PALGRAVE STUDIES IN LATIN AMERICAN HETERODOX ECONOMICS

LATIN AMERICA AFTER THE FINANCIAL CRISIS

Economic Ramifications from Heterodox Perspectives

EDITED BY **JUAN E. SANTARCÁNGELO**, **ORLANDO JUSTO**, AND **PAUL COONEY**

Latin America after the Financial Crisis

Palgrave Studies in Latin American Heterodox Economics

Series Editors: Juan E. Santarcángelo and Guido Perrone

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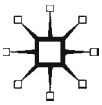

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Introduction

Paul Cooney, Orlando Justo, and Juan E. Santarcángelo

The global crisis is considered by many economists, scholars, and policymakers to be the worst crisis since the Great Depression of the 1930s. It resulted in the threat of total collapse of many large financial institutions, the bailout of banks and other businesses by national governments, and significant downturns in stock markets around the world. However, the economic and social impact of the crisis was not the same in all countries and regions.

Several economic analyses have emerged that attempt to account for the main features of the crisis, highlighting the contribution made by different heterodox schools of thought. These approaches, among which we can underline the Post-Keynesians and various Marxian interpretations, not only provide strong criticisms of the dominant neoclassical theory, but also propose conclusive analyses to understand the complexities of the current social reality.

One of the regions that has a longstanding tradition of heterodox economics and has been less affected by the global financial crisis is Latin America. The countries of this region were able to achieve annual growth rates of around 4% for the period 2003–2013, 48% higher than the average annual GDP growth rate registered in the period 1990–2002.[1] The aim of this book is to explain how the global financial crisis affected Latin America, analyze the main transmission channels that helped the crisis to spread in the region, and understand why this one was not as severe as other crises have been in the past.

The purpose of this book is to combine different heterodox traditions with analysis of how the global crisis affected Latin America. To do that, we have selected a comprehensive group of countries

including—Argentina, Brazil, Chile, Colombia, Cuba, Mexico and Venezuela—which accounts for 80% of the GDP of the region. The goal is to understand the impact of the crisis on the accumulation path of the region without losing sight of the particularities of each country, and the way their different administrations have dealt with the crisis. Therefore, financial and trade mechanisms are studied, as well as the application of any counter-cyclical policy toward maintaining the standards of living that have been achieved.

The analysis of each country were performed by leading scholars and heterodox researchers who have vast experience in the field and have been debating over the regions prospects and challenges since the outbreak of the crisis. Some of the main questions addressed by the book are

(a) What is the impact of the financial global crisis on Latin America?
(b) Why was its impact less severe than in previous crises?
(c) What have been the roles played by different governments?
(d) Which were the main policies applied to confront the crisis?
(e) How has the economic crisis affected income distribution, the conditions of the labor market, and the level of poverty?
(e) What are the main challenges the region will face in the coming years?
(f) What was China's role during the crisis in relation to Latin America?

The book is divided in ten chapters. The following section (chapter 2), developed by Orlando Justo and Juan Santarcángelo, explains firstly the main causes, characteristics, and effects of the global financial crisis and how it spread globally, and secondly analyzes the notions and explanations provided by the neoclassical, Post-Keynesian (traditional and Minskian perspectives), and Marxian theories regarding the inner causes and triggers of crises.

After this introductory chapter, the second part of the book focuses on the analysis of different countries. Chapter 3, written by Juan Santarcángelo and Guido Perrone, begins with a detailed examination of Argentina, one of the most important and dynamic countries of the region during the beginning of the twenty-first century. The aim of this chapter is to study the main features of the dynamics of growth experienced in recent years. In addition, the paper assesses the role of the manufacturing sector, evaluates the impact of the crisis on economic growth, and analyzes the transmission mechanisms of the international financial crisis.

The analysis of Brazil, the most important economy of the region, has been presented by Paul Cooney and Gilberto Marquez. Chapter 4 starts with a brief description of the main events associated with the crisis including the mortgage crisis in the United States. There is also a discussion of the financing mechanisms of the global economy and the role performed by fictitious capital in the context of the crisis. The second part of the chapter examines the impacts of and responses to the global crisis in Brazil, and the difference between PT governments (Lula da Silva and Dilma Rousseff) to introduce countercyclical policies in order to reduce the recessionary impact.

In chapter 5, Claudio Lara focuses on the main characteristics of Chile, a country often praised for its economic performance. According to the author, the goal of the chapter is to discuss with the extended idea that "Chile was yet another victim of the global financial collapse." According to the so-called experts, the country suffered the negative consequences of external shock—particularly financial and demand shocks. Lara challenges this vision by examining external shocks stemming from the decrease of world trade and the drop in capital flows, as well as the instruments (increased fiscal spending and cuts in interest rates) implemented by the government to counter them. The chapter ends with a study of the existing conditions of the accumulation pattern of Chile. Lara examines both the dominant export sector (copper) and the financial sector, leading to the accumulation of international reserves and causing the appreciation of the peso for long periods of time, with its corresponding impact on the *reprimarization* of the economy.

In chapter 6, Guillermo Maya Muñoz and Restrepo Soto focus their analysis on the performance of the Colombian economy in recent decades, the factors underlying their economic recessions, and the impact of the crisis on GDP, employment, wages and prices. Once the general trend is revealed, the paper analyzes the Colombian mining boom and the role China played in the development path, which has consolidated an extractive economy, which goes hand in hand with the process of deindustrialization.

The challenges of Cuba at the beginning of the twenty-first century are presented in chapter 7 by Al Campbell. This chapter considers the impact of the post-2007 global economic crisis on Cuba's economy, especially regarding their main macroeconomic indicators as well as the balance of trade and the evolution of foreign direct investment (FDI). After this general analysis, Campbell studies the impact of the global economic crisis on nickel production and tourism, two of the

most important sectors of its economy, and claims that the impact of the crisis on Cuba is distinct from that of most other countries.

The 2008–2010 cyclical crisis of the Mexican economy was one of the most severe since the Great Depression and is addressed by Abelardo Mariña Flores and Sergio Cámara Izquierdo in chapter 8. The contraction of the Mexican economy was the deepest in Latin America and among the worst in the world. Although the triggers of the crisis are to be found outside Mexico, this chapter aims to show that the severity of the 2008–2010 crisis in the country, both historically and in comparison to other economies, has its structural roots in the precariousness of the Mexican neoliberal regime of accumulation. Abelardo Mariña Flores and Sergio Cámara Izquierdo argue that this situation has resulted into Mexico's ever-increasing dependency on the United States, a concomitant structural weakness of its domestic market, caused by its specific articulations with the world market and its anti-labor policies, and a systemic instability, associated with its financing nature.

Chapter 9, written by Diego Mansilla, focuses on Venezuela. The purpose of this chapter is to understand the reasons behind the impact of the international crisis on the Venezuelan economy. Mansilla analyzes Venezuela's particular productive structure as well as its social and political reality, with petroleum as its focus. After an overview of the Venezuelan economy by the time the crisis started, Mansilla examines its internal effects, detailing the evolution of the main macroeconomic variables and the key sectors of the economy.

Finally, the last chapter, by Paul Cooney, Orlando Justo, and Juan Santarcángelo, examines the general factors that affected the region during the 2007–2008 financial crisis, comparing the various countries in the study, and identifying similarities and differences based on their specific experiences. The section includes a comparison of the economic measures and countercyclical policies implemented by these countries, and it also explores their mechanisms of insertion within the world economy, as well as the dominant tendency for reprimarization in the region. Lastly, it assesses the implications for the region as a result of this tendency and the period of neoliberal globalization, addressing future scenarios in the context of developmental trajectories for the region going forward.

Note

1. IMF (2013), Perspectivas de la economía mundial, Washington.

2

The Global Crisis: Causes and Main Theoretical Explanations

Orlando Justo and Juan E. Santarcángelo

2.1 Introduction

The effects of the sub-prime global financial crisis have had devastating economic consequences worldwide. The bursting of the housing bubble in the United States began in 2007 and quickly spread to most of the developed countries of the world, later arriving in many developing countries. Looking at the 30 most advanced capitalist economies members of the Organization of Economic Cooperation and Development (OECD), the drop in output and income due to the crisis was 6.5% in 2009 (Roberts, 2009: 1). The ultimate outcome was the collapse of significant financial institutions, and more importantly, a major adjustment of financial corporations and the stock market.

Due to the impact of the crisis in the global economy, different economists and social scientists have actively worked to explain its causes and possible solutions. Heterodox schools of thought, especially the Post-Keynesian and Marxian, have provided very interesting explanations. They critique the shortcomings of the neoclassical approach, offering alternative explanations based either on the functioning of the financial system or on the evolution of the rate of profit.

In this context, this chapter aims first, to explain the main causes, characteristics and effects of the global financial crisis and how it spread globally, and second, to analyze the notions and explanations provided by the neoclassical, Post-Keynesian (traditional and Minskian perspectives), and Marxian theories regarding the inner

causes and triggers of crises. The chapter is subdivided into three sections. The first explores the reasons and consequences of the global financial crisis, the next focuses on the development of the main theoretical explanations of the crisis, and lastly, the main conclusions are highlighted.

2.2 The Global Crisis

2.2.1 The Outbreak of the Global Crisis

The 2007–2008 financial crisis was a result of a sequence of events that go back to the change in the US business cycle at the turn of the century. After a decade of economic growth that started in 1991, on the US economy entered into a period of economic contraction. The collapse of NASDAQ Composite (an index of hi-tech companies) in March 2000, triggered the explosion of the dotcom bubble and fueled the end of the so-called dotcom revolution. By this time, the transparency of the American corporate sector had been hit by accounting scandals that prompted the fall of companies such as Enron, Tyco International, WorldCom, among others.

All these events aggravated investor's confidence, not only on Wall Street, but also on the US economy. Fears of an escalated recession prompted the Fed to use monetary policy tools, and lowered interest rates to inject liquidity into the financial system and stimulate private borrowing. From May 2000 until June 2003, the Fed lowered the federal funds rate several times from 6.5% to 1%, the lowest in over 4 decades, as shown in figure 2.1. Even when they raised it, these new rates remained considerably below the average of the previous decade.

Moving away from a disappointing stock market, investors, and speculators turned their attention to real estate. After a long decade in which the technology sector and Wall Street absorbed most of the financial funds, investors now saw the housing market as undervalued, but with the perception that real estate is always a safe long-run investment. With so much money flowing into the banking system, prime borrowers did not experience any difficulty obtaining mortgage loans. Once these customers were served, the attention of investors and speculators went to a large pool of sub-prime borrowers, whose poor credit history, low income, and unstable employment history put them in a second tier of riskier borrowers.

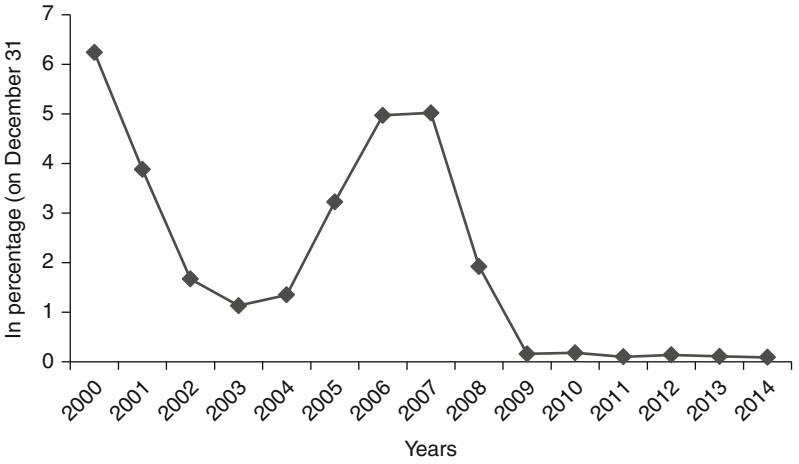

Figure 2.1 Federal funds rate.
Source: Federal Reserve Bank.

The mortgage industry in the United States operates based on commission payments, putting a lot of pressure on brokers and loan officers to sell. The vast majority of the sub-prime customers could not qualify for conventional loans to acquire the houses they were pursuing, but as easy credit flourished, and the demand for real estate properties increased, the mortgage industry was forced to respond to this opportunity. Taking advantage of lax government regulations, the banking sector engineered different kinds of loan instruments to make the figures work for these borrowers, at least during the first year. Sloppy underwriting brought out a new supply of dangerous crafted products in the mortgage industry. These included loans with no income verification, or with interest-only monthly payments plus a five-year balloon, or with monthly mortgage payments that excluded taxes and insurance in escrow accounts, or with adjustable rates for the first and second year of the loan, or with a 0% down payment and no closing costs, among other financial innovations.

The result was a historical growth in household mortgage liabilities from 2001, as depicted in figure 2.2. This exuberant real estate demand drove home prices to national record levels during most of the first half of the twenty-first century (see figure 2.3). Paradoxically, while this bonanza was taking place in housing markets, national income was not growing at the same rate during the 2001–2006

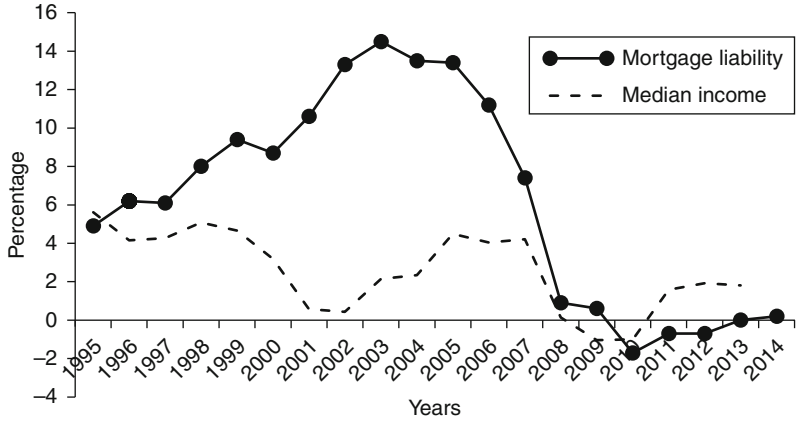

Figure 2.2 US household growth of median income* and mortgage liabilities,** 1995–2015 (annually).

