduction of investment and private consumption, companies and consumers desperately seek to reduce debt and increase savings.

In such circumstances, the State's policies to generate deficit and create new public debt - instruments aimed at sustaining companies' profit and protecting the portfolios of the private banking sector - face long-term expectations that are less sensitive to conventional stimuli. In an economy going through a crisis like the present one, fiscal imbalance and the growth of public debt in the composition of private wealth are likely to become deeper and more lasting. In the face of the private sector's pessimistic expectations - which affect primarily credit demand and supply for consumption and investment - the government deficit fails to revive private spending, and is only able to prevent an accelerated decline in production and further deflation of assets. Thus, the crisis is not overcome, but is transformed: a private finance crisis gives birth to a financial crisis of the state.

In this case, private expectations become oriented by assumptions about the evolution of the "State's financial crisis." The relevant fact in the coming months will be the evaluation of the wealth holders, particularly the credit controllers, regarding the direction of fiscal policy and public debt. There are signs that the lords of finance - saved by the State's vigorous intervention - already consider the U.S. government's fiscal deficits and debt unsustainable. Private distrust deeply affects state sovereignty, undermining the legitimacy of the State as currency and debt manager. Given the advance of anticipations, the State may be led to devalue its debt - now the dominant form of private wealth - through continued monetization. With this measure it will sanction the shortening of the timeframes set by the private sector, in search of safety and liquidity for its stock of wealth. Thus, liquidity premium is increased and markets are restricted for longer-term contracts, undermining the very capacity of the State to issue new

debt and manage the stock of existing debt. This tends to further reduce the scope of monetary policy, subject to the imperatives of high real interest rates, with disastrous effects on the recovery of the economy.

By observing the effects of public-private management of money and credit over productive accumulation, Keynes proposed a "moderately conservative" formula. In General Theory, he recommended the use of taxation to promote income distribution and encourage consumption among working classes, elimination of rent-seekers and socialization of investment. "While this state of affairs is perfectly compatible with *a degree of individualism*, elimination of rent-seekers would mean the end of the capitalist's power of oppression to exploit the value of scarce capital. The owner of capital can charge interest because capital is short, just as the landlord can charge rent because land is scarce, but if there are intrinsic reasons for the scarcity of land, while none of this happens with the availability of capital (money). "(1936, p. 30)

Contrary to the recommendations of the great economist, the intensive process of ideology homogenization celebrates "*exaggerated individualism*" against any interference in the process of differentiation of wealth, income and consumption made through the capitalist market. The ethic of solidarity is replaced by the ethos of efficiency and, thus, the programs of income redistribution, repair of regional imbalances and assistance to marginalized groups have encountered strong resistance within societies. There is no doubt that this new individualism has its social roots in the great middle class produced by long prosperity and more egalitarian processes that prevailed in the Keynesian era. Today new individualism is strengthened and supported by the emergence of millions of outsourced businesses and "autonomated" creatures of the changes in working methods and in the organization of large enterprises.

In the early 1980s, Thatcher's and Reagan's election reflected the unease of the middle and upper classes with stagflation. For the most favored, the high taxes, excessive regulation and the power of trade unions were undoubtedly responsible for the poor performance of economies. The famous *Laffer curve* guaranteed that the tax burden stifled the richest and discouraged savings, which threatened investment and therefore reduced the supply of jobs and incomes to the poorest. The neo-corporatist practices, according to neo-liberal ideologues, created serious "microeconomic" distortions by intentionally promoting interventions in the pricing system - in exchange rates, in interest and in tariffs. Aiming to induce the growth of selected sectors or protect business segments threatened by competition, governments distorted the price system and thus blocked markets in its noble and indispensable function of producing information for economic agents. Such violation of the golden rules of competitive markets culminated in the spread of inefficiency and the multiplication of groups of "income predators", which entrenched themselves in the spaces created by the State's financial profligacy.

Even in the 1950s, a time of splendor and glory of Keynesian policies and of the Welfare State, the libertarianism of Frederich Hayek (1995) and the monetarism of Milton Friedman (1967) formed a front line against “the enemies of economic freedom”. For Hayek, the market is a process of exchange and accumulation of information, not a static environment endowed with forces that restore it to balance. State intervention is detrimental, because only the *market process* enables innovation in production methods and organization, based on the continued flow of information that arises from the interaction of free individuals. The key point of this concept is the emphasis on the ability of a market free of impediments to mobilize individual resources and make them fluid. The body of “reformist” proposals labeled neo-liberal is therefore committed to the idea that you need to unlock the market’s creative forces. The renewal of capitalism, in gestation since the twilight of the Keynesian era, was meant to pave the way for the preeminence of relations between free individuals looking for monetary gain. This is the society of the neoliberals.

But the liberalizing reforms undertaken since the end of the 1970s tried to mobilize political and financial resources of the National States to strengthen their business systems involved in global competition. The State did not leave the stage, it just changed its agenda. In his major work, Material Civilization and Capitalism, historian Fernand Braudel wrote, “the most serious mistake (of economists) is to sustain that capitalism is an economic system. We should not deceive ourselves, the State and Capital and are inseparable, yesterday as today. “(1996, p. 63)

In the wake of the decisive support of the state, global corporations began to adopt competitive governance standards aggressively. Among other procedures, companies subordinated their economic performance to “value creation” in the financial sphere, reflecting the expansion of shareholder power. In alliance with managers, now paid with generous bonuses and committed to exercising company share purchase options, shareholders exercised aggressive individualism and required intense and recurrent bouts of administrative re-engineering, increased flexibility of labor relations and cost reduction.

The location strategies of globalized corporations introduced important changes in organizational patterns: formation of network companies, with *centralized* decision-making and innovation functions and *outsourcing* of commercial and industrial operations and services in general. The neoliberal doctrine intended to teach us that globalization emerged from an amazing technological revolution capable of bringing mankind closer to the time when we will be rid of the curse of work and will enjoy the charms of cosmopolitan life. Microelectronics, information technology, automation of industrial processes etc., promise to free us from the limitations imposed by space and time. Free individuals can work at home, and become, in addition to their

own masters, a participant in universal prosperity. Globalization, coupled with technology and transformation of the forms of work, would deliver this wonderful promise of modernity.

But the reality of neoliberal globalization was different. The individualization of labor relations promoted intensification of the pace of work, according to a recent study by the International Labor Organization and other institutions dealing with the matter. Work has intensified, especially among those who have become independent of formal relations, those who negotiate daily the sale of their working skills in free markets.

This happened in the same period in which new financial forms increased the power of large corporations in their relations with employees and outsourced contractors. Mergers and acquisitions gave rise to greater control of markets and launched campaigns against social and economic rights, considered an obstacle to the operation of competition laws. The opening of markets and increased competition coexisted with the trend towards monopoly, and thus prevented citizens to exercise the right to decide over their own lives, in the exercise of democratic politics.

Neo-reformists, in fact, tended to transfer the risk to scattered individuals, while seeking the State and their collective strength to limit the losses caused by wealth devaluation episodes. The intensification of competition among enterprises in the global space not only accelerated the process of financializing and concentration of wealth and income, but also subjected citizens to the anguish of uncertainty.

The effects of increased competition among firms and workers are clear: the trends toward greater equality observed in the period from the end of the Second World War until the mid-1970s - were reversed, both within the social classes and between them. In the era of "turbinated" and financialized capitalism, the fruits of growth were concentrated in the hands of holders of securities portfolios that represent ownership rights to income and wealth. Others were left with the lingering threat of unemployment, growing insecurity, precariousness of new occupations, and social exclusion.