Source: *US Census Bureau; **Federal Reserve Bank.

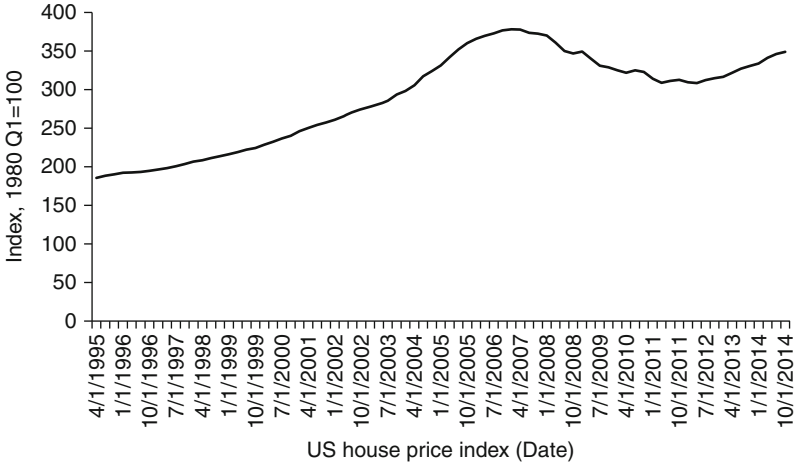

Figure 2.3 US house price index, 1995–2014 (quarterly).

Source: Federal Reserve Bank of St. Louis.

period. As we can observe in figure 2.3, the growing trend of mortgage loans outpaced that of the household median income. In these circumstances, it was just a matter of time before these sub-prime borrowers defaulted on their payments.

Investing in higher yield sub-prime loans was quite attractive in a market where interest rates were at historically low levels. The financial sector moved one step further and created a secondary market for these sub-prime mortgages by including them in collateralized debt obligations (CDOs). These were packages of loans composed of different type of debt instruments, including a large number of these risky sub-prime mortgages, and they yielded between 2% and 3% higher returns than identically rated corporate bonds (Morgenson and Rosner, 2011; McLean and Nocera, 2010). The CDOs served two purposes for banks: first, they helped them to make quick profits, which were small in per-unit bases but large enough in volume to generate liquidity and continue investing, and second, they managed to pass on and share the risk with other financial institutions. Credit rating evaluators like Moody's, and Standard and Poor's overlooked the actual risk of these instruments, and AAA-rated banks and investment companies amassed large stocks of these toxic instruments in their portfolios. A total of around $1.4 trillion were included in CDOs issued between 2004 and 2007 (Morgenson and Rosner, 2011).

By June of 2004, fears of inflation prompted the Fed to raise interest rates as depicted above in figure 2.3. They kept rising for the next 2 years, after which they were stable for another 14 months until August of 2007. This measure carried adverse consequences for the real estate market. We can observe in figure 2.4 that by 2006, the growth path of house prices decelerated as demand for houses slowed down, pictured by a declining rate in mortgage liabilities by household starting in 2006 (see figure 2.3). Consequently, the construction of new houses contracted from 2006 onward, as shown in figure 2.4.

Higher interest rates eventually led to higher monthly payments for many sub-prime borrowers, particularly those who had taken large loans with floating rates. Others started receiving due notices of back taxes, insurance premiums, or balloon payments and began defaulting on their mortgages. This situation spread all over the country, and the number of default loans skyrocketed exponentially. There were 2,824,674 home foreclosures and repossessions in 2009, which represented a 120% increase from 2007 (Blomquist, 2010). As greater number of borrowers stopped paying, the chained sequence of money exchange was interrupted, and a snowball effect expanded through the financial system with devastating consequences. The real estate bonanza was over.

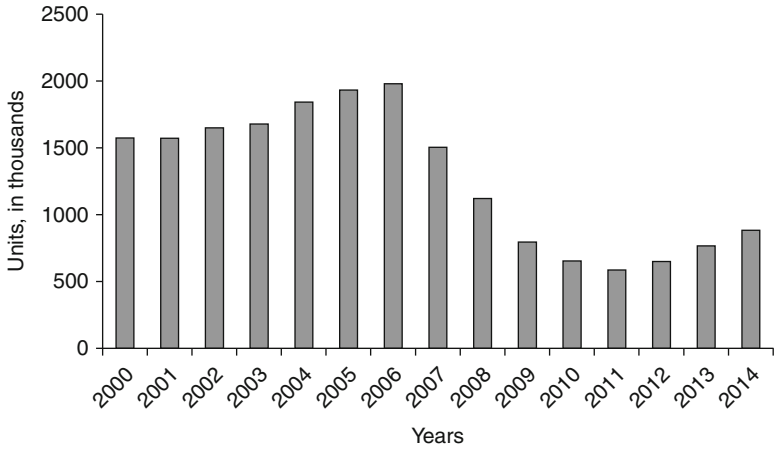

Figure 2.4 US: New privately owned housing units completed.
Source: US Census Bureau.

Financial lenders with large number of bad loans in their balance sheets experienced serious liquidity issues. Likewise, many investment banks were caught with over $1 trillion in CDOs, packed with sub-prime loans (Dodd and Mills, 2008). In July 2007, two hedge funds sponsored by Bear Sterns tried to go short on these toxic securities, an indication of concern to other institutions, but the situation was really aggravated when a French bank, BNP Paribas, stopped borrowing from money market funds in August 2007. This triggered financial panic, and the interbank market froze, limiting the ability of banks to rely on wholesale markets to fund themselves. Hoarding large sums of cash became a common practice, and banks increased the demand for short-term liquidity to be prepared for large number of cash withdrawals.

Northern Rock, a UK-based bank, had to be rescued by the Bank of England, because of its inability to generate liquid funds and continue operating. So it was with Bear Sterns in the United States, which exhausted its emergency reserves of $17 billion in three days and was rescued by the NY Federal Reserve Bank and JP Morgan Chase (Dodd and Mills, 2008). Central banks of several nations coordinated their responses to avoid a global financial cataclysm. They tried to provide liquidity to the system and restore interbank market operations. The Fed lowered the federal fund rate slightly above 1% (see figure 2.2) between 2008 and 2009, and similar steps were followed

by the central banks of Sweden, China, England, the European Union, Canada, and Switzerland. But unfortunately, the snowball continued growing downhill, and several banks collapsed. This was the case of Lehman Brothers, which went bankrupt; other banks that were overloaded with contaminated loans were acquired under the supervision of the Fed, like Merrill Lynch, which was taken over by Bank of America, Washington Mutual which was acquired by JP Morgan Chase, and Wachovia, which Wells Fargo took over. Likewise, the government directly controlled Freddie Mac and Fannie Mae, and the FDIC seized Indymac Bank.

2.2.2 The "Globalization" of American Subprime Loans

The financial crisis hit foreign markets very quickly. American and European banks recoiled their international loans to deal with liquidity issues and concerns about their business stability. This affected those economies that had borrowed heavily from American and European financial institutions, creating credit shortages and causing foreign trade to collapse in countries whose operations are tied to letters of credit and other mechanisms of international financing. Europe showed two different pictures: on the one hand, southern European economies dealt with growing current account deficits during the first decade of the Euro; on the other hand, their northern neighbors ran surpluses. These imbalances drove capital flows into the saturated housing markets of Spain and Ireland. Like banks in the United States, many in Europe were overloaded with bad loans. The effects of the crisis were rapidly seen in Iceland, Spain, Australia, Ireland, Great Britain, Dubai, among others, particularly those whose economies were also exposed to housing financial bubbles, unwarranted current account deficits, and disproportionate spending. The crisis expanded through spillover effects to other group of nations as well, especially developing economies, via fewer exports, falling remittances, and drop in commodity prices.

In the case of the United States, the domestic factors mentioned above were not solely responsible for this financial catastrophe. During the pre-crisis years, trends in US capital inflows followed similar paths to those that generated previous crises in developing countries: large cash inflows created abundance of cheap loanable funds, they were channeled into an attractive short-term profitable sector, and the financial exuberance ignited financial bubbles in the long-run.

But not only American money financed this global financial collapse. The US economy, in spite of the slowdown that took place at the beginning of the century, remained an attractive destination for foreign financial capital, as depicted in figure 2.5.

Roubini and Mihm (2010) argue that these inflows contributed to fixed-mortgage prices and long-term interest rates remaining low during 2004–2006, in spite of the Fed raising the federal funds rate as explained above. Schwartz (2009) links large foreign investments to the boost in the housing market. These funds contributed to large stocks of cheap credit that were channeled into an attractive and well-structured real estate market, characterized by large home ownership, with easy access to first and second mortgage loans.

Other studies call attention to the way capital inflows were helping the United States to finance its current account disparities and growing fiscal deficit. They argue that this posed potential threats to the American financial system and the US dollar, if these foreign investors, fearing financial distress, pulled their assets from US banks (Helleiner, 2008; Andrews, 2008). Notwithstanding, this notion was later challenged by real events, since the response to the subprime crisis in the United States did not generate such large withdrawal of foreign capital investments, in spite of a considerable drop in interest rates and an appreciating dollar (Helleiner, 2011).

A group of scholars claim that foreign financial institutions were quite attracted by the buoyant American real estate market and

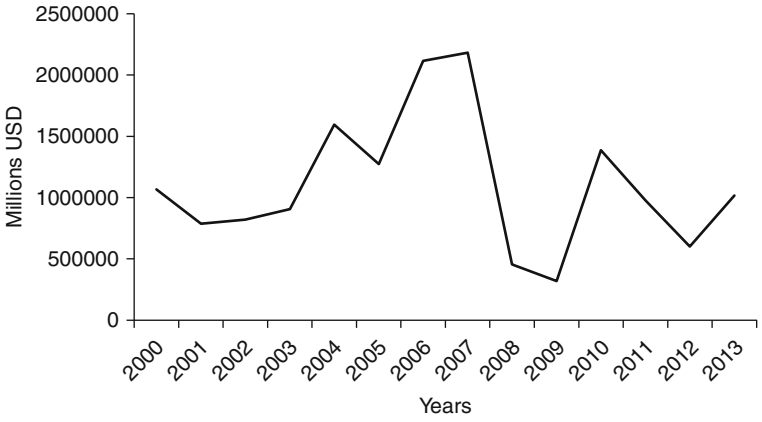

Figure 2.5 US: net increase in financial inflows.

Source: US Department of Commerce.

channeled their funds into the profitable—and risky—CDOs and mortgage backed securities (Langley, 2006, 2008). Among those instruments, many foreign investors felt particularly interested in bonds issued by Fannie Mae and Freddy Mac, which they thought were backed by the US government, and ended up absorbing large flows of foreign capital (Sester, 2008; Thompson, 2009).

Facts show that in spite of the initial negative impact following the collapse of banking institutions in 2007, capital inflows never were in the red and reversed very quickly by 2009, showing growth again. Before and after the crisis, the United States has enjoyed a solid competitive advantage over other international financial markets, supported by the key role of the dollar in international transactions, the liquidity of the banking sector, and the security of US financial markets (Helleiner, 2008; Schwartz, 2009). These factors explain why countries with an export-led growth strategy and current account surpluses, such as China, Japan, and Germany, continued pumping money into the American financial system from both private investors and governments (Helleiner, 2011).

Large sums of the capital inflows received by the United States originated from public sources. Governments of oil-exporting countries engrossed substantial income from a period of high oil prices that started in 2002, and part of these funds ended up being invested in American banks. Some Middle East allies were also driven by their political and security ties with the United States.

The American financial system, in addition to the expansionary monetary policy fed by the central bank, was also fueled with large capital inflows from foreign markets that helped the Fed to keep interest rates low, guarantee a flow of fresh credit into the banking sector, and stimulate private borrowing. The crisis turned global because it had a global origin. Once liquidity issues emerge in one market, in a globalized world, this may turn very quickly into a solvency disaster or a balance of payments shortcoming, which can ignite a global crisis of confidence.

2.3 Theoretical Explanations on Crises

2.3.1 Neoclassical Explanation of Crisis

A "crisis" can be defined as a set of generalized failures in the economic relations of capitalism. The capitalist system is exposed to internal and external imbalances regularly, but only in certain cases

these shocks transform themselves into crisis. Neoclassical economics assumes a world in which all markets are alike and work perfectly, always reaching equilibrium. In these markets, supply and demand function without external interference, relying on their efficient self-adjustment mechanisms to correct any imbalance that may arise. Market supply and demand are aggregated across firms, and individuals' interactions determine equilibrium output and price. According to this approach, agents have rational expectations; all firms are alike and minimize their costs, while consumers try to maximize their utility. In this framework, the State should be kept to a minimum, as should any other regulation that can alter the perfect functioning of markets.

But how do crises arise in a world that works so perfectly? According to the neoclassical framework, crises are caused by external factors beyond the normal operations of the system, or by unnecessary intromissions by the State and other entities (such as unions), which generate imperfections in the market. These factors could be divided in problems linked to the role of the State in the economy (State intervention, market regulations, etc.); natural factors: earthquakes, crop failures, flooding, etc.; or human factors: wars, revolutions, cycles of optimism and pessimism, fraud, etc.