The project of individual autonomy is inscribed in the portico of modernity. It means self-realization within the rules of republican freedoms and respect for others. It is opposed to submission to authorities - public and private - over which citizens have no control. The spread of more aggressive forms of competition have so far found little resistance in their ceaseless work to reduce the "contents" of human life to relations dominated by the expansion of exchange value. But it can become intolerable for individuals - or most of them - to feel that their daily lives and their fate is governed by the troops of suffocating "rationalization" that destroys the project of a good and decent life.

Hegel imagined that equality and difference would not only be inseparable in modern society, but they should subsist, reconciled, under the laws of an Ethical State. This State would allow individuals to preserve their differences in relation to others and at the same time maintain the integrity of the whole. But the economic transformations of modern societies and the failure of attempts to impose the Ethical State strengthened fragmentation and, in particular, the discourse of post-modernity only concludes what the *facts* say. The *facts* say that we are witnessing the decline of Utopias, the degradation of collective proposals, the *memento mori* of the Great Philosophies.

The world seems to be getting closer, in its evolution and transformation of consciousness, to an incomprehensible colorful mosaic, formed by all the football fans have in common their passion for the ball and the difficulty to accept the reasons of others. "Let the others come to us. Then we can knock them as much as we want", summarizes Umberto Eco (1984, p. 42). American critic Fredric Jamenson suspects that the transition from the modern to the postmodern period meant replacing *alienation* of the individual with *fragmentation* of the individual. Jamenson is concerned with the inability of the modern individual to understand the meaning of what appears fragmented. For him, the fragmentation of the subject and his life is the counterpart of blind integration - and increasingly abstract and unattainable - promoted by the "objective" forces that control society. Actually, it means that the transnationalization of markets and production, lifestyles and consumption, operates relentlessly and promotes the "colonization" of individual and collective life.

The relentless logic of global competition requires submission of private life to the uncertainties of an impersonal process which is absolutely indifferent to the fate of individuals. Companies move their factories to China. American workers in the small town of New England where the auto parts used to be manufactured are advised to leave their homes and seek employment elsewhere. For common citizens, incomprehensible economic processes drag them downhill.

The erratic and seemingly inexplicable convulsions of the stock exchanges or the mysterious evolution of prices and currencies are capable of destroying their livelihoods. But the prevailing consensus is to explain that if it were not so, life can get even worse. The formation of this consensus is in itself an effective method of blocking social imagery, preventing individuals from seeking, through collective action, to build a society where the exercise of autonomy and freedom is possible.

Built on the ruins of a society destroyed by the Great Depression and the two world conflicts, the Welfare State is among the main suspects accused of triggering the fiscal crisis in which governments are stuck. The State's action is seen as counterproductive by those who are successful and integrated, but

as insufficient by those who are demobilized and unprotected. These two perceptions converge toward the "delegitimization" of administrative power and devaluation of politics. Apparently we are in a historical situation in which the "great transformation" occurs in the opposite direction than the one predicted by Polanyi (1980, p.82): the economy is to be freed from the shackles of society. But events in Europe suggest that society is preparing new responses to the exploits of the Bad Fare economy.

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PREFACE TO GLOBAL POWER*

José Luís da Costa Fiori**

This paper, divided into three sections, aims to present a systematization of key issues for the study of global changes since the second half of the twentieth century, as well as for the analysis of the current international scenario, with a view to trying to identify long-term trends. In the introduction, the debate on the formation of States and European national economies is presented, and some of its implications on the relations between power, money and capital accumulation are pointed out. In section 2, the debate on the internationalization of capital and power and operation of the "world system" is presented, outlining the three major schools of thought in political economy: the theory of imperialism, the theory of "world hegemony" and the theory of "world system". In the conclusion, the prospective dimension of such theoretical assumptions is discussed.

PREFÁCIO AO PODER GLOBAL

Este trabalho, dividido em três seções, tem por objetivo apresentar uma sistematização de questões-chave para o estudo das transformações mundiais desde a segunda metade do século XX, bem como para a análise da conjuntura internacional contemporânea, com o objetivo de tentar identificar suas tendências de longo prazo. Na introdução, apresenta-se o debate sobre a formação dos Estados e das economias nacionais europeias, apontando algumas de suas implicações sobre as relações entre poder, dinheiro e acumulação capitalista. Na seção 2, explicita-se o debate sobre a internacionalização do poder e do capital e o funcionamento do "sistema mundial", apresentando em linhas gerais as três grandes escolas de pensamento da economia política: a teoria do imperialismo, a teoria da "hegemonia mundial" e a teoria do *world-system.* Nas conclusões, discute-se a dimensão prospectiva de tais premissas teóricas.

FOREWORD

1 POWER, SURPLUS AND MONEY

The analysis of the international state of affairs and the study of contemporary global changes in the late twentieth century have led us on a long journey back in time to the origins of the "modern world system"[1], with a view to understanding long-term trends. Starting from the "wars of conquest"[2] and the "commercial revolution"[3] that took place in Europe in the twelfth and thirteenth centuries, we reach Karl Marx's

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1. This expression became classic with the work of Immanuel Wallerstein, The Modern World System (New York, Academic Press, 1974). In this foreword, however, it refers only to the chronological period addressed by Wallerstein, between the sixteenth and the twenty first century, without the same theoretical connotations of the author.

2. Philippe Contamine, *War in the Middle Age* (London, Blackwell Publishing Limited, 1992).

3. Henri Pirenne, *História econômica e social da Idade Média* (Lisboa, Mestre Jou, 1982); Robert S. Lopez, *The Commercial Revolution of the Middle Ages, 950-1350* (Cambridge, Cambridge University Press, 1976); Peter Spufford, *Power and Profit. The Merchant in Medieval Europe* (Nova York, Thames&Hudson, 2002); and Jacques Le Goff, *Mercaderes y banqueros de la Edad Media* (Madri, Alianza Editorial, 2004).

(1995) "transition to capitalism, and the "long sixteenth century"(1450-1650) of Fernand Braudel (1987), Immanuel Wallerstein (1974) and Giovanni Arrighi (1994), when national states and economies are shaped and Europeans' successful world expansion[4] is initiated. In Europe - unlike in the Asian empires - the collapse of the Roman and Charlemagne's Empires led to fragmentation of territorial power, and to almost complete disappearance of currency and market economy between the ninth and eleventh centuries.[5] However, such political breakdown and economic atrophy were reversed in the twelfth and thirteenth centuries[6], with the onset of the process of territorial power centralization and commodification of the economy[7], which gave rise to the establishment of "national Economy-States"[8] in Europe[9]. This "prehistory" of the "modern world system" provides a privileged spot for the observation of early relations between power, money and wealth, which have become the specificity and major driving force of the "European miracle". The study of such "prehistory," however, led us to some conclusions which differ - sometimes – from the authors mentioned above.

1.1

In his account of the consolidation of the "European world-economy", Braudel (1996) draws a fundamental distinction between the concepts of "market economy" and "capitalism."[10] Furthermore, he defends that capitalism is the "anti-market", since the market is a place of "normal" trade and profit and capitalism, the place of accumulation of "large profits" and "large predators".[11] Despite that, in his history of "Mediterranean world-economy" Braudel (1996) focuses on the development of individual trade and markets and conveys the idea of a gradual transition - within the "games of exchange" - to the "high gear" world of capital and capitalism. Marx (1995, p. 103, 638), in turn, speaking of "primitive accumulation", underlines the importance of "State power and the concentrated and organized power of society to accelerate the transformation of the feudal production system into the capitalist system." At the same time, however, he asserts that the "modern biography of capital begins with world trade and market" (Marx 1995, p. 105). And this is explained, because in fact the "violence of power" comes up in his reasoning as

4. David B. Abernethy, *The Dynamics of Global Dominance, European Overseas Empires 1415-1980* (New Haven, Yale University Press, 2000) and Marc Ferro, *História das colonizações* (São Paulo, Companhia das Letras, 1994).