In relation to the global financial crisis of 2007–2008, and following Palley's analysis (2012: 23–26), neoclassical economists' explanations can be subdivided into two main categories: a hard-core government failure hypothesis and a soft-core market failure hypothesis. Under the former, the crisis is rooted in the housing bubble, which in turn is a result of a combination of failed monetary policy and failed regulatory policy (Palley, 2012: 23). Neoclassical economics states that wrong monetary policy corresponds to Federal Reserve measures of targeting the interest rate to 1%, and hard-core market fundamentalists argue the Fed mistakenly continued lowering the interest rate, which created a loose monetary background that drove the housing price bubble (Palley, 2012: 24). On the other hand, the lack of sound regulations is basically due to problems with the regulatory authority, which was performed by the Federal Reserve, the Securities and Exchange Commission, the Federal Deposit Insurance Corporation, the Commodity Futures Trading Commission, the Office of Thrift Supervision, and state regulation of insurance companies. The result was a flawed regulation system unable to prevent the crisis. The second explanation, which Palley named the "soft-core market failure perspective," focuses on the idea that financial market regulation was

too weak, and incentive pay structures within the financial firms did not work properly. This inadequacy allowed excessive leverage and risky exposures by banks and financial firms, which was fueled by the housing price bubble, and in some cases, it generated fraud practices.

Summing up, the neoclassical paradigm supports the idea that the current global crisis was due to some combination of unsound monetary policy, regulatory failures and fraudulent practices within the financial sector.

2.3.2 Post-Keynesian and Minskian Explanations of Crisis

2.3.2.1 Post-Keynesian Explanation of the Crisis

Post-Keynesian economics is concerned with non-equilibrium, non-market clearing analysis, and the explanation of the erratic nature of the expansion path of the capitalist economy (Arestis, 1996: 118). The driving force of the system is effective demand, and institutions play a central role in the analysis, since they are responsible for closing the gap between the actual level of unemployment and full employment. Like neoclassical and Keynesian theory, Post-Keynesians do not recognize profit as the key variable in economics; instead they believe that the key variables are consumption and investment (Carchedi et al., 2011, 91).

Post-Keynesians believe money and production are organically linked, and prices are not the result of a market clearing mechanism (as in orthodox theory) but are determined by the conditions prevailing in the production sector. They reject the axiom of efficient market theory to explain the financial market behavior, and therefore, speculation is not an "anomaly," explained by the existence of foolish "noise traders," but is a consequence of the operational way in which financial markets work in the real world (Alves Jr., et al., 2000: 208).

In the context of the 2007–2008 financial crisis, the Post-Keynesian approach agrees with market failure arguments regarding fractured and inadequate regulation, faulty incentive structures, and fraud. However, it also views these factors as insufficient for explaining the crisis. A housing price bubble and financial crash of the scale experienced require a larger macroeconomic explanation and cannot be explained solely by microeconomic market failures, most of which have been around for a long time. Therefore, the global financial crisis was a result of regulatory failure, but also of inefficient macroeconomic policy toward employment and income

distribution, as well as the malfunctioning of international economic policies (Palley, 2012: 24).

2.3.2.2 Minsky and Financial Fragility Hypothesis

Minsky's analysis placed financial relations at its center, arguing that during economic booms, the economy becomes more vulnerable and does not show the same ability to absorb shocks, which are more likely to end up in crises (Minsky, 1986: 29).[1]

According to Minsky, capitalist economies are inherently unstable and unbalanced, and unemployment is a common feature of the system. He focused on the behavior of bankers in a capitalist economy, in which a significant portion of business investment is financed by bank credit. In this scenario, bankers go from very loose to very strict lending policies. Minsky's hypothesis of financial instability can be summarized in the following four propositions (Minsky, 1986):

1. In a capitalist economy with a developed financial sector, bank credit pro-cyclically acts in the absence of policies or institutions that actively neutralize.
2. This pro-cyclical behavior of credit causes an increase in systemic risk in the expansionary phase of the economic cycle.
3. The growth of systemic risk is not detected by operators.
4. And systemic risk has the potential to explode significantly, causing a process of debt deflation.

Minsky argued that a key mechanism that pushes an economy toward a crisis is the accumulation of debt by the non-government sector during booms. He identified three types of borrowers: hedge, speculative, and Ponzi. In the first, revenue flows are higher than expenditures, while for Ponzi borrowers, it operates the opposite way. Speculative borrowers will be exposed to future periods in which revenue flows will be lower than expenditures, and this gap should be covered with additional credit.

The higher the proportion of firms with speculative or Ponzi positions, the greater the financial fragility of the economy and the systemic risk will be. The interesting thing for Minsky is that capitalism has an inherent tendency for financial structures to move from hedge to Ponzi situations as a normal process of economic expansion.

According to Minsky, the transformation of a stable economy into a fragile one occurs as follows: At the trough of the economic cycle, profits and earnings expectations are low. At this point, the financial structure is robust or solid as deflation and debt during the preceding

contraction resulted in the bankruptcy of overleveraged companies. As the upturn of the business cycle progresses, profits begin to grow, but expectations are still low because memories of the crisis are still fresh, and risks for lenders and borrowers remain high. Therefore, funding patterns remain relatively cautious (Minsky, 1986: 233–237).

However, as the recovery continues, expectations begin to improve, and companies are more willing to borrow in search of new profit opportunities. As it approaches full employment, the expectations become euphoric. At this point, the rate of credit growth exceeds the rate of earnings growth. The financing structure of firms becomes increasingly speculative and Ponzi-oriented, which will eventually drive the economy into a crisis.

Hyman Minsky's theories about debt accumulation received revived attention with the outbreak of the global financial crisis. The striking result is that the cyclical instability of the financial system is a result of its good performance and not due to market failure, aberrations, or extraordinary exogenous shocks. Thus, for Minsky, the "inherently unstable" characteristic of financial markets in capitalism makes recurring crises inevitable in the absence of countercyclical financial policies.

2.3.3 Marxist Explanations

Marx discusses his theory of economic crisis in a wide variety of contexts, and probably the most elaborated analysis on the subject can be found in Chapter 17 of *Theories of Surplus Value* (1963). In this book, Marx stated that the restricted purchasing power of the working class is a necessary condition for capitalist crisis (Marx, 1963: 492), while a sufficient condition is the existence of capitalist production itself, because capitalists do not sell in order to buy; rather, they buy in order to sell (Foley, 1986: 144).

Marx provided many useful insights about their causes, trigger mechanisms, and possible solutions of crisis. Marx's theory draws upon the interaction between competition, class conflicts, and the law of the tendential fall in the rate of profit (Fine and Saad-Filho, 2008: 89). The central point of Marx's argument is that crises arise from within the system. They are inherent to capitalism and regularly appear from the contradictions of the capitalist mode of production (Foley, 1986: 145). Thus, they are not imposed on the system from outside, but develop from within, as a regular response to the process of capital accumulation and reproduction of the system.

Consequently, crises are not only inevitable under capitalism, but they are also recurrent phenomena. Crises tend to resolve the inherent problems generated by the evolution of the system, and they are essential to restore the proper conditions for accumulation to be resumed. According to Marx, a proper understanding of crises needs differentiation between the triggers and the real causes. While financial and monetary speculation may trigger crises, the ultimate origin lies in the "real" side of the economy: in production and exchange (Marx and Engels, 1975, vol. 15, 401).

The causes of and solutions to crises are a very disputed subject in the Marxian literature. In general, we can observe four different causes of crises in Marxian economics, which correspond to different emphasis on certain aspects of Marx unsystematic presentation on the topic. These categories are, first, those who locate crises in the disproportionalities that arise during capital accumulation; second, those who support the idea that the source of capitalist crisis is underconsumption or inadequate aggregate demand; third, those who point out fictitious capital, financialization or neoliberalism as the main reasons behind the current crisis; and finally, those who claim that economic crises are a result of the continuous tendency of the rate of profit to fall. In what follows, we present the main arguments of each of these theories.

2.3.3.1 Theories of Disproportionality

The supporters of the disproportionality hypothesis center their analysis on the importance of the capital allocation during capital accumulation. Their advocates can be divided in two sub-theories (Roberts, 2010: 1). One puts the emphasis on the anarchy of production in which inputs (raw material) might be produced in insufficient amounts as industrial production expands, leading to an economic crisis. The other sub-theory puts the emphasis on the relationship between the two departments of production: the one that produces means of production (Department I) and the one that produces consumer goods (Department II). It is asserted that either Department I produces too much relative to Department II, or Department II produces too much relative to Department I, and that this leads to a general economic crisis (Roberts, 2010: 1).

Marx's analysis on simple and expanded reproduction points out the necessity for a capitalist economy to allocate capital correctly between the two departments of production of the schemes of reproduction (Foley, 1986: 148). But at the same time, Marxian economics

states that capitalist production is characterized by anarchy, since the allocation of capital is decided by decentralized decisions of capitalists. Therefore, if the decision of capitalists results in too much capital being allocated in one department, the balancing conditions for smooth reproduction will be violated (Foley, 1986: 148). As a result, the overexpanded department will find it difficult to sell its whole output, and crisis will arise due to disproportionality.

This argument is a basic topic for classical political economists, especially Adam Smith, who supported the idea that allocation imbalances will generate changes in the rate of profit between departments. These changes will drive capitalists away from the overexpanded department toward the underinvested one, seeking for higher rates of profit. Moreover, it is this movement that will eventually correct the allocation problem between departments.

However, as Foley (1986) points out, Marxian disproportionality theory takes a different turn at this point. These authors argue that the contraction of the overexpanded department is not matched by an expansion of the underinvested department. Hence, aggregate demand falls during the adjustment process and a crisis of realization occurs in both departments. In this version of the theory, excessive investment in one department sets in motion a sequence of events that leads to a fall in aggregate demand, and thus triggers a general crisis in the process of reallocating capital from the overexpanded to the underinvested department.

Advocates of this Marxian interpretation also claim that the system has the need to correctly distribute capital among its various forms: money capital, productive capital, and commercial capital. Smooth reproduction requires not only a correct allocation of capital between departments, but also a correct distribution of capital among its different forms.

2.3.3.2 Under-Consumption Theories of Crisis

The father of the underconsumptionist theory of crisis was the Swiss economist Simondi de Sismondi, and some of the most important advocates of this position were Rosa Luxemburg, Paul Baran, Paul Sweezy, and Harry Magdof. In this branch of Marxian economics, the general idea is that the distributional inequities of capitalist relations of production are inconsistent with system-wide requirements for the growth of demand and the realization of the product (Foley, 1986: 146). For these theorists, the system inevitably tends toward stagnation, and crises in capitalism are due to the inability of capitalist producers to sell all the products they produce.

It is important to note that the core of this argument is based on the definition and nature of effective demand. Under-consumptionists basically identify three types of effective demand: replacement demand, which buys back producer goods to replace those used up; workers' consumption demand, which buys back their share of the product and capitalist consumption; and net investment demand, which must fill the "demand gap" in net output (Shaikh, 1978: 226).

Therefore, there is a lack of aggregate demand in relation to aggregate supply. In spite of the fact that it could be true that under some specific conditions, aggregate demand could not be big enough to buy back all aggregate supply, this is very different than saying that there is always an intrinsic pattern of shortage of aggregate demand in relation to aggregate supply.

Following this line of argument, Bellamy Foster and Magdoff (2009) state that the cause of the current crisis can be found in the development of the new stage of capitalism, which went from the competitive capitalism of the nineteenth century into the monopoly capitalism of the twentieth century (Santarcángelo, 2014). According to these authors, competition has a new distinctive form under the monopoly stage, and since workers cannot spend as much as the system needs, monopoly surpluses build up. The solution for monopolies is to get demand from abroad or fuel demand internally through arms spending or a credit boom. Eventually the credit bubble bursts and the stagnatory nature of capitalism is revealed (Bellamy Foster et al., 2009, and Bellamy Foster, 2012). The crisis occurs not because profitability is too low but because the surplus is too high to be bought or realized, and crises are not cyclical (boom and slump), but structural (stagnation) (Roberts, 2011, 2).

There are two main problems with this argument. The first one is the assumption that under capitalism, consumption is the goal of production, when it is perfectly clear that the aim of capitalist production is to obtain profits. Profitability lies at the heart of the capitalist system. The second problem is that it does not take into account the notion of time, and once we consider it, it is perfectly possible to show that aggregate demand can grow in line with aggregate supply.

2.3.3.3 Fictitious Capital, Financialization and Neoliberalism as a New Stage

The third group of theories under analysis corresponds to a rather heterogeneous group of authors who consider the predominance of finance as the main cause (fictitious capital and financialization) or

an important element (neoliberalism) of the global crisis. Marx was the only classical economist who tried to provide a fully coherent explanation of fictitious capital in volume 3 of *Capital*. The capital is fictitious because it has no immediate connection with real production, whereas value is created as a way of reproducing capital as value that valorizes itself (Rollemberg Mollo, 2010: 4). Marx defines fictitious capital in opposition to real capital, and it is called fictitious because without going through the process of exploitation, it cannot generate new value (Brunhoff, 1990).

Following Marquez and Nakatani (2013: 34), in Marx we can find four forms of fictitious capital: bank capital, debt (i.e., bonds and mortgages), stocks (i.e., equities or shares) and derivatives. Marx analyzed all of them in *Capital* except derivatives, which can be defined as a contract that derives its value from the performance of an underlying entity, which can be an asset, index, or interest rate (Department of Treasury, 2015: 2).[2]

Derivatives can be used for a number of purposes, including insuring against price movements (hedging), increasing exposure to price movements for speculation, or getting access to otherwise hard-to-trade assets or markets (Koehler, 2011: 11). Some of the more common derivatives include forwards, futures, options, hedge funds, and swaps, and variations of these, such as synthetic collateralized debt obligations and credit default swaps.