5. Norbert Elias, *O processo civilizador* (Rio de Janeiro, Jorge Zahar, [1939] 1993, v. 2, parte 1).

6. Janet L. Abu-Lughod, *Before European Hegemony, the World System A.D. 1250-1350* (Oxford, Oxford University Press, 1993).

7. Fernand Braudel, *Os jogos das trocas* (Rio de Janeiro, Martins Fontes, 1996).

8. José Luís Fiori, "Formação, expansão e limites do poder global", in José Luís Fiori (org.), *O poder americano* (Petrópolis, Vozes, 2004).

9. Long secular process that advanced throughout Europe despite the Black Death and the "hunger epidemics" that wiped out nearly half the European population in the fourteenth century.

10. Braudel, *Os jogos das trocas*, cit., p. 403; and Idem, *A dinâmica do capitalismo* (Rio de Janeiro, Rocco, 1987, cap. 2).

11. "Capitalism only triumphs when it relates to the State, when it is the State", ibid, p. 55.

a historical condition and not as a significant theoretical dimension of his theory of capital. And even in his theory of the capitalist mode of production, there is no relevant space for the concepts of territory, nation, and interstate competition and struggle. That is why it is so difficult to reconcile Marx's (1995) historical view of the "origin" and "primitive accumulation" of capital with his theoretical deduction of the value and the laws of capitalist accumulation. Similarly, it is hard to go straight from Braudel's (1996) "games of exchange" to his theory of capitalist "large profits" and "large predators", without the mediation of power and wars, which are not highlighted in his account of the birth of European capitalism.

From our perspective, however, one can not explain or infer the need for profit and wealth accumulation on the basis of the "world market" or "games of exchange." Even if men had a natural inclination to exchange - as Adam Smith (2006) thought - this does not necessarily imply they also had a natural penchant to accumulate income, wealth and capital. There is no "intrinsic factor" related to exchanges and markets that explains the decision to accumulate and the universalization of markets themselves. Rather, trade has always existed at all times, but for most of history, its natural tendency was to keep to the level of immediate needs or "simple circulation" and only expand very slowly and secularly. Even after the "remonetization" of European economy (as of the twelfth century), trade remained, for long periods, restricted to small and isolated areas.[12] That is, the expansive force that accelerated the growth of markets and produced the first forms of capital accumulation was not derived from the "games of exchange," or from the market itself, neither did it come, in its onset, from the provision of wages to the workforce. It emerged from the world of power and conquest,[13] from the momentum generated by the "accumulation of power," even in the case of Italy's large "commercial republics"[14], like Venice[15] and Genoa.[16]

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12. "A peasant, when following his ancient customs, would hardly be aware of acting according to an 'economic motivation', in fact, he would not; he would be following the orders of the feudal lord or the dictates of custom. Not even his lord was economically driven. His interests were military, political or religious and not directly geared towards the idea of profit or expansion. Even in cities, the usual conduct of businessmen was inextricably intertwined with other non-economic goals [...] making money was more of a peripheral rather than a central concern in ancient or medieval existence", Robert Heilbroner, *A formação da sociedade econômica* (Rio de Janeiro, Jorge Zahar), p. 80.

13. This "logical precedence" of "power" over production and distribution of wealth is obvious in the period between the eleventh and the seventeenth century. However, it persists, even after the formation of the capitalist mode of production and consolidation of the process of concentration and centralization of private capital. One can observe the growth of markets' autonomy and increased role of inter-capitalist competition, however, one can also observe a steady increase in the role of political power in the successful and internationalizing expansion of national capitals, in the management of major financial crises, in the forefront of technological innovation, and the continuous and silent role of credit and public spending required for combined expansion of national economies.

14. "According to George Friedrich Knapp, it was the Venetian military success between thirteenth and fifteenth centuries that allowed the rise of its currency in the relationship of Europeans with the East. And as occurred after the conquest of Constantinople in 1204, the next centuries witnessed similar outcomes: from military conquest to market domination and, thereof, to the conversion of its currency into the reference currency in the Mediterranean trade circuit", Maurício Metri, Poder, moeda e riqueza na Europa medieval (PhD thesis, Institute of Economics, Federal University of Rio de Janeiro, mimeo, 2007), p. 179.

15. See Frederic Chapin Lane, *Venice, a Maritime Republic*, (Baltimore, The Johns Hopkins University Press, 1973).

16. See Steven Epstein, *Genoa and the Genoese, 958-1528*, (Chapel Hill, The University of North Carolina Press, 2000).

1.2

Political power is flow rather than stock. In order to exist, it needs to be exercised; it needs to multiply and be accumulated continuously. And the act of conquering is the driving force that establishes and accumulates power.[17] To this effect, conquest is a movement to expand a "sovereign power" (P1) that accumulates more power (> P), mainly through war against other sovereign powers (P2). In a world where everyone had the same power, there would be no need for further power, simply because the very relation of political power, which is always uneven and, in its most elementary form, is always a zero-sum conflict, would not exist. Therefore, every power relation exerts a "competitive pressure" on itself. Firstly, on the side of the subjects (S), who resist the will of their prince or sovereign (P) and try to expand their own space and strength. And, secondly, on the part of other sovereign powers (P2, P3, etc.), which resist expansion of P1's power, aiming to expand their own. In this sense, the "competitive pressure" of power is always systemic, since all "sovereign powers" (P1, P2, P3 ...) need to expand or defend themselves, even if it is simply to maintain the power they already have.

Since war and preparation for war[18] are the ultimate instrument for conquering and accumulating power, and also for defending and maintaining power,[19] they tend to turn into "chronic" activities within the system. As per Machiavelli: permanent preparation for war should be the main activity of all princes, because in the "game of war" there is no space for "apathetic" powers, there are only the powers that win and those that defend themselves.[20] That is, in the universe of sovereign powers formed in Europe, power accumulation has always been an inevitable, permanent and absolute need. Therefore, by studying thirteenth-century European wars, Norbert Elias concluded that in such a world, "those who do not rise, shall fall", and therefore increasing power was an essential condition for its maintenance, through the "domination of those who are closer and their reduction to a state of dependency."[21] In such a system, therefore, all sovereign powers are and will always be extensive, ultimately aiming to achieve increasingly global power, to the best of their resources and means, and regardless of who controls them at different moments of their own expansion.

17. "The desire to win is something truly natural, and ordinary men who can do it will always be praised rather than censured," Niccolo Machiavelli, *O príncipe* (São Paulo, Civita, 1983, Os Pensadores), p. 14.

18. "For war consists not only of battling, or the act of fighting, but that lapse of time during which the will to battle is sufficiently known. Therefore, in the notion of time both the nature of war and the nature of the climate should be taken into account " (HOBBES, 1983, p. 75)

19. "Others who would otherwise be content to remain quietly within modest limits, would be unable to survive long if they did not increase their power through invasions and restricted themselves only to an attitude of defense" (HOBBES, 1983, p.75)

20."A prince should, therefore, have no other objective, or thought, nor should he have anything else as a practice but war, since this is the only art expected of those in command," Machiavelli, op. cit., p. 59.

21. Elias, op. cit., p. 94.

1.3

Before and during a good part of the “long thirteenth century”,[22] accumulation of power by princes or rulers used to be estimated by the amount of territory (T) and rural and urban populations (C + U) within their domains: ($>P = >T+ >\{C+U\}$). And it was measured by the ability of the sovereign power to establish the amount and frequency of payment of taxes (I) and rents and services (R) by the population.[23] This taxing power was essential, since it “financed” further power multiplication, by means of the hiring of mercenary armies and military mobilization of subjects, peasants and city dwellers. At that moment in history, the material basis of the sovereign’s power and wealth could be expressed in a similar way: $P = R = (\{I + R\}/ (T + \{C+U\})$. And power accumulation of P1 took place through the conquering of more T, C and U, subtracted from P2, P3 etc., and through increased ability to create new taxes and impose the provision of new services. Taxation, in any of its forms, has always represented an act of force essential to increase a sovereign’s power over a certain territory and population. By determining the taxes paid by the people, sovereigns also established - authoritatively - the most basic distinction between “necessary labor” and “surplus labor”, by forcing the separation between the share of production to be handed over as payment, from the share to be used in workforce multiplication.

In this regard, William Petty (1996) - father of classical political economy - reversed the order of factors. According to him, taxes were created because there was surplus production available,[24] when, in fact, taxes were created because there was a sovereign with power to proclaim them and impose them on a particular population, regardless of production and labor productivity. That is, only after taxes were established, the population was forced to set aside a portion of production to deliver to the sovereign. And as of then such part of production became a compulsory production surplus to be regularly transferred into the hands of the “taxing power”, regardless of the level of production and productivity of land and labor. Thus, the value of taxes in currency - defined by the sovereign power - became the first price of “surplus labor”, and also, by deduction, of the

22. Term used by Peter Spufford, in explicit analogy with Braudel’s “long sixteenth century”, in Peter Spufford, *Money and Its Use in Medieval Europe* (Cambridge, Cambridge University Press, 1989).

23. In the case of the “maritime republics” of Italy, their accumulation of “sea power” was achieved by means of conquest and expansion of the monopolistic control of increasingly large “maritime territories”, which included sea routes and ports over which taxes were charged. Furthermore, they operated their business, at least until the thirteenth century, with coins, debts and credits (and the “credibility”) of the great territorial powers of Byzantium and Egypt, especially in the case of Venice and Genoa. And, with the tithes and debts of the Catholic Church, especially in Florence. The non-accumulation of power in the form of territory and population may be one reason why the concentration of power and wealth, for these republics, did not lead to the formation of States and national economies.

24. “As of then, taxation is possible if the production system in the political society generates a surplus - especially goods required for consumption minus consumption needs (work) in their production. The key notion in Petty’s discussion on taxation is that taxes and public spending constitute the collection and redistribution of a surplus product at the service of political purposes,” Tony Aspromourgos, *On the Origins of Classical Economics. Distribution and Value from William Petty to Adam Smith* (London, Routledge, 1996), p. 24.

"necessary labor". Therefore, without violating logic, one can say that the value of taxes became the elementary unit of value of the first pricing system within the "payments community," unified by the sovereign's taxes and currency.

Likewise, the "monetization" of taxes represented a radical change in the process of power accumulation and in the relations between power and the world of production and trade. The growth of taxes, required by the increase of wars and conquering, promoted increased production, productivity and surplus labor and land.[25] And the payment of taxes in cash fostered the exchange of surpluses in markets where "taxpayers" could accumulate the credit required for the payment of their debts in the sovereign currency. This created a virtuous circle of sovereign power accumulation and increased surplus, trade and markets. The proliferation of wars and growth of armies,[26] plus the cost of administering newly conquered territories, forced the "monetization" of taxes, rents and tithes, which began to be paid in cash, in the currency issued by the sovereign power.[27] And sovereigns' power came to be defined by the amount of territory and population under their rule and their wealth in cash, accumulated mainly through tax collection and war conquests. From that moment on, the same power defining the value of compulsory taxes, rents and services also defined the value of the only currency accepted as payment for due taxes and services[28].

1.4

The introduction of currency into the world of power and exchange changed Europe into a huge "money mosaic"[29], as rulers gradually "monetized" their taxes and, consequently, their credit and long-term domestic debt.[30] Thus, endless currencies emerged in Europe, each valid within their "taxation area," which became at the same time a "community of payments," from a market perspective. Private currencies have always existed in the market, but "state currency" - or money authorized by the sovereign - has maintained its hierarchical primacy as compared to all the others, as it was only accepted by the "prince's tellers"[31] Now, it was in operations for cancellation of the sovereign's debts and claims and arbitration of

25. Petty's key argument - in his *Political Arithmetic*, published in 1690 - about the relationship between power and wealth and on the possibility of England superseding the power of France - despite its inferiority in terms of territory and population - through increased economic productivity and taxing abilities.

26. Willian H. McNeill, *The Pursuit of Power* (Chicago, The University of Chicago Press, 1982).

27. "In one town after another, one can follow the change of the old feudal payments in kind - work days or poultry or eggs that lords received from their tenants – into the payment of taxes and rents in cash, to settle tenants obligations with their lords, "Heilbroner, op. cit., p. 77.

28, Central idea of the "state theory of money" by George Friedrich Knapp, *The State Theory of Money* (London, Simon Publications Inc., [1905] 2003).

29. Metri, op. cit.

30. See Mitchell Innes, "What is Money?" and "The Credit Theory of Money", in *The Banking Law Journal*, New York, 1913 and 1914. The texts were reprinted in Randall Wray (org.), *Credit and State Theory of Money, The Contributions of A. Mitchell Innes* (Cheltenham, Edward Elgar, 2004).

31. Basic idea of the "state theory of money," Knapp, op. cit.

"exchange", among infinite currencies of the "European money mosaic", that the first opportunities emerged for the multiplication of money through money itself. The first European banks rose from such operations and began to internationalize operations and multiply securitized or "financial" wealth in the shadow of power.[32] The wars of conquest themselves faced the problem of "exchange" and "equivalence" between currencies of territories and populations involved in conflicts and in commercial transactions required to support the troops. And after the end of every war and the taking over of new territories, once again the problem of imposing the "winning currency" over the "defeated currency" was faced, since only the former was accepted in payment of taxes and duties imposed by the winning power to populations of territories conquered by war.

In turn, trade also expanded during and after wars, through pacified paths and monopolistic positions achieved within dominated territories. That was how "market economy" networks expanded during the "long thirteenth century" in Europe, giving rise to "bills of exchange", which became new instruments of financial multiplication for private wealth. But the expansion also took place outside Europe, bringing about the so-called "long distance" trade with the Middle East, Egypt and Asia. During this period, Venice and Genoa played a central role in several trade circuits that connected Europe with the entire Mediterranean and Asia.[33] *The two State-cities operated as "major clearing fairs" and spearheads of trade, which was mostly carried out as bartering and ultimately used as a reference the currencies of large territorial empires such as the Byzantine, Egypt and China,[34] and later the Ottoman Empire.[35] Venice and Genoa only minted their own coins later;[36] and Venice only did so after losing its privileged position vis-à-vis the Byzantine imperial power.

1.5

Along such paths, an ever closer and multiform alliance between power and capital was consolidated in Europe; which represented a major difference between Europe and the Asian empires, where the relationship of sovereign powers with financial and commercial activities was not so close - a relationship

32. "Moneychangers did not create a monetary territory of stability and consistency per se: they penetrated the crevices of monetary territories created by others," Ms Marie-Thérèse Boyer-Xambeu, Ghislan Deleplace and Lucien Gillard, *Private & Public Money Currencies* (New York, ME Sharpe, 1994), p. 124.

33. Abu-Lughod, op. cit..

34. "In the three cultural areas, recognized currencies were a *sine qua non* condition for international trade, [and] the states of the three regions played a role in minting, printing and/or backing such currencies. [...] Currencies were valuable because they were supported (and subsequently controlled) by the State", ibid, p. 15.

35. Halil Inalcik, *An Economic and Social History of the Ottoman Empire 1300-1600* (Cambridge, Cambridge University Press, 1994, v. 1, parte 1 D).