Initially, derivatives were developed in order to escape risk, but operations became almost completely speculative. The result was an exponential growth of total turnover driven by forward contracts, futures and options, which allowed for very high leverage (Marquez and Nakatani, 2013: 55). The US financial market lavishly created derivatives, while deregulation and integration of financial markets allowed the transfer of money capital from European, Asian, and other regions to the United States.

According to this theory, different ingredients that favored the emergence of the crisis in the United States were present in the early 2000s. There was a huge sum of surplus capital, which pushed down the interest rate and provided one of the necessary conditions for the credit boom. The rising demand led to a rise in the prices of securities, which reinforced credit demand and speculation. The result was that US households and financial institutions became increasingly indebted or overleveraged. However, credit injections could not be sustained indefinitely, and the credit bubble eventually collapsed in 2007–2008.

This approach supports the idea that fictitious capital is at the root of the current crisis. In this type of reasoning we see that what defines and amplifies the fictitious character of capital is the difference between what is really created in production, and its value at the moment when it is sold (Rollemberg Mollo, 2010: 6). The speculative element arises from the difference between production and circulation.

In contrast, some Marxian authors are promoting a different explanation, stating that the crisis is due to the "financialization" of capitalism. According to these authors, capitalism has entered a new stage totally dominated by the financial sector, which now operates under its own laws. Financialization has resulted from the epochal changes that followed the first oil shock of 1973–1974, such as the technological revolution in information processing and telecommunications, as well as profound institutional and political changes (Lapavitsas, 2009: 11). One of the main exponents of this group is the Greek economist Costas Lapavitsas, who argues that the current crisis is essentially an outcome of the financialization of contemporary capitalism. In his view, the crisis arose in the United States because of the enormous expansion of mortgage lending, and it became general because of the trading of debt by financial institutions and the transformation of banks and other financial institutions in the course of financialization (Lapavitsas, 2009: 1).

A different variant of this type of crisis explanation can be found in the works of Dumenil and Levy (2013) and David Kotz, who believed that capitalism has entered into a new structural stage since 1970s: *Neoliberalism*. According to these authors, financialization is an important phenomenon of this new stage, but the global crisis is not only due to financial elements. Dumenil and Levy (2012: 1) believe neoliberalism is a stage characterized by a sharp increase in income inequality and the domination of the financial sector over the productive one, which the authors called "financial hegemony"; the crisis can be defined essentially as a crisis of neoliberalism. The crisis was a "crisis of neoliberalism", which is fundamentally a class phenomenon. Therefore, all aspects of globalization were involved, and as stated, the crisis was not only a financial phenomenon (ibid., 4).

On the other hand, Kotz (2012) claims that the cause of the current crisis is the exhaustion of neoliberal capitalism, which was no longer able to promote high profits and relatively stable accumulation over the long run. According to Kotz, neoliberal capitalism promoted three long expansions, one in each decade of the neoliberal

era, by driving consumption upward relative to disposable income. Business responded by creating the necessary productive capacity to satisfy the elevated level of consumer demand. In addition, the asset bubbles instilled a sense of euphoria among corporate decision-makers, leading to overly optimistic expectations of future profits, which promoted excessive investment. The latter effect showed up in a long-run downward trend in capacity utilization in industry. Once the last big asset bubble burst, consumer spending fell sharply relative to disposable income, while profit expectations reversed, leading to a very rapid fall in business-fixed investment that started one quarter after consumer spending began to decline (Kotz, 2012: 7).

2.3.3.4 Falling Rate of Profit Theories of Crisis

As we saw in the previous sections, the theories of disproportionality and underconsumption give a central role to aggregate demand. In this perspective, crises are linked decisively with the most fundamental and historically progressive aspects of capitalist production—its technical progressiveness and its ability to mobilize enormous productive forces (Foley, 1986: 153). Let us briefly analyze this notion in more detail.

Capital accumulation is driven by profitability, and the goal of production is to obtain surplus value. In production, capitalists use both constant capital (c), which represents all expenses on machinery and equipment used and transferred to the new product, and variable capital (v), which are the expenses on the real wages of workers. Using these, we can define the rate of profit as

$$\text{Rate of profit} = s / (c + v) \tag{2.1}$$

where, s = surplus value, c = constant capital, v = variable capital.

The capitalist firm has four main ways of increasing surplus value: augmenting the length of the working day, increasing the intensity of labor, reducing the level of real wages, and introducing technological change. Each method, if employed successfully, should provide the capitalist higher levels of profits. However, three of these methods (augmenting the length of the shift, increasing the intensity of the work, and reducing the level of real wages) have natural limits, which are 24 hours, a maximum level of intensity, and a minimum level of wages. Though the capitalist will try to use them all, in the long run, technological change, which has no boundaries under capitalism, will be most commonly used. Based on this, Marx developed a theory of

technical change that has many implications for the capitalist system, but for our purposes, it has two outcomes that need to be pointed out. First, mechanization will produce a reserve army of labor. This is the pool of unemployed and partially employed population that is created and reproduced by the accumulation of capital. Second, it will generate a double process of concentration (every successful capital tends to become larger through time) and centralization of capital (the process by which large, successful capitals tend to absorb smaller capitals in the course of competition).

Now, returning to the definition of the rate of profit and dividing (2.1) by v, we have

$$\text{Rate of Profit} = (s/v) / [(c/v) + 1] \tag{2.2}$$

Where s/v = rate of surplus value or rate of exploitation; and c / v = organic composition of capital.

The long run movements on the different components of this rate determine its ultimate outcome, and the predictions in this respect are that (1) the organic composition of capital (c / v) will tend to rise due not only to the increase in mechanization, but also to the rise in the reserve army of labor; (2) the rate of exploitation will tend to rise due to the increase in the productivity of labor. As a consequence of these outcomes, the long run tendency of the rate of profit will be to fall, since the increase in (c / v) will be greater than the increase in (s / v). These will ultimately lead to periodic crisis.

Crises are characterized by excess in the capacity of production, unemployment, and depression which give rise to a restructuring of capitals, which slowly set up the basis for economic recovery. In this sense, crisis and economic recovery are two sides of the same coin. Regarding the current global crisis, this approach supports the idea that the financial crisis was only the trigger and the underlying cause of the crisis was the decline in the rate of profit. Since it is one of the main explanations of the crisis, in what follows we will review the main arguments of Carchedi, Kliman, Moseley, Roberts, and Shaikh, who can be considered among the most significant contributors to this group[3].

Guglielmo Carchedi (2011) empirically shows in his book, *Behind the Crisis*, that if you look at the productive sector over the last 50 years, you can observe a secular fall in the rate of profit, which has been driven by Marx's tendency for the rate of profit to fall. This is basically due to a rise in the organic composition of capital, which

may deliver faster productivity, but because goods get produced in less labor time, there is also a slower growth in value and profitability falls (Roberts, 2011, 3). Despite the counteracting influences on profitability, Carchedi explains the crisis as a result of the law of the tendency of the rate of profit to fall, which eventually overcomes the counteracting influences leading to the crisis.

Andrew Kliman, on the other hand, developed his theory while discussing the roots of the crisis with the Monthly Review School. One of the particularities of his approach, which contradicts the findings of the rest of the Marxian analysts, is that although he believes the falling rate of profit is the underlying cause of the current crisis, he finds empirical evidence that the rate of profit never recovered from the fall it experienced in the late 1970s and early 1980s. As a result, workers' pay has increased and their share of national income has been stable; the rate of accumulation fell because the rate of profit fell, not because portfolio investment increased at the expense of productive investment (Kliman, 2010: 1). Thus, the fall in the rate of profit was a key indirect cause of the poor performance in growth, while the debt buildup and crisis, and its long-run tendency, are the main causes of the current crisis (Kliman, 2010; 2012).

Fred Moseley tried to understand the fundamental causes of the current crisis by taking a long-run view of the entire post-World War II period. He carefully describes how capitalists have responded to the decline in the rate of profit (50% from the 1950s to the 1970s) by attempting to restore it in a variety of ways: inflation, reducing money wages, cutting back on health insurance and retirement pension benefits, increasing the intensity of labor, and even going bankrupt (Moseley, 2009: 2). The success of capitalists has not resulted in a substantial increase in the level of investment, which provided the financial funds lent to workers that eventually fueled the housing bubble. In addition, these dynamic, structural changes in the financial sector have greatly increased the instability of the economy. After the bubble burst, Moseley states, there seem to be only two options: bail out the financial capitalists in some way or suffer a more severe financial crisis, which will in turn cause a more severe crisis in the economy as a whole, which would cause widespread misery and hardships (Moseley, 2009: 11). The only way to avoid this dilemma is to make the economy less dependent on financial capitalists; Moseley proposes the nationalization of banks.

Michael Roberts' studies on the global financial crisis led him to empirically demonstrate that after a decline in profitability from 1965

to 1982, the variable reversed its tendency, showing an upward trend under the veils of "neoliberalism". The main factors explaining this outcome were greater exploitation of the American workforce (falling wage share); wider exploitation of the labor force elsewhere (globalization); and "speculation" in unproductive sectors (real estate and the rise of finance capital) (Roberts, 2012: 17). Profitability peaked in 1997 and began to decline, setting the basis for the Great Recession, which was a "classical" Marxist crisis rooted in the tendency of the falling rate of profit.

Finally, Anwar Shaikh considers the present crisis to be the first Great Depression of the twenty-first century (2011, 2012). According to Shaikh, what really supercharged the great boom that began in the 1980s in the US was the rise of the net profit rate—the net difference between the profit rate and the interest rate—which is the crucial rate to motivate active investment.[4] This was possibly due to the offensive policies against the working class already mentioned by the previous authors analyzed, and also because of a dramatic fall in the (T-bill, 3 month) interest rate, which went from 14% in 1981 to a little above 1% in 2003 (Shaikh, 2012: 19). The evolution of the net profit rate accelerated growth during the 1990s and 2000s, but a falling interest rate also spurred a corresponding rise in debt-financing expenditures by businesses and consumers. Therefore, the growth boom in production went hand-in-hand with bubbles in real estate and financial markets. The fall in the interest rates in other parts of the world, sometimes even faster, as well as the application of deregulation policies, fuelled a similar international boom in accumulation and an international bubble in finance (Shaikh, 2012: 18). Therefore, the sub-prime mortgage crisis in the US was the trigger, not the cause of the present crisis, which is due to the law of the tendency of the rate of profit to fall, a longstanding recurrent pattern of capitalist accumulation (Shaikh, 2012).

2.4 Conclusions

The origins of the 2007–2008 global financial crisis can be traced to the recession that affected the US economy at the turn of the twenty-first century. In response, monetary policy brought interest rates down, which alongside loss of investors' confidence in the stock market, channeled financial funds into real estate markets. As this sector became attractive, the housing market was oversaturated with sub-prime borrowers, who took large credits under uncertain

repayment conditions. The financial market was overloaded with risky loans and collateralized debt obligations, increasing the exposure of financial institutions. As interest rates increased during 2004–2006, subprime borrowers were hit by large payment obligations and harsher conditions, driving them massively into default and causing catastrophic liquidity problems for banks and investment firms. The financial system collapsed in the United States as banks ended up with large stocks of toxic debt instruments on their balance sheets without the ability to generate funds to keep operating. In this context, the Fed intervened with substantial bailouts to save the banking sector and prevent the crisis from expanding with chaotic consequences for the rest of the economy.

The crisis spread worldwide immediately through both financial and trade channels. US investment banks had been attractive for foreign banks and speculators, becoming large recipients of financial inflows. In addition, as the economies of many exporting countries, including those in Latin America, had strong commercial relations with the United States, these trade flows were severely affected.

Was this crisis an isolated phenomenon driven by speculation? Was the explosion of the real estate bubble just the trigger mechanism for an issue that transforms itself in different ways and comes back cyclically? Are financial crises preventable in a capitalist economy, or are they an inherent part of the system? Economists from diverse schools of thought have tried—without consensus yet—to find answers for these questions, focusing their attention on different factors aimed to establish a sound cause-effect relationship.

Neoclassical economics argues that the economy operates efficiently, and markets are always in equilibrium. Thus, crises are caused by external factors which prevent the natural and effective mechanisms of self-correction of the capitalist system, such as an unnecessary intervention of the State or other institutions in the economy, natural factors, or human intervention.

Coming from a different perspective, post-Keynesian explanations of crisis can be subdivided into two main contributions. First, the core argument claims that this crisis was caused by both microeconomic and macroeconomic factors. The breakdown of market mechanisms, such as inadequate regulation, poor incentive structures, and fraudulent practices, in addition to failed policies toward employment and income distribution, as well as ineffective international economic policies, contributed to ineffective demand and the inefficiency of the

economic institutions. These disruptions created a fertile soil that led gradually to the harvest of a deep financial crisis.

Second, Hyman Minsky pays special attention to financial problems and institutions, arguing that capitalism has inherent contradictions that make it prone to economic crisis. A key factor that drives the economy into a crisis is the accumulation of debt by the private sector during the upturn part of the business cycle. The capitalist, following her growth goals, generates the seeds that will explode in the form of a crisis. Minsky believed that crises could be prevented by the application of sound policies by the government, representing a crucial difference from Marxian interpretations. Moreover, the traditional Marxist literature on crisis focuses mainly on the real sector, while the financial sector is analyzed and developed as a residual; on the other hand, Minsky analyzes this phenomenon in the opposite way: by concentrating attention on the role of the financial sector and leaving the real sector aside.

Finally, according to the Marxian tradition, the capitalist system is a complex and interdependent social network, which is continuously exposed to internal and external unbalances, but only under specific circumstances do these shocks end up in crisis. In this regard, any explanation of how capitalism reproduces itself is at the same time (implicitly or explicitly) an answer to the question of how and why non-reproduction occurs, and vice versa. In other words, the analysis of reproduction and the analysis of crisis are inseparable (Shaikh, 1978: 219).