36. "Venetian and Genoese merchants, until the mid thirteenth century, used gold coins from Constantinople and Egypt rather than developing their own, indicating their semi-peripheral status in world trade," Abu-Lughod, op. cit., p. 67.

of "indifferent neutrality", in the words of Irfan Habib[37] - thanks to their great ability to tax land use[38], a possible reasons for the discontinuation of Chinese expansionism in the early fifteenth century.[39] European sovereigns had less land, with lower productivity, and were squeezed in a highly competitive area,[40] unable to finance their wars and conquering only with taxes. In turn, European "banker-merchants" soon discovered that the financing of rulers and their conquest could multiply their money, by providing financial gains and "extraordinary profits" through the financing of wars, financial management of sovereigns' debts and credits, currency exchange and achievement of favored monopolistic positions in all fields of economic activity. [41]

1.6

War, currency and trade have always existed. What was original in Europe, as of the "long thirteenth century", was the way the "need for conquering" induced, and was later associated to, the "need for profit." That is why the historical origin of European capital and the capitalist system[42] is inseparable from political power. Radicalizing our argument: the historical origin of capital does not "derive from the world market," nor the "games of exchange." It derives from the conquering and accumulation of power and the authoritarian encouragement to the growth of surpluses, exchanges, and large financial gains built in the shadow of winning powers. And as a consequence, the theory of capital and capitalism must also

37. Irfan Habib, "Merchant communities in precolonial India", in James D. Tracy (org.), *The Rise of Merchant Empires* (Cambridge, Cambridge University Press, 1990), p. 371.

38. "It was a state which, in fact, played a minor role. There were reasons for this. Mostly, the empire's income needs, vast as they were, could be met by large amounts of land rent collected by a well coordinated and efficient network of government officials," Michael Pearson, "Merchant and States", in James D. Tracy, *The Political Economy of the Merchant Empires* (Cambridge, Cambridge University Press, 1991), p: 52

39. Frederick W. Mote and Denis Twitchett (orgs.), *The Cambridge History of China* (Cambridge, Cambridge University Press, 1988, v. 7 - The Ming Dynasty, 1368-1641).

40. "Unlike the Chinese and Ottoman empires, unlike the domain which the Mongols would establish shortly in India, there was never a united Europe, in which all parties recognize a secular or religious leader. Instead, Europe was a mixture of petty kingdoms and principalities, border lordships and State-cities [...] and all regarded each other as rivals rather than as allies in the fight against Islam," Paul Keneddy *Ascensão e queda das grandes potências* (Rio de Janeiro, Campus, 1989), p. 14.

41. "Thus, monarchs and bourgeois teamed up to promote the slow growth of centralized governments, and from the latter, in turn, stemmed not only the unification of laws and currencies, but also direct encouragement to the development of trade and industry [...]. The growth of national power also meant a new incentive: the construction of ships, military equipment and the payment of these new national forces, mostly mercenaries. All this made circulation centers move more quickly," Heilbroner, op. cit., p. 72.

42. According to Braudel, the word "capital" began to be used in the twelfth and thirteenth centuries, "in the sense of funds, stock of goods, money supply or interest-earning money," Braudel, op.cit., p. 201. We use the word "capital" here referring to money that is multiplied, according to the D-D' formula, through interest loans made to rulers or through other forms of use of power and, therefore without immediate intermediation of goods. And we use the word "capitalism" referring to the "moment" of medieval European history in which the pursuit of profit becomes a permanent objective or an almost mechanic "compulsion", and therefore well prior to the formation of " capitalist mode of production." When commercial gain itself "*no se obtiene mediante la exportación de los productos del próprio país, sino sirviendo de vehiculo al cambio de los productos de comunidades poco desarrolladas comercialmente y em otros aspectos econômicos y mediante la explotacion de ambos países de producción*", Marx, op. cit. (v. 3), p. 318.

derive from the power, taxes and surpluses, from the earliest forms of the definition of surplus labor and its transformation into money and capital, on the basis of the power of rulers.[43]

2 CAPITALIST INTER-STATE SYSTEM

After studying the origins of political power, market economy and earliest forms of capitalist accumulation in Europe, as of the twelfth century, our research has brought us back to the "long sixteenth century": the actual date of birth of national economies and States and of the "modern world system", created and controlled by Europeans until the early twentieth century. That is when its leadership is handed over to the United States and the decolonization of Africa and Asia increases the number of "partners" with the creation of 130 new independent States. Marx was the first to mention the inevitable internationalization of the "bourgeois mode of production." But after Marx, one can observe three main schools of thought within international political economy, addressing the internationalization of power and capital, and the functioning of the "world system", as of the seventeenth century: the theory of imperialism, of John Hobson, Rudolf Hilferding, Nikolai Bukharin and Vladimir Lenin; the theory of "global hegemony" of Charles Kindleberger, Robert Gilpin, Robert Cox; and the world-system theory, of Andre Gunder Frank, Wallerstein and Arrighi, which assimilates Braudel's concept of "global center of gravity". Our reading of the history of such "modern world system" has led us to some conclusions that are different to those of the abovementioned authors.

2.1

As noted, the concepts of power, territory and war do not play a leading role in Marx's theory of capital and the capitalist mode of production. Therefore, strictly speaking, Marx does not have a theory of the "world capitalist system." Bukharin[44] and Lenin[45] were the ones who formulated this theory, in the Marxist camp, and they limited themselves to the study of imperialism in the late nineteenth century. In turn, Gilpin's realist theory of "global hegemony"[46] , for instance, claims that the trend towards a global empire is a pre-modern characteristic that disappeared with the emergence of national states, against all evidence provided by modern history. Braudel, on the other hand, studies the formation of the first "European world-economy" and believes that

43. The logical method "is, in fact, nothing but the historical method, only stripped of its historical form, and disturbing contingencies. There, where history begins, the chain of thought must also begin, and its further development will be simply a mirror-image of the historical course in an abstract and theoretically corrected form; a corrected reflex image, but corrected according to the laws that provide the historical path itself,", Friedrich Engels, "*A contribuição à crítica da economia política de Karl Marx*", in Karl Marx and Friedrich Engels, *Obras escolhidas* (São Paulo, Alfa-Omega), p. 310.

44. Nicolai Bukharin, *A economia mundial e o imperialismo* (São Paulo, Abril Cultural, [1915] 1984).

45. Vladimir Lenin, *O imperialismo, fase superior do capitalismo* (1916).

46. Robert Gilpin, *War & Change in World Politics* (Cambridge, Cambridge University Press, 1982).

the formation of "national markets" was a political revolution and an achievement of the state[47], but does not draw the international consequences of his own thesis. Finally, Wallerstein and Arrighi consider that the "modern world system" precedes the establishment of national states and constitutes a single economic unit, where interstate struggles fluctuate somewhat without theoretical precision[48].

For us, however, the real starting point of the "modern world system" is embedded in the "national Economy-States" "invented" by Europeans and that became "power and wealth-accumulating machines", endowed with a bigger "expansive compulsion" than that of the first power and capitals established in Europe during the 'long thirteenth century".[49] In fact, the "national Economy-States" constituted the finished product of the power and wealth accumulation that occurred before the sixteenth century. But after that, "competitive pressure", "conquest" and "accumulation of power" continued to be an "imperative need" of the new system, as it had already occurred in the world of medieval domain s and towns[50]. The number of sovereign and competitive units dropped and their balance of forces increased, but war[51] continued to be the most important means for conservation and accumulation of power[52]. That is, the old medieval rule defined by Elias as "those who do not rise, shall fall" continued to apply among national States. The difference was that, in the new competition system, the units involved were States and economies articulated under the same national bloc, and with the same expansive and imperialistic ambitions vis-à-vis the other "national Economy-States" in the system. The goal of conquest was no longer, necessarily,

47. Braudel, *O tempo do mundo*, cit. (Chs. 1 and 4).

48. "The modern world system has its origins in the sixteenth century [...]. It is and has always been a 'world-economy'. It is and has always been a capitalist world-economy [...]. Capitalists need a large market, but also a variety of states so that they can achieve the benefits of working with States and also encircle States that are hostile to their interests in favor of friendly States", Immanuel Wallerstein, *World-Systems Analysis* (London, Duke University Press, 2004) , p. 23.