If we approach the analysis of crisis from the point of view of reproduction, we can identify four main branches of Marxian theory of crises. The first two correspond to the disproportionality and underconsumption crises theories, which support the idea that the system is incapable of self-reproduction. In order to survive, the system needs an external source of effective demand, since the internal forces of the system, at most, can reproduce it at a stationary state. The group of Marxian theories under analysis corresponds to a group of authors that remark on the role of finance as an important element (if not the main one) of the global crisis. This includes the supporters of fictitious capital, who believe that crises arise mainly as the result of excessive production of this particular form of capital; proponents of financialization, who believe that the current crisis is essentially an outcome of the financialization of contemporary capitalism; and those who state that main cause of the crisis is rooted in the characteristics of neoliberal capitalism, where financial motives are not the

only explanation of the current crisis. The last theory advocates for the tendency of the rate of profit to fall as the main reason for crisis, and supports the idea that capitalism is capable of self-reproduction but has internal limits. In their view, crises arise as a result of the normal functioning capitalist system, which in its accumulation process, develops the counteracting forces that will end up in crisis.

The current crisis will last a long time. The structural changes it will bring about are still under negotiation, and the struggle over the future is only beginning. Understanding the real reasons behind the crisis is essential to start thinking of possible solutions, and as it is clear from our review, selecting different variables as the main determinants of the crisis will suggest different relevant strategies to be applied.

Notes

1. Hyman Minsky was an American economist who developed a theory of financial market fragility, which has the peculiarity that incorporates theoretical elements of Michal Kalecki, John Maynard Keynes, Karl Marx, Joseph Schumpeter and Irving Fisher (Maya Muñoz and Santarcángelo, 2012).
2. Office of the Comptroller of the Currency, US Department of Treasury (2015).
3. This group has been recently criticized by Michael Heinrich and David Harvey. In order to see more details on the ongoing debate, see Freeman (2013), Harvey (2015), Heinrich (2013), and Kliman (2015) among others.
4. Marx calls this rate the rate of profit-of-enterprise (Marx, 1961).

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3

The Global Crisis and Its Effects on the Accumulation in Argentina

Juan E. Santarcángelo and Guido Perrone

3.1 Introduction

Many economists consider the global financial crisis that started in 2007 to be the worst crisis since the Great Depression of the 1930s. Some of the immediate effects of it have been the collapse of significant financial institutions, an intense process of concentration and centralization of financial assets, and a massive injection of public resources, which tried by different means to rescue the more compromised commercial banks and financial institutions. The correlate of this phenomenon has been seen in the real economies of the countries that were most affected, especially the European periphery, which saw how labor market indicators worsened with the development of the crisis.

Despite that historically international crisis have had significant negative effects on Latin America, the current crisis appears to have affected the countries of the region less severely. A particularly special case in this sense is Argentina, which after experiencing its worst and most dramatic economic and social crisis in 2001, has succeeded in changing the dynamics of accumulation, achieving for the period 2003–2013 the most important economic growth decade of its history.

The aim of this chapter is to study the main features of the dynamics of growth experienced by Argentina in recent years, the role performed by the manufacturing sector in it, and the different

transmission channels of the international financial crisis on the path of growth. The chapter is divided in the following sections: the first part examines the main features of the growth process that begins after the abandonment of the convertibility regime and the contribution that the industrial sector made in this process. Secondly, we examine how the collapse of the housing bubble originated in the United States and quickly spread to all major developed countries, and the subsequent impact on Argentina's growth path. We will pay particular attention to the different mechanisms by which the crisis could have affected (or not) the local economy. Finally, we close the chapter by presenting the main conclusions.

3.2 Growth Path and the Role of the Manufacturing Sector

The global financial crisis that started in 2007 had a significant impact on the level of economic growth (figure 3.1).

As can be observed, after the crisis the level of activity contracted in the major economies of the world. The slowdown, although registered globally with a negative GDP growth rate for the year 2009, exhibits important differences among countries. On the developed side, the G7 had a negative average growth rate of 3.7% in 2009, lead by the European Union and the United States. Probably the main exemption to this general trend was China, which suffered a decline in its GDP growth rate, but in 2009, the annual growth rate was 9.2%, which is extraordinary in international terms.

The financial crisis not only affected the growth path but also the level of international trade. As can be seen in figure 3.2, in 2009, the level of world exports fell by 22%, and although after that, the trend shows signs of recovery, the crisis stopped the strong expansionary trend the world had until 2008.

The situation of emerging countries, and especially Latin America, was not as harmful as the one registered by developed countries. While they experienced a slowdown in their growth rates (in 2009, the annual average rate was –1.3%), the economic recovery in Latin America occurred very rapidly and vigorously. A paradigmatic case in point is provided by Argentina. After experiencing one of the deepest economic and social crises of its history in 2001, the country was able to rapidly expand its economic activity, accompanied by export growth and significant job creation.

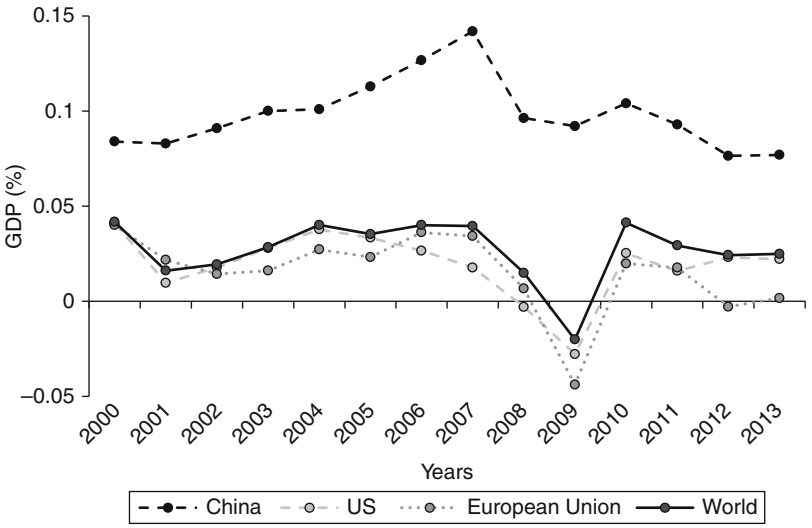

Figure 3.1 GDP annual growth rate, 2000–2013.

Source: Own elaboration using IMF Information.

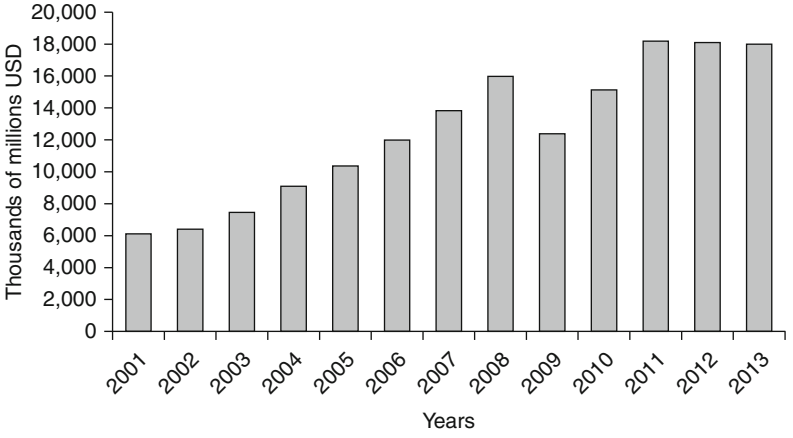

Figure 3.2 World exports, 2001–2013.

Source: Own elaboration using Comtrade Information.

The abandonment in 2002 of the convertibility regime—an overvalued fixed exchange rate that had ruled economic activity for a decade—marked a significant change in relative prices. The new structure of relative prices favored growth in tradable goods and a rapid growth in the manufacturing sector, improving the competitiveness of local production due to the new level of the exchange rate, which cheapened local productions and made imported goods more expensive. It also imposed upon the working class a significant reduction in real wages (especially measured in dollars), which resulted in a sharp increase in the internal level of profitability.

Thereafter, Argentina's economy showed very high growth rates of GDP until 2009 (annual average of 8% for the period 2003–2008—figure 3.3). This occurred in a very favorable environment for exporters of primary commodities and derived products, where prices of these goods, especially soybeans, continuously exceeded their historical highs.

The period of economic growth that started with the Kirchner administration in 2003 has no parallel in recent history. To appreciate the particularities of this stage, it is important to contrast the period of the convertibility regime (1991–2001) and the post-convertibility period (2003–2013). This analysis is carried out in figure 3.4.

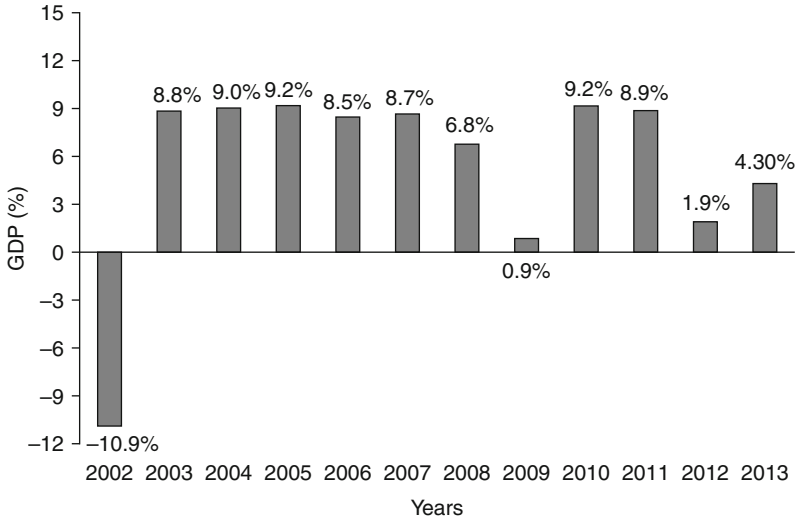

Figure 3.3 Annual GDP growth rate, Argentina, 2002–2013.

Source: Own elaboration using INDEC information.

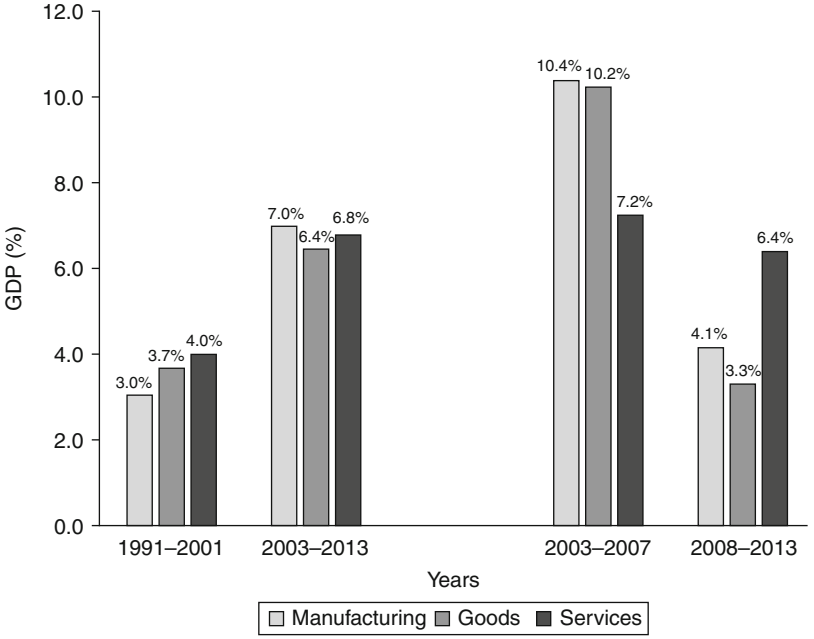

Figure 3.4 Average annual GDP growth rates by main sectors, Argentina, 1991–2013.
Source: Own elaboration using INDEC information.

As can be observed on the left side of figure 3.4, during the post-convertibility regime, Argentina exhibits higher annual average growth rates in all sectors than the ones recorded during the convertibility period. Moreover, not only can we perceive a major change in the levels of average growth rates, but we can also see that the leading sectors of the growth process are very different in both periods. While during the 1990s the service sector led the growth process (with annual average growth rates of 4%), during the current period, the leading role fell on the manufacturing sector, which has grown at an average rate of 7% between 2003 and 2013.

However, the growth of Argentina's economy in the last decade did not record homogeneous dynamics over the period. As can be perceived on the right side of figure 3.4, the post-convertibility regime clearly has two sub-periods regarding its growth dynamics: 2003–2007 and 2008–2013. During the first sub-period, the growth rates achieved by the economy were extremely high, and the manufacturing, goods production and services sectors grew at average annual

rates of 10.4%, 10.2%, and 7.2% respectively. However, from 2008 on, a slowdown in the overall economy is observed, and although the manufacturing sector did not entirely lose its prominence (as the average growth rate of 4.1 is significantly above the growth rate of 3.0% during the convertibility period), the service sector again lead the growth path with an average annual rate of 6.4%. This is because, even though during the first years of the current regime the industrial sector had managed to grow above the aggregate economy rates, the economy did not carry out any structural change in the sector, which prevented the country from overcoming some of the historical contradictions in its economic development path (Fernández Bugna and Porta, 2011; Santarcángelo and Perrone, 2012).

Moreover, within the industrial sector, different trajectories were recorded in the growth pattern since 2008, and the economy in 2012 was more similar to the one registered during the 1990s. In order to appreciate this process in detail, we study the evolution of the

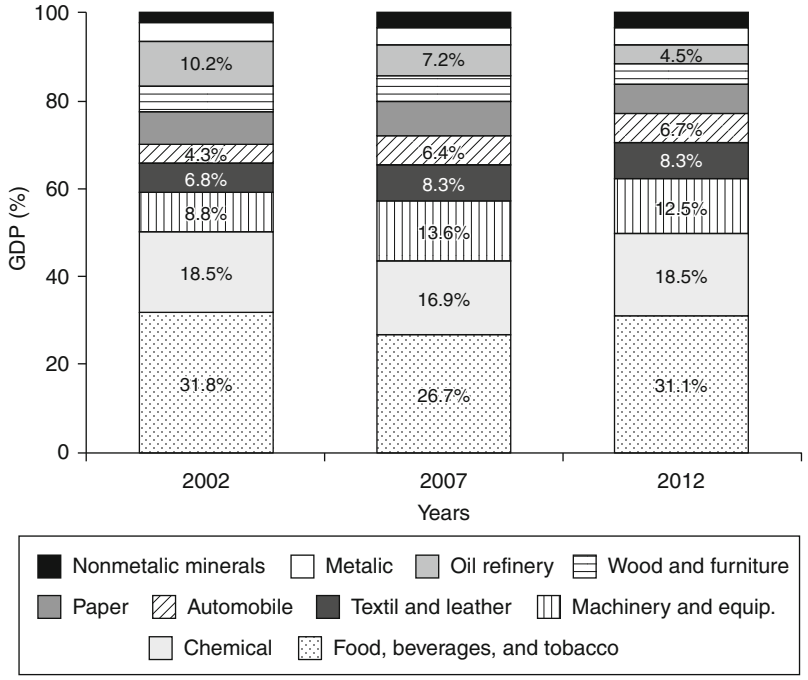

Figure 3.5 Structure of the manufacturing sector, Argentina, selected years.
Source: Own elaboration using INDEC information.

industrial sector structure by large branches in a set of selected years: 2002, 2007, and 2012, as depicted in figure 3.5.

As can be seen, the participation of the different branches in the manufacturing sector in 2007 exhibit some differences from the manufacturing structure developed during the convertibility regime. First, a set of branches suffered a significant reduction in its share of the manufacturing sector in 2007. The most important were food, beverage and tobacco (declining from almost 32% down to 26.7%), chemicals (from 18.5% to 16.9%) and oil and refining (from 10.2% to 7.2%). This decline implied a loss of relative weight of the order of 18%, 9% and 30% for each sector respectively. Second, the branches that experienced an increase in terms of industrial production were machinery and equipment, textiles and leather, and automobiles, which increased their share by 55%, 22%, and 48% respectively.

However, when looking again at 2012 in terms of the structure of the manufacturing sector, we can observe that some of the transformations registered a few years early have disappeared. In particular, in 2012, the share of the food, beverages and tobacco and chemicals sector are similar to those registered in 2002, which together account for nearly half of total industrial production. Overall, no significant changes were recorded between 2002 and 2012 in the manufacturing sector, and the leading sectors of the convertibility regime had regained their participation after 2008.

As a result, the dynamics of economic growth registered by Argentina in the last decade is unprecedented in recent history. However, the pace of growth has not been homogeneous for the period 2003–2013, and although at the beginning of the post-convertibility regime important changes were registered within the industrial sector, the dynamics of these last years has reduced the scope of the changes attained evidencing a lack of significant structural change.

3.3 From the Global Crisis to the Real Economy

Historically, international crises have had a very negative impact on the growth of peripheral economies, particularly in Latin America. The decline in the level of international trade, the reversal of capital flows, and the shrinking of external financing channels were the main mechanisms through which the economies of the region had to face restrictions arising from international contexts of economic crises. However, the context of the current crisis has seen that the economies of the region have shown a positive performance, since they could

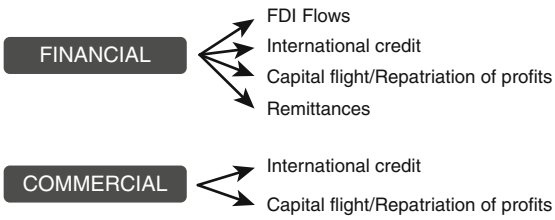

Figure 3.6 Transmission channels of international economic crisis.
Source: Own elaboration.

deal with their adverse effects with a level of unusual strength for these economies (low debt, trade surplus, and high level of reserves).

In order to study the way in which Argentina had to deal with the current financial crisis, we will focus on the two main transmission channels by which an economic crisis can be spread out around the world (figure 3.6).

The first is a financial mechanism that impacts foreign direct investment (FDI), access to international credit, capital flight/repatriation of profits, and remittances. The second mechanism is commercial and it takes place by either an alteration in the level of international trade or in a change in the terms of trade. In what follows, we will analyze each of these mechanisms.

3.3.1 Financial Mechanisms

3.3.1.1 Foreign Direct Investment (FDI)

FDI flows to peripheral countries have traditionally influenced the dynamics of internal growth, since they not only provide capital inflows usually associated with productive investment, but they also increase the amount of dollars in the economy. The latter is often equally or more important for underdeveloped economies. In the event of a crisis, sharp declines in FDI flows have historically been one of the main outcomes and channels through which international crises are spread in these regions.

However, during the current global financial crisis, FDI flows have shown a different dynamic. As can be seen in figure 3.7, and in spite of a decline in the first years of the new century, global FDI flows experienced a strong upward trend until 2007, when they reached a peak of around 2 billion dollars.

Since the outbreak of the international crisis, international flows were reduced significantly, with a slight recovery in 2010 and 2011

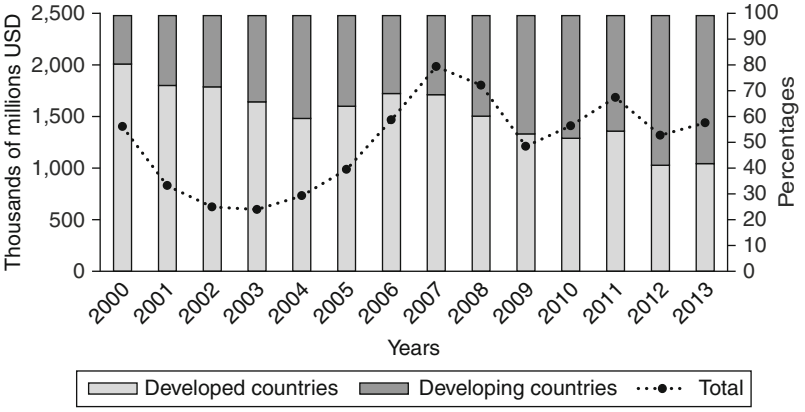

Figure 3.7 Total FDI flows and share of developed and developing countries, 2000–2013 (in billion dollars and percentages).

Source: Own elaboration using CEI and ECLAC information.

and a new decline in 2012, ending in 1.3 billion dollars, a value slightly below the level of 2000. However, if we study the destination of the FDI, we can observe that the decline after 2009 is mainly explained by the reduction in FDI flows to developed countries (the decline was almost 60% between 2007 and 2013 among these countries). On the other hand, FDI flows to developing countries increased 32% over the same period, and since then, constituted more than half of all FDI flows.

After the outbreak of the financial global crisis Latin America has greatly benefited by the evolution of FDI flows, and between 2007 and 2013 received an increase of 67 billion dollars, 65% more funds than in 2007.

Notice also from figure 3.7 that throughout the whole post-convertibility period, Argentina had a relatively low share of FDI flows to the region, averaging around 7%: well below its historical levels and the 20% share it had during the 1990s. Immediately after the crisis, Argentina lost share due to a higher contraction of FDI flows than the ones registered in the region, but quickly recovered previous values and remained around 8% with a downward trend registered in 2013.

This means that in a context of increasing FDI flows to Latin America, Argentina did not benefit by attracting more international capitals flows since it was not able to increase its low share as a destination for FDI during the entire decade.

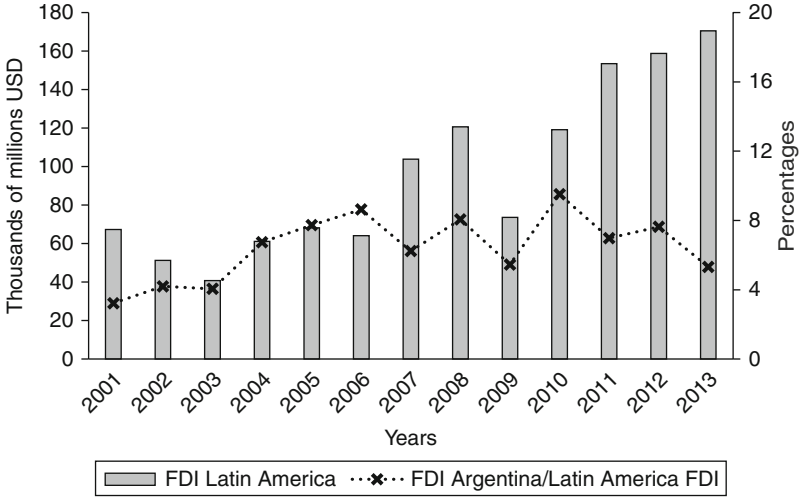

Figure 3.8 FDI flows in Latin America and Argentina's percentage, 2001–2013 (billions of USD, %).

Source: Own elaboration using CEI and ECLAC information.

3.3.1.2 International Credit and Foreign Indebtedness

One of the distinctive features of the current stage of economic growth is that after the devaluation of the peso and the recovery of the economy from the 2001 crisis, Argentina has followed a strong and successful policy of foreign debt reduction. This allows the country to reduce its share of debt in foreign currency relative to the payment capacity of the domestic economy. Throughout the last decade, the burden of external debt went from 87.9% of the country's GDP in 2002 to less than 15% in 2013.

Three elements are central to explaining such a positive outcome. First, the renegotiation of external debt burden carried forward by President Nestor Kirchner since 2003 and finally signed in 2005 was highly successful. This process is one of the most important international renegotiations, not only for the magnitude of the amounts involved, but also for the results achieved. The result was extremely beneficial for Argentina, and meant a 65% reduction in the nominal value of the debt (which is equivalent to a saving of 46.5 billion dollars) and a reduction of 21 billion dollars in payment of interest arrears from the default.

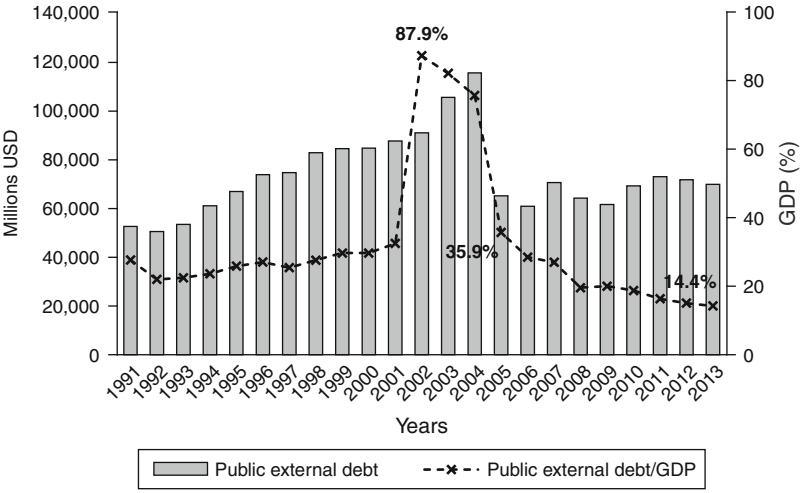

Figure 3.9 Public external debt and ratio of public external debt to GDP, Argentina, 1991–2013.

Source: Own elaboration using CEI and ECLAC information.

The outcome of this policy can be seen in figure 3.9, where the ratio of public external debt to GDP went from 87.9% in 2003 down to 35.9% in 2005.

The proposed defaulted debt swap was widely accepted by creditors, reaching a level of 76.2% of the eligible debt. In 2010, the government of Cristina Fernández reopened the restructuring of the defaulted securities, and even in an unfavorable scenario, due to the international financial crisis, it was possible for the government to restructure 85% approximate 20 billion-dollar debt. Argentina was granted discount of 66% of the nominal value and the non-recognition of interest from the default to the first swap, although they did recognize interest earned from 2005 onward.

The second crucial element to understand the decrease in the level of foreign indebtedness of the country was the advance payment made to the International Monetary Fund of the whole debt (around 10 billion dollars) by using Central Bank reserves. This payment reduced the level of external debt of the country, but more importantly, it gave the government more political autonomy from international financial institutions. Finally, the government decided not to resort to external

financing in international markets. This decision was supported despite very low international interest rates (after the crisis LIBOR and Fed rates were below 1% per year).

3.3.1.3 Capital Flight and Profits and Dividend Payments

Capital flight occurs when assets or money rapidly flow out of a country due to a crisis or a specific economic event. As can be observed in figure 3.10, after a few years with low levels of capital flight (an annual average of 2.000 for the period of 2003–2006), the outbreak of the global financial crisis in 2007 produced a significant rise in capital flight, which reached its peak of 23 billion dollars in 2008. This is equivalent to one and a half times the amount of dollars that total exports of the soybean complex provided to the country during that year. Capital flight remained at high levels the following years until October 2011, when Central Bank Communication 5239 established a foreign exchange restriction, creating the Reference Exchange Operations controlled by AFIP. As a result, the agency monitored all requests for purchases of foreign currency, and in December of that year, through two communications, the BCRA included tourism and travel activities among the operations supervised by AFIP and set up new standards for the buying and selling of foreign exchange for services, rents and current transfers.