49. "As in the past, once again, it was the need to finance the British wars that caused these changes. But this time, the meeting of power and banks produced a completely new and revolutionary phenomenon: the "national Economy-States." Genuine power and wealth accumulating machines that have expanded from Europe across the world, at a speed and scale that border a new expanding universe, as compared to what had happened in previous centuries. Along with the nationalization of banks, finance and credit, a state tax system was created and the army and navy were nationalized and submitted to direct control of the State's administrative structure. And, even more difficult to define and measure, a new concept and a new identity were consolidated in the world of war, business and citizenship: the concept of 'national interest'," Fiori, "*Formação, expansão e limites do poder global*", cit., p. 34.

50. See Jack Levy, *War in the Modern Great Power System*, (Lexington, University of Kentucky Press, 1983) and Jeremy Black, *The Rise of European Powers* (New York, Hodder Arnold, 1998).

51. "Since 1900, if we count carefully, the world has witnessed 237 new wars - civil and international - that have killed at least a thousand people a year [...]. The gruesome nineteenth century had 205 wars and 8 million deaths. From 1480 to 1800, every two or three years a significant new international conflict began somewhere; from 1800 to 1944, every one or two years; since the Second World War, about every fourteen months. The nuclear age has not diminished the trend of former centuries towards more frequent and deadlier wars. [...] The figures are only approximate, but determine the intense involvement in war, century after century, of European states [...]. Throughout the millennium, war was the dominant activity of European states", Charles Tilly, *Coerção, capital e Estados europeus* (São Paulo, Edusp, 1996), p. 123 and 131.

52. Richard Holmes (org.), *The Oxford Companion to Military History* (Oxford, Oxford University Press, 2001) and Michael Codfelter, *Warfare and Armed Conflicts* (London, MacFarland & Company Publishers, 2002).

the destruction or territorial occupation of another state, it could be simply its economic submission. But the conquering and monopolizing of new positions of political and economic power continued to be the driving force behind the new system. And within those expansive territorial units the "capitalist mode of production" was forged and then internationalized hand in hand with their global "Empire-States" [53].

As of the sixteenth and seventeenth centuries, political units that won wars and made conquests in the previous period centralized and ultimately monopolized taxation power over much more extensive territories and populations and enhanced their power to issue national currency, creating an organized credit system and banks backed by the States' public debt bonds[54]. Thus, currencies and banks were finally nationalized, along with the armies and public bureaucracies, and all ended up with a single national identity, transforming the "dynastic imagery" of Europeans[55]. In the new system, each country's domestic production and wealth became a key condition for international power[56]. And within the world system, there is no "wealth" or "currency" that is "world" in a strict sense[57]. National economies and currencies compete with one another to increase national wealth through the conquering of increasingly larger supranational economic territories, where the winner's currency is imposed and where its capitals can occupy monopolistic positions and obtain "extraordinary profits." After the sixteenth century, capitalist expansion was always led by the "national Economy-States", and the winning expansive States have always led capital accumulation on a

53. "The first Europeans became the heads of new empires almost immediately after birth, both within and outside Europe. Therefore, one can speak of a paradox in the origin of the state system: its "founding fathers", the first states that were born and immediately expanded beyond their own territories were hybrid beings, a kind of 'minotaur', half State, half empire. As they struggled to impose their internal power and sovereignty, they were already reaching outside their territories and building colonial domains", in Fiori, "*Formação, expansão e limites do poder global*", cit., p. 38.

54. Peter G. M. Dickson, "*War Finance, 1689-1714*", in J. S. Bromley (org.), *The New Cambridge Modern History* (Cambridge, Cambridge University Press, 1971, v. 6).

55. "These nationalisms that emerge in a valid form, to oppose the backward and romantic ones lagging behind, are the ones that achieve enough power to support themselves. If the accumulation of power seemed to be the primary goal of European states in modern times, it has also been said that no ruler or state before Napoleon sought to justify aggression and conquest by visions of cultural and national superiority or destiny. [...] If the Habsburgs themselves belonged to a dynastic and supranational tradition of imperialism, the Spaniards who bore the burden of imperial defense in the early seventeenth century did not see things the same way. The Spaniards' sense of destiny to conquer and control has generated resentment in the other Iberian peoples", J. P. Cooper (org.), *The New Cambridge Modern History* (Cambridge, Cambridge University Press, 1970, v. 4), p. 4.

56. Eli F. Herckshер, *La época mercantilista* (Mexico, Fondo de Cultura Económica, 1955).

57. Marx, for example, refers repeatedly to the "world market" and "world money" in the first volume of *Capital*, defining them as the true place and true way to achieve "absolute wealth": "*En los diversos uniformes nacionales que visten el oro y la plata acuñados en monedas y de los que en el mercado mundial se despojan, se nos revela el divórcio entre las órbitas interiores o nacionales de la circulacion de mercancias y la órbita genérica del mercado mundial*", Marx, op. cit., p. 83. "*Es en el mercado mundial donde el dinero funciona en toda su plenitud como la mercancia cuya forma natural es al mismo tiempo forma directamente social de realizacion del trabajo humano en abstracyo*", ibidem, p. 99. "*El dinero mundial funciona como medio general de pago, como medio general de compra y como materializacion social absoluta de la riqueza en general* [universal wealth]... *El oro y la plata [...] se presentan como materializacion social absoluta de la riqueza*", ibidem, p. 100 and 101.

global scale. In addition, the "international currency" has always been the currency of the most powerful "national Economy-State" in a given region for a given period[58].

2.2

The competitive expansion of European "national Economy-States" created colonial empires and internationalized capitalist economy, but neither the empires nor the "international capital" have eliminated national States and economies[59]. Within this paradox lies the most important political-economic contradiction of the "modern world system." States that expand and conquer or submit new territories also expand their "monetary territory" and internationalize their capital. However, at the same time, their capital and wealth are expressed in their national currencies and can only be internationalized by maintaining their link with some national currency, whether their own or that of a more powerful national State. Therefore, one can say that "economic globalization" is an original and constitutive feature of the capitalist system, but is not a product of "capital in general", nor does it represent the end of national economies. Quite the contrary, it is the result of successful expansion of those "national Economy-States" that managed to impose their power of command over an increasingly larger supranational economic territory, along with their currency, their debt, their credit system, their financial capital and various forms of selective indirect taxation aimed to cover part of the costs of managing their own global power[60].

This contradiction of the system prevented the birth of a single global power or world empire, but did not prevent the concentration of international power and wealth in the hands of a small group of major powers, which never had more than six or seven European members, until the United States and Japan joined the "ruling circle" of the world in the early twentieth century. At times, conflict predominated, at other times the States of this "ruling circle" complemented each other, and there was always a more powerful one that led the "military balance". Many authors speak of "hegemony" to refer to the stabilizing role of such leader within the core of the system. But in general, they do not realize that the existence

58. "Although an international currency can be used as payment in all countries, there is one country where it could be used first, for the simple reason that it is the country that created it by an act of sovereignty and put it into circulation; that is the country that conferred its nationality", Boyer-Xamba, Deleplace and Gillard, op. cit., p. 138.

59. "The development of world capitalism results, on the one hand, in the internationalization of economic life and economic leveling, and on the other, and to an infinitely greater extent, in extreme intensification of the trend toward nationalization of capitalist interests, the establishment of closely connected national groups armed to their teeth and ready to attack each other any time", Bukharin, op. cit., p. 66.