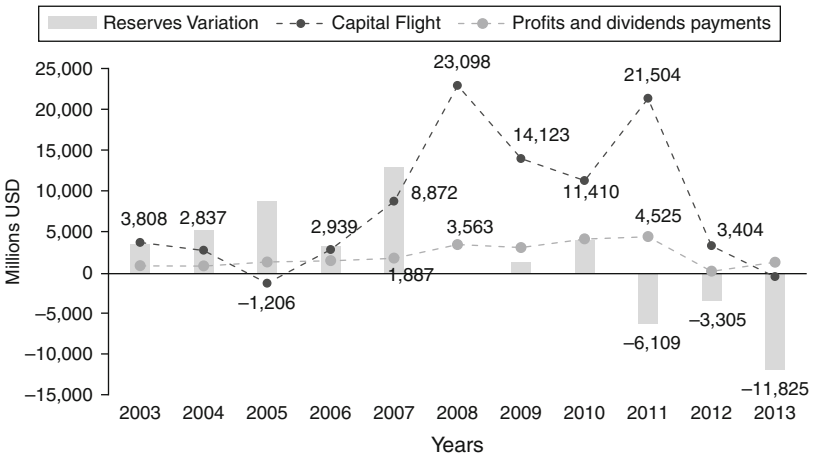

Figure 3.10 Reserves, capital flight, and profits and dividend payments, Argentina, 2003–2013.

Source: Own elaboration using INDEC data.

A similar trend is evident in the evolution of profits and dividend payments, which remained at the same level (an annual average around 1.6 billion dollars) during the first years of the post-convertibility regime. However, with the beginning of the crisis, the profits and dividends payments doubled in value and exhibited an upward trend until 2011, when the government applied more restrictions on profits and dividend payments, establishing top limits for these categories. In February 2012, the government ruled that companies could not buy foreign currency in order to send royalties and dividends abroad.

Finally, the bars in the figure show the variation of reserves for the period under analysis. As can be observed, the amount of reserves increased 34.43 billion dollars during the period 2003–2007. The beginning of the crisis had a significant impact on the variation of reserves (in 2008, it was virtually equal to zero), and after that, the last years of the period under analysis showed a sharp decline in the level of reserves. As a result, the amount of reserves of the country in 2013 was 38.97 billion dollars.

3.3.2 Commercial Transmission Channels

3.3.2.1 Terms of Trade

In Argentina, as in most Latin American countries, the periods of manufacturing growth traditionally have been limited by external constraints. Thus, during the decades of industrialization by import substitution, the growth in the level of activity (and especially manufacturing output) registered a cyclical pattern of expansion and crisis, which gave rise to the beginning of a new period of industrial growth. This dynamic process, known as "stop and go," had as its starting point the rapid growth of a manufacturing sector oriented to the domestic market, strongly dependent upon foreign exchange, which is necessary for the imports of inputs and capital goods required for production. Simultaneously, the agricultural sector, which was the principal provider of foreign exchange, grew at a slower rate than manufacturing, resulting in recurrent balance of payments crises, which interrupted the process of manufacturing growth.

A particularity of the recent expansion of industry is that, until recent years, it has not faced the limitation imposed by a chronic shortage of foreign exchange. On the contrary, the domestic economy has registered strong growth in manufacturing production for many years, without generating problems in the balance of payments. This, however, is not due to a reduction of imports for the industrial sector,

but mainly to strong growth in total exports, thus allowing Argentina to obtain significant trade surpluses over the last decade.

As shown in figure 3.11, despite strong import growth over the decade, which increased eightfold between 2002 and 2013, during this period the Argentina's economy managed to maintain a significant trade surplus. This was achieved by increasing exports from just over US$ 25 billion in 2002 to a record level of US$ 84.3 bn in 2011, which represents an average annual growth rate of 12%. Although all exports grew, the growth of exports of agricultural and derivative goods was particularly notable. These latter activities only depend on local inputs, so increases in exports of these products represent a substantial improvement in the balance of trade. However, the imported component in local manufacturing production is high, so every dollar contributed by the manufacturing industries in terms of exports requires a significant percentage of imports of parts, components, supplies, and machinery.

Thus, the ongoing expansion of manufacturing activity (while requiring very high levels of imports of inputs and machinery) has been financed by the huge volume of exports of primary and manufacturing goods, as well as by the extraordinary evolution of the prices of some of its main crops, such as the price of soybeans price (figure 3.12). The price increase was so significant that in the case of the soy complex exports doubled between 2006 and 2008, in a context in which production only increased by 14%.

As can be observed in the figure, main crops production went from 65 million tons in 2000—2001 up to 93 million tons in 2012—2013. On this basis, unlike what happened decades ago, Argentina's economy was able to maintain for more than a decade a process of industrial growth. This was the case even when this sector had a strong trade deficit, which increased sevenfold between 2003 and 2013, from just over US$ 4 billion to nearly US$ 30 billion in recent years.

Argentina is one of the major players in the international market for soybeans. Local soybean production doubled between 2000 (when it was by far the main local crop) and 2010. Argentina is currently the third largest exporter of soybeans, although only a relatively small proportion of soybean production is exported (approximately 20%), while 80% of total production is consumed domestically in the industrial processing of flour and oil. Moreover, the country is one of the countries with the largest installed capacity for soybean oil, and currently it is the world's largest exporter, one of the leading producers

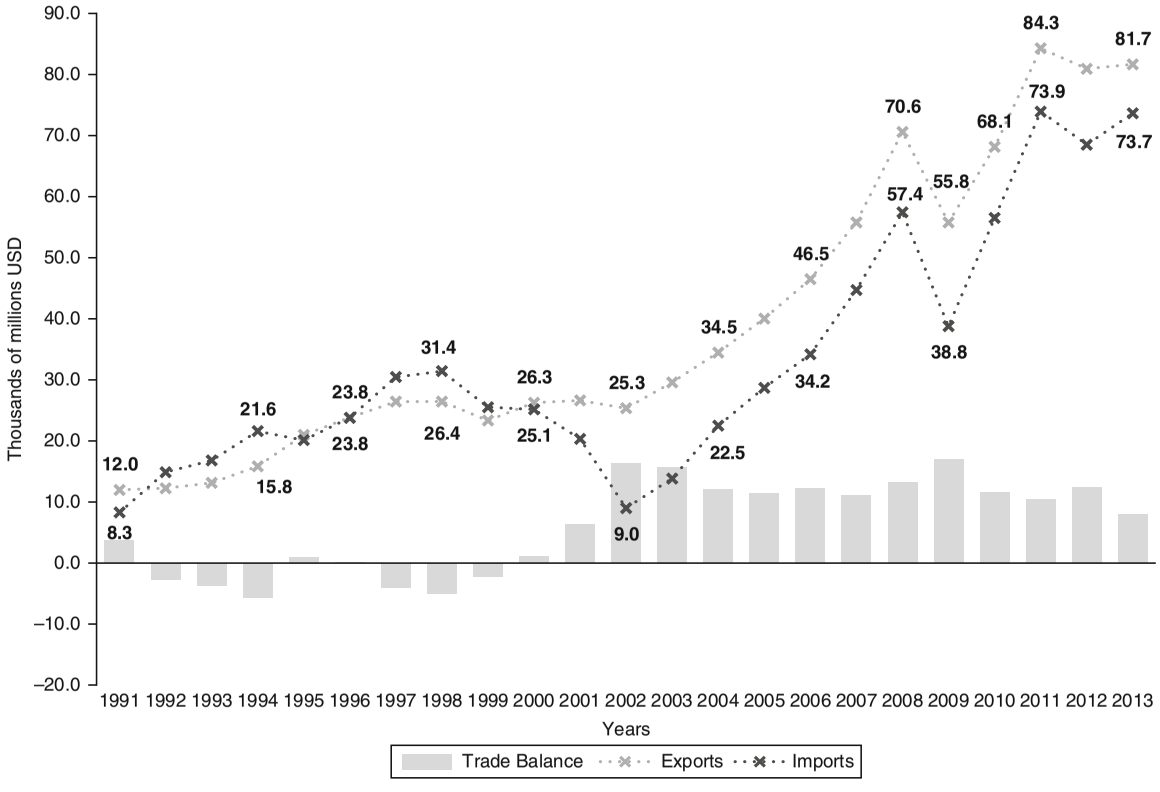

Figure 3.11 Exports, imports and trade balance, Argentina, 1991–2013.

Source: Own elaboration using INDEC data.

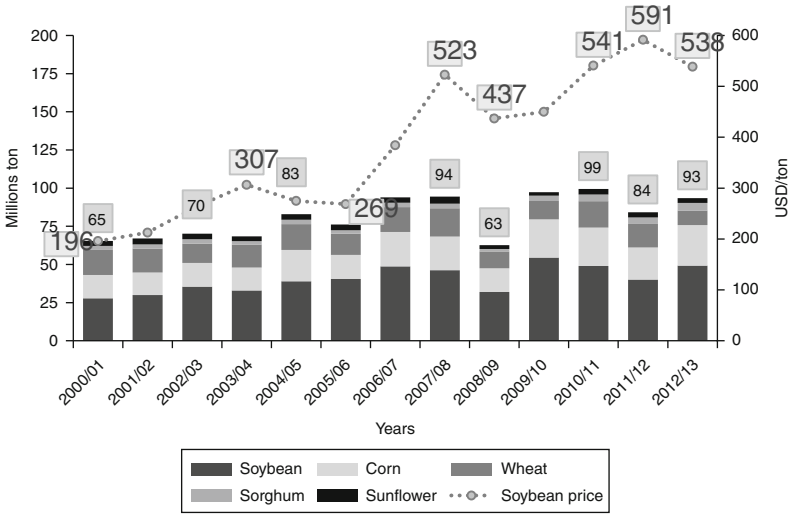

Figure 3.12 Main crops production, Argentina, 2000–2013 (millions of tons and US$/ton).

Source: Own elaboration using INDEC data.

of biodiesel from soybean oil, and the second largest exporter of corn (about 20% of world exports).

The increase in agricultural and agro-industrial exports was based on the strong growth recorded by these industrial sectors during the post-convertibility regime. In fact, it was one of the few sectors that hardly suffered during the 2001–2002 economic crisis (agricultural GDP just fell 2%, while the total economy decreased by 11%). In 2003, the sector's production was 4.4% above its 2001 level, and during the first years after the devaluation, the agricultural frontier expanded significantly. Several factors explain such a favorable performance: First, the collapse of domestic activity after the abandonment of the convertibility regime did not affect this sector, since its production can be placed on foreign markets. Second, the new macroeconomic scenario favored the production of tradable goods by making local production more competitive internationally and also boosting these productions' profitability.

Furthermore, the world registered strong growth throughout the decade in commodity prices, particularly of soybeans (the main Argentine crop), which tripled in price between 2001 and 2011. The openness toward the markets of Asian countries (China, India) with a strong and sustained economic growth is essential to explain

the trajectory of international commodity prices. In the context of expanding global demand for commodities, the outbreak of the international economic crisis gave a strong impetus to international commodity prices, which became a refuge of value, given the loss of the backing of the dollar. For example, the reference price of soybeans doubled between 2006 (before the crisis) and the peak of the crisis in 2008, and the rest of commodities and their derivatives (oil, flours, etc.) moved in the same direction.

This enormous spike in international prices for the main products of Argentine exports resulted in a significant improvement in the terms of trade, which allowed for major foreign exchange earnings. As we can observe in figure 3.13, the terms of trade exhibited a constant upward trend, especially since 2005, and ended up 18.2% higher in 2013 than the level registered in 2003. Therefore, during the post-crisis period, Argentina was in a very favorable position in relation to the early years of the decade.

After the global crisis, agricultural production became even more important to maintain the levels of the current account surplus, which is one of the pillars of the economic model. During the post-convertibility regime, Argentina achieved a trade surplus for 13 consecutive years (figure 3.14). Between 2006 and 2008, the ratio of exports of all

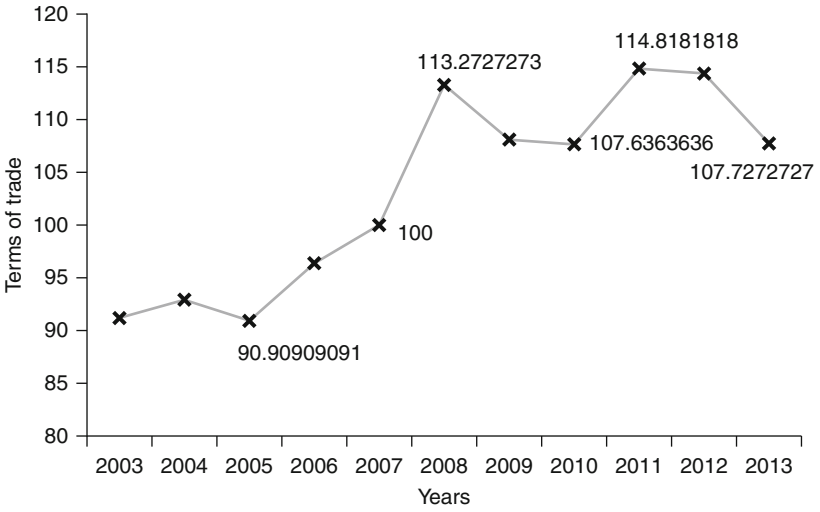

Figure 3.13 Argentina's terms of trade, 2003–2013 (index base 2007=100).
Source: Own elaboration using ECLAC data.