60. "Therefore, the borrowing capacity and international credit of winning States are always ahead of the capacity and credits of the other competing States. In the winners' case, their 'public debt' can grow over the product generated within their national territory, unlike the other economies, even the great powers that become imprisoned by lower debt capacity, restricted to their more limited area of monetary and financial influence", in Fiori, "*Formação, expansão e limites do poder global*", cit., p. 46.

of such leadership or hegemony does not interrupt the expansionism of the other states, or that of the leader or *hegemon* itself. Therefore, every hegemonic situation is transitory, and furthermore, it is self-defeating, because the *hegemon* itself ends up undoing the rules and institutions that it helped create in order to continue expanding and amassing more power than those it is "leading".

So from our point of view, what stabilizes - always in a transitory fashion - the hierarchical order of the world system is not the existence of a leader or *hegemon*, but the existence of a central and latent conflict and a potential war among great powers. It suffices to read the history of the "modern world system"[61] to see that there has always been a central conflict, a potential war, which operated as an organizing axis for the whole system; a kind of reference point for the strategic calculation of all other States, and a brake on the unilateral will of the most powerful. Similar, for example, to the dispute between the Habsburg Empire and France in the sixteenth century, or between France and Britain in the eighteenth and nineteenth centuries, or, more recently, between the United States and the Soviet Union after the Second World War.

2.3

Until the late eighteenth century, the "modern world system" was restricted to European States and the territories under their colonial or imperialist domain.[62] This system only expanded and changed its internal organization after the USA's Independence and the multiplication of nation States outside Europe. However, Latin American States, created in the nineteenth century, at the time of their independence did not have efficient centers of power or integrated and coherent "national economies". Moreover, until the end of the twentieth century, they did not constitute a competitive regional economic and State subsystem, nor formed blocks of power and capital with expansive features. This same national and regional scenario was repeated after 1945, with the new states created in Africa, Central Asia and the Middle East: in most cases, they did not have efficient and centralized structures of power, capable of maintaining internal order and an effective tax system, nor did they have expanding economies. Only in South and Southeast Asia can one speak of the existence of a system of highly integrated and competitive States and national economies, according to the original European model.

Despite the enormous heterogeneity of these new members of the "modern world system", one can make some generalizations about their recent and future developments. There are rich countries that are not, and never will be, expansive powers, nor will they be part of the competitive

61 Cooper (org.), op. cit.; and Jan Glete, *War and the State in Early Modern Europe* (London, Routledge, 2002).
62. Abernethy, op. cit..

game of great powers. In addition, there are a few militarized States on the periphery of the world system that will never become economic powers. But there is no way that any of these national States can become a new power without a dynamic economy and an expansive political-economic project. It becomes increasingly difficult for any individual capital or block of national public or private capitals to expand beyond national borders without relying on active support by member States, which will only occur when these States also have "extraterritorial" projects[63]. Outside Europe, only the United States, Japan, and now China and perhaps India managed to become regional powers, and only the United States managed to achieve global prominence[64]. Most other national States are still dealing with the problem of low economic development and the consequences of having become independent while remaining part of "supranational economic territories" operating under the rule of the conquering powers' currencies and capitals.

2.4

Within this world system formed by "national Economy-States", "leading economies" are transnational and imperial, by definition, and their expansion generates a kind of trail stemming from their own national economies. Each "imperial Economy-State" produces its own trail and within it, other national economies are ranked into three major groups according to their political-economic strategies[65]. The first group is comprised of the national economies that develop under the leader's immediate protective influence. Several authors have spoken of development by invitation or association to refer to economic growth of countries that enjoy privileged access to the markets and capital of the dominant power. As happened in the former British colonies of Canada, Australia and New Zealand after 1931, and also in Germany, Japan and Korea after World War II, when they

63. "Hence the demand of all interested capitalists in foreign countries that state power be strong, whose authority they require to protect their interests also in the farthest corner of the world, hence the demand that a banner of war be raised and seen everywhere so that the banner of trade may be planted everywhere. But export capital feels better when the state power of its country completely dominates the new region, because then it is excluded from the export of capital from other countries, the capital enjoys a privileged position and its profits also rely on the State's warranty", Rudolf Hilferding, *O capital financeiro* (São Paulo, Nova Cultural, 1985), p. 302.

64. The history of the United States is no exception to the "model" of European national States and economies. On the contrary, they are a product and an essential part of the expansion process of the model itself, unlike what many historians and social scientists think, including Marxists. The birth of the United States is inseparable from the competition and wars among the great European powers, the same way that capitalist development was not an exclusive work of its large private corporations. It would be unthinkable without the decisive intervention of the American State and of the American wars and without the initial and ongoing support of British financial capital", in José Luis Fiori, "*O poder global dos Estados Unidos: formação, expansão e limites*", in Fiori (org.), op. cit., p. 67.

65. "Thus, both the expansion or change in the hierarchy of the countries in the center and the rapid growth and even significant decrease in the relative backwardness of peripheral countries are processes that are neither automatic nor natural and essentially depend on internal development strategies of national States. Moreover, precisely because of the asymmetries mentioned above, the end result of such projects is strongly associated, in each historical period, to their external conditions", Franklin Serrano and Carlos Medeiros, "*Padrões monetários internacionais e crescimento*", in Fiori (org.), op. cit., p. 120.

were transformed into military protectorates with preferential ties with the US economy. The second group contains countries that adopt strategies to catch up with "leading economies." For offensive or defensive reasons, they take advantage of periods of international change to change their rank and increase their participation in global wealth through aggressive economic growth policies. In such cases, in general, the country's economic empowerment precedes its military buildup and increased international power. These projects can be blocked, as has happened often times, but they can also be successful and bring about a new "leading Economy-State". Precisely what happened with the United States, Germany and Japan in the late nineteenth and early twentieth centuries, and is about to happen with China, India and Russia in the beginning of the twenty-first century. Finally, a third and much larger group is comprised of nearly all other national economies of the world system, acting as "economic periphery of the system", providing primary and industrial specialized inputs to the economies "upstairs". They may have robust growth cycles and achieve higher levels of income per capita, as in the case of Nordic countries and Argentina. And they can become industrialized, such as Brazil and Mexico, and carry on as peripheral economies[66]. In short, inequality in the development of wealth distribution among nations is a key economic feature of the "modern world system." Nevertheless, the system allows for national mobility, depending on the political and economic strategy in each country.

2.5

For different reasons, in periods of great international economic prosperity, as well as during periods of intensifying competition and struggles among the world system's great powers, the spaces and opportunities for peripheral states tend to broaden. In all cases, however, the political and economic exploitation of these opportunities has relied on the existence within those States and national economies of classes, coalitions of power, bureaucracies and leaderships capable of sustaining the same aggressive strategy of protecting their national interests and of expanding their international power for extended periods of time. In this sense, great social and political mobilization - in the form of wars or revolutions – can be detected in all nation States that have become powers by reaching outside themselves and building the "modern world system". As in the earlier cases of the Avis Revolution in Portugal and the *Reconquista* in Spain, the classic cases of the English Civil War and the French, Russian and Chinese revolutions, as well as the American Civil War, the Meiji Revolution in Japan, the Prussian unification wars of Germany in the 1860s, and the great "peaceful revolution" led by Gandhi in India in the early twentieth century.

66. "At one side, the 'lowland areas' of countries such as Argentina, Canada, Australia and New Zealand became stronger, true extensions of European agriculture fully integrated into international finance and trade. These countries were able to grow at high rates, induced by great dynamism in exports. On another level, a diverse set of peripheral countries (in Europe, Latin America and Asia) emerged, whose exportation dynamics and type of financial integration were unable to boost their economies towards high growth rates", ibidem, p. 127.

3 TRENDS AND HORIZONS

Finally, all theories about the formation and transformation of the world system include some prediction, and sometimes they combine international forecasts with strategic analysis, targeted to governments, political parties or social movements. In this field, Marx's theory of the capitalist mode of production, class struggle and revolution[67] became the classic reference model for those who want to combine in a single theory their international outlook and proposed social revolution; as is the case of Bukharin and Lenin and their theory of imperialism, of Wallerstein[68] and Arrighi and their world-system theory [69], And unlike the realistic theory of "global hegemony", which is only concerned with crises and hegemonic changes, as in Kindleberger[70], with a focus on State policies and the "musical chairs" played by the great powers.

3.1

However, as yet there is no unified theory of international conflict and national struggles. And, within the world system, there is no single "player" or "historical subject", with the "manifest destiny" to save or improve humanity[71].

In the world of great powers and other national States and economies, there is no good or evil, better or worse, in absolute terms, but States taking positions that are more or less favorable to peace and "international justice" at given points in history. But even in these cases one has to distinguish rhetoric from concrete action, because all major powers have already been colonialist and anti-colonialist, pacifists and warmongers, liberal and mercantilist, and almost all of them, moreover, have changed position several times along history.[72]

None of this, however, discredits the need for and possibility of national revolutions and a constant struggle of the weaker States, political parties and social movements for justice, peace and democratization of global decisions. But these movements cannot ignore the real world, rather they should act upon objective knowledge and rigorous analysis of it.

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67. Tom Bottomore (org.), *Karl Marx. sociología e filosofía social* (Barcelona, Peninsula, 1973, part 3, chap. 5 and part 4).
68. Immanuel Wallerstein, *After Liberalism* (New York, The New Press, 1995, part 4).
69. Giovanni Arrighi, *Caos e governabilidade* (Rio de Janeiro, UFRJ, 2001).
70. Charles Kindleberger, *World Economic Primacy* 1500-1990 (Oxford, Oxford University Press, 1996).
71. "Again some nations claimed to be specially chosen by God; this conception was propagated in England by Foxe's *Book of Martyrs* and culminated in Milton's theological and historical projects. The Scots had an older tradition which the Covenanters invoked. The Swedes saw themselves as heirs of the Goths, descendants of Japheth, the oldest nation in the world, conquerors of the world and teachers of the ancient Greeks. These myths were systematized by Johannes Magnus with further inspiration from the prophecies by Paracelsus and Tycho Brahe of the Lion of the North, as the precursor of the second coming and universal peace, " J. P. Cooper, " *General Introduction*", in Cooper, op. cit., p. 4.
72. Fiori, op. cit., p. 57.

3.2

In this sense, it is possible to draw some logical conclusions “about the future” from the theoretical premises of this preface:

- by definition, all countries are dissatisfied and intend to increase their power and wealth. In this sense, even if to a lesser degree, all are expansive, even when it is not their aim to conquer new territories;
- there is no end in sight for States and national economies, even with the advance of global power and the internationalization of capital;
- in the “expanding universe” of “national Economy-States, there is no logical possibility of “perpetual peace”, nor balanced and stable markets;
- there is no possibility of the great powers practicing, on a permanent basis, a policy aimed only to preserve the status quo, i.e., they will always be expansionist, even when they are at the top of the power and wealth hierarchy of the world system;
- there is not the slightest possibility of the leadership of capitalist economic expansion ever leaving the hands of the expansive and conquering “national Economy-States” and their “major predators” that defy market rules and institutions to achieve their “extraordinary profits” and secure monopolistic positions, and
- finally, within the “modern world system”, the appearance and rapid rise of a new “emerging power” will always be a factor of destabilization of the system’s central core. But the most significant destabilizing factor in any hegemonic situation and of the system itself will always be the “central core” of the great powers and, in particular, its leader or *hegemon*, since it cannot stop expanding in order to maintain its relative position in the continuing battle for global power.

3.3

At the beginning of the twenty-first century, the “modern world system” is suffering five major structural and long-term transformations. The first is the exponential multiplication of the number of independent national States, which were about sixty in 1945, and amount to almost two hundred now. This, at a time when the “brakes” of the colonial system are no longer in place, nor is the bipolarity of the Cold War, which somehow “maintained order” within this huge mass of independent territorial political units until 1991. Secondly, in recent decades, the dynamic center of global capital

accumulation[73] has shifted to Asia, giving rise to a new Sino-American articulation axis of the global economy. Thirdly, still as a peripheral exporter, China already acts as an articulating and "periphery leading" hub for the rest of the world economy, thanks to the dynamism and size of its domestic market. Fourth, the new international monetary system - "flexible dollar"[74] - consolidated and universalized after the end of the Cold War, along with the successful expansion of US power and globalization of its currency and financial capital, unveiled a truth hidden by successive metal currency benchmarks of the earlier ruling currencies: the "flexible dollar" system has no other benchmark than the global power of its issuing State, along with the "credibility" of its public debt bonds. Since currencies are also used as instruments of power in the struggle among nations for regional and international supremacy, from now on a geometric increase in the "sensitivity" of the dollar and the entire international financial and monetary system is to be expected, if geopolitical conflicts between the powers leading the growth of the world economy continue to increase. Fifth, it is clear that the new nerve center of geopolitical competition will involve at least two world powers - the United States and China - which are increasingly complementary in economic and financial terms, and which today are essential to the expansive mode of the world economy. In addition, the new axis of world geopolitics will involve three "continental" States - United States, Russia and China - which jointly hold about one quarter of the world's territory and over one third of the global population.

3.4

Currently, there are several hypotheses about the end of the "modern world system"[75], but it is highly likely that before this apocalypse, the world system will live for at least another round of adjustments, conquests and wars, as in the old geopolitics inaugurated by the Peace of Westphalia[76]. It seems

73. Carlos Medeiros, "*A economia política da internacionalização sob liderança dos Estados Unidos: Alemanha, Japão e China*", in Fiori, op. Cit.

74. Franklin Serrano, "*Do ouro imóvel ao dólar flexível*", in Revista Economia e Sociedade, Campinas, n. 19, 2002.

75. "So the third blessing, equality, at best will be guaranteed to the United States for 25 to 50 years. At some point, far into the future, in 2025 or 2050, the time of reckoning will come. And the world will be facing the same kind of choice that the United States faces now. The international system will march towards a restructuring that will be repressive or equitable [...]. Of course here we are talking about the extinction of the current international system and its replacement with something totally different. And it is impossible to predict the outcome. We will be at a split on the road and the random fluctuations will have very different effects. What we can do is simply be lucid and active, because our activity is included in these oscillations and will greatly influence the outcome", Immanuel Wallerstein, *Após o liberalismo*, (Petrópolis, Vozes, 1995), p. 209.

76. "In this first decade of the twenty-first century, attention is drawn to how quickly the utopia of globalization and the end of national borders got buried, and with even greater speed the system returned to its old "geopolitics of nations", with the strengthening of national borders and mercantilist economic competition and the increased struggle for regional hegemonies", José Luis Fiori, "De volta para o futuro: a nova geopolítica das nações" (Institute of Economics, Federal University of Rio de Janeiro, mimeo, 2006) , p. 13.

that the final hour of the “modern world system” has not chimed yet, albeit the structural changes underway could be creating a complicated “systemic saturation” situation. From the intellectual point of view, therefore, it is best to carry on with detailed study of its history and transformation movements. This is the only way to move forward in the knowledge and unified discussion of national and international changes and revolutions that are so important for all who envision the world in a transforming way.

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It is important to point out the tribute given to Fernand Braudel through the enhancement of his formulation on the *time of the world*, which, together with the *structures of everyday life* and the *games of exchange*, shapes his originality. Braudel always sought to address issues involving the dimensions of development in a historical and long-term perspective. He emphasized that a world dominated by a mode of production based on the accumulation of capital had always had to balance society, market and state. As the master taught us, in places where this task was most successful, there was prosperity, and where difficulties were persistent, results were not as successful. This initiative is not new in Brazil – its great precursor was Celso Furtado, in *The Economic Growth of Brazil*. This seminal work was welcomed by Braudel as innovative under a methodological perspective.

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