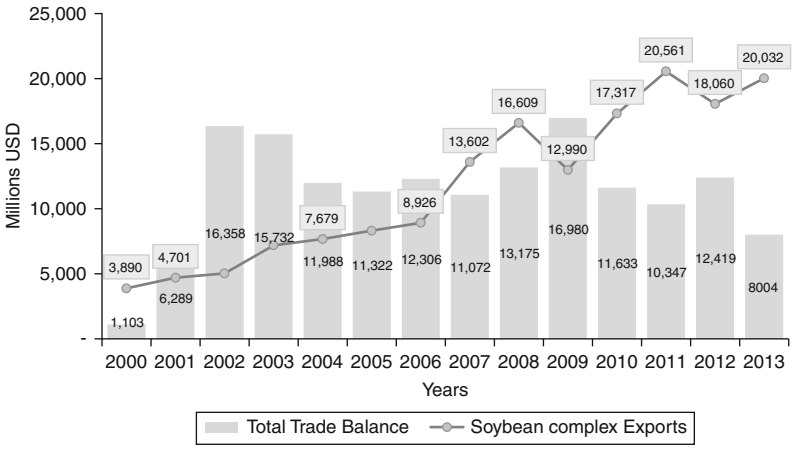

Figure 3.14 Trade balance and soybean complex exports, Argentina, 2000–2012.
Source: Own elaboration using INDEC and Comtrade.

agricultural complexes (including derivatives) and total trade balance went from 1.7 to 2.7 times, while in 2012, this ratio was 3.2 times.

However, the situation for energy was not as favorable as that of the agriculture complex. The production of oil and gas is essential in Argentina for the high weight that hydrocarbons has within the energy matrix (between 85% and 90% of total energy consumed in Argentina uses oil or natural gas as a primary source). In particular, the extraction of natural gas is very important, because over 60% of electricity is generated from hydrocarbons, primarily natural gas, in addition to its use as fuel in industries and for domestic consumption across the residential gas network.

However, following the devaluation of the peso, dollarized contracts inherited from the privatization process were suspended and converted into pesos, and companies that extract oil and gas froze their prices. Furthermore, exports of most of the hydrocarbons were suspended, only allowing the sale of surplus while variable tax rates were implemented. After these changes, companies stopped investing in exploration (in the 1990s, the level of exploration was already very low) and focused on extracting oil and gas they knew they had in their respective areas. This was especially true in the case of YPF, which was the main operating company of the sector and the largest company in terms of volume of sales in the country. The result, as displayed in figure 3.15, was that between 2004 and 2012, oil and natural gas production contracted by 13% and 20%, respectively.

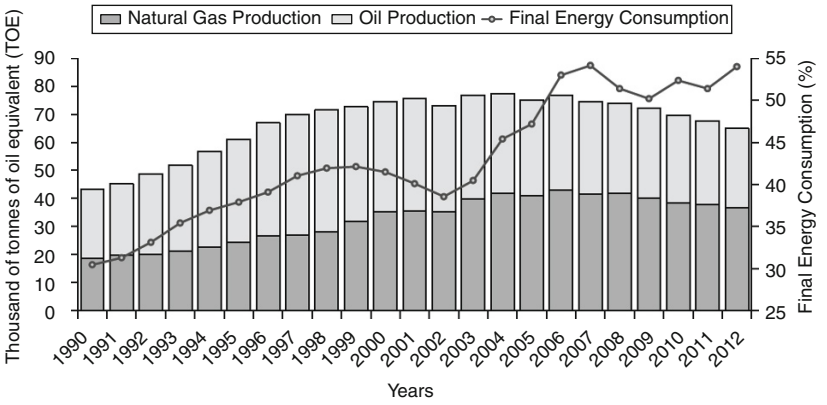

Figure 3.15 Oil and natural gas production and final energy consumption, Argentina, 1990–2012.

Source: Own elaboration using Secretary of Energy data.

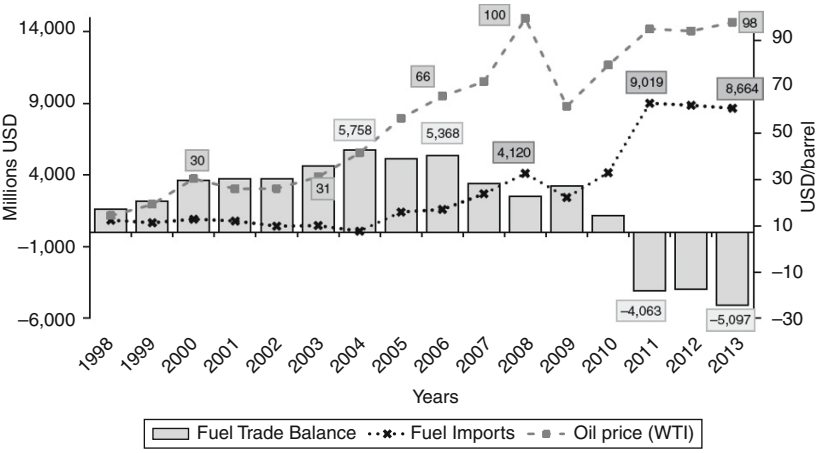

Figure 3.16 Fuel trade balance, fuel imports and oil price (WTI), Argentina, 1998–2013 (millions US$ and US$/barrel).

Source: Own elaboration using EIA and Comtrade.

In addition, the country experienced strong growth in energy consumption between 2003 and 2012 of 34%, due to the increase in industrial demand associated with the process of expansion of manufacturing activity and the growth of residential demand. In order to meet the growing demand for energy in a context of declining local

production, since 2008 Argentina had to reimport energy, primarily to replace natural gas that was not enough to cover local needs.

Therefore, the significant increase in the international price of oil and fuels that was registered after the outbreak of the international crisis had a heavy impact on the Argentine energy trade balance. As we can observe in figure 3.16, the fuel trade balance was reduced rapidly, and between 2006 and 2013, it contracted by more than US$ 10 billion. As a result, since 2011 there has been a deficit in the fuel trade balance, and in 2013, the deficit reached over US$ 5 billion.

Despite this deficit, during 2012 and 2013, there has been a slight decline in imports (on the order of 2% annually), which, however, did not result in a reduction in the deficit of the trade balance, since between 2011 and 2013, exports fell by 28%.

3.3.2.2 Relationship with Main Trading Partners

From the commercial point of view, the global financial crisis has had different impacts on the economic growth of the main trading partners of Argentina. To account for this phenomenon, and due to their centrality in the dynamics of local accumulation, we will analyze Argentina's two main trading partners: Brazil and China, and how the crisis has affected commercial relationships with their economies.

On the one hand, Brazil accounts for more than 20% of Argentine exports and is by far the largest trading partner of our country. After the outbreak of the crisis, the Brazilian economy significantly reduced its growth rate, strongly recovering in 2010, and after that, the country had low levels of growth in the last three years (figure 3.17).

Therefore, it could be considered that the reduction in the rate of growth of the neighboring country (the annual average growth rate of Brazil in the period 2011–2013 was half the rate registered during 2006–2008) could have had a negative impact on the accumulation in Argentina due to the expected contraction in demand for imports. However, as is clear from the figure, since the beginning of the crisis, Argentine exports to Brazil have continued the upward trend they have exhibited since 2002.

Even the observable decline in 2009 sales to Brazil are largely explained by Argentina's internal factors and not by lower demand from the neighboring country. The main contractions are observed in agriculture and its derivative products (oil, flour, etc.), which is explained in great extent by the decline in yields related to the acute drought in the 2008–2009 season. This caused a reduction in the soybean and corn production per hectare by 35% and 14% respectively

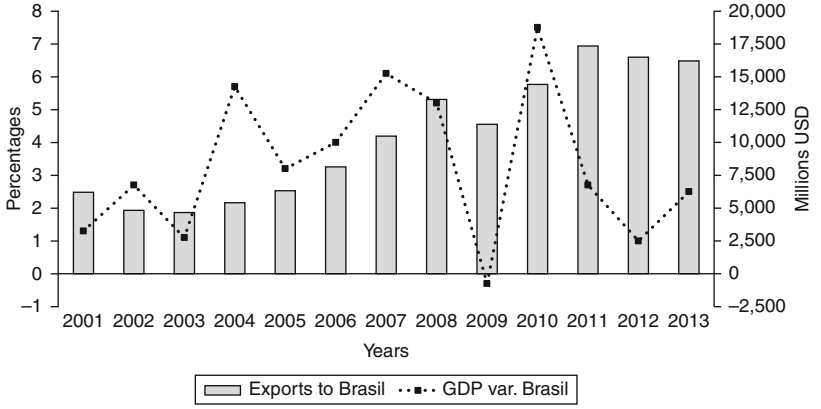

Figure 3.17 Brazil GDP and Argentine exports to Brazil, 2001–2013 (millions US$ and percentages).

Source: Own elaboration using ECLAC and Comtrade.

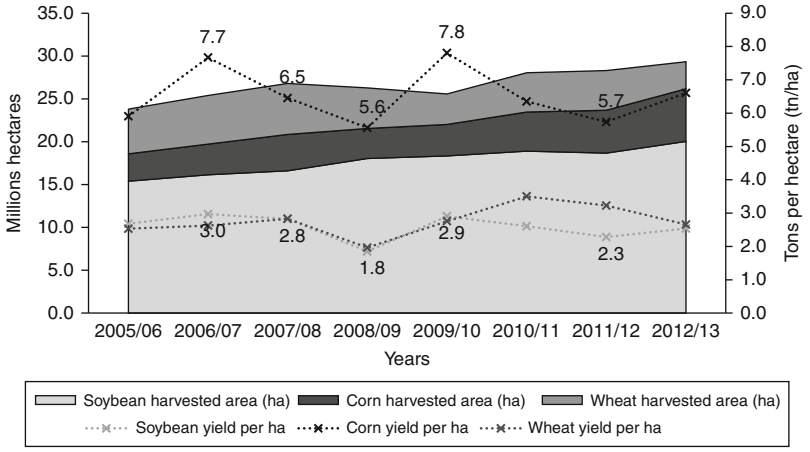

Figure 3.18 Soybean, corn, and wheat harvested area and yield per ha, Argentina, 2005–2013 (millions hectares and ton/ha).

Source: Own elaboration using Ministry of Agriculture, Livestock and Fisheries data.

(figure 3.18). Similar impacts can be seen in 2012, when drought again hit local agricultural production.

Another factor that recorded a significant contraction since 2008 was the sale of fuels, which, as we saw previously, responds to the

implementation by the government of new restrictions on the export of hydrocarbons (primarily natural gas, in the case of Brazil) in response to increasing energy problems registered in Argentina. On the other hand, exports of industrial manufactures doubled its value between 2007 and 2013, explaining over 75% of total exports to Brazil in the last year.

A similar dynamic can be seen in the business relationship between Argentina and China. China is the country's second-largest trading partner of and receives 8% of total exports. After the crisis, the Asian country significantly reduced its rate of growth (figure 3.19), but the rate is still very impressive in international terms (the annual average growth rate is 9.2% for the period 2010–2013). On the other hand if we study the evolution of Argentine exports to China, we can observe a significant contraction of 42% in 2009. This sharp drop is mainly related to the heavy weight of agricultural products and agricultural manufactures, which together account for almost 90% of total sales to China.

As in the Brazilian case, the reduction in Argentine exports to China corresponded to a reduced availability of products due to weather problems experienced in 2009, as is evidenced by the rapid recovery of the levels of exports from 2010 on, even though the volume of exports at the end of the period under consideration exhibits a slightly downward trend. The figure also shows a significant drop in

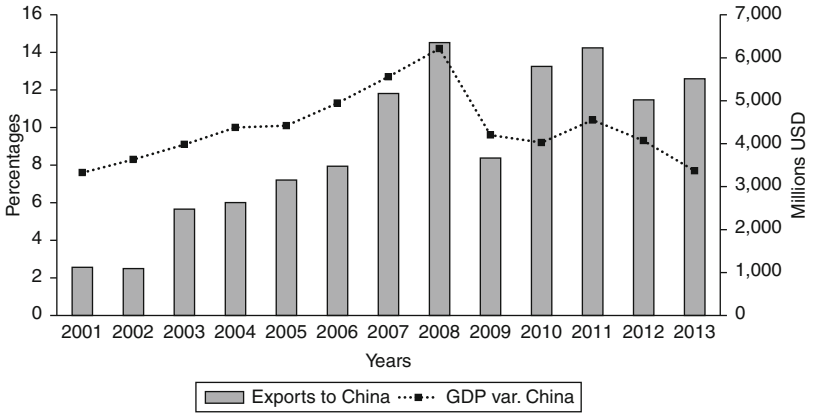

Figure 3.19 China's GDP growth rate and Argentine exports to China, 2001–2013 (millions US$ and percentages).

Source: Own elaboration using ECLAC and Comtrade.

exports in 2012, which can be explained mainly by climate problems that negatively affected agricultural production.

As follows from the analysis of the two main trading partners, the drop in exports to Brazil and China in 2009 and 2012 was not caused by the global financial crisis, but rather to a particular situation that affected Argentina. Once the country recovered from this exports returned to levels similar to what they were pre-crisis.

3.4 Concluding Remarks

After having gone through one of the worst crises in its economic history at the dawn of twenty-first century, Argentina managed to carry out a successful cycle of economic growth between 2003 and 2013. While the global financial crisis has had an impact on the local economy, and during 2009 the rate of economic growth hit the lowest level in the decade, many of the problems experienced since then—lower expansion rates, reprimarization of economic structure and balance of payments growing deficits (among other weak economic dynamics not analyzed in this study, such as poor job creation, wages stagnation, rising inflation, and fiscal deficit)—are due more to its own limitations on the accumulation model than to effects derived from the international crisis.

In this sense, we have seen that despite the high rates of average annual economic growth and the prominent role of the manufacturing sector throughout the decade, the growth dynamics exhibit two different trends with a clear turning point in 2008. While during the first sub-period, economic and industrial growth has been superlative, and the economy was able to create nearly five millions jobs (Santarcángelo and Perrone, 2013), from 2008 onward, the industrial performance in terms of growth and employment weakened, and the growth pattern started to show a more similar structure to the one existing in the 1990s during the convertibility regime.

In this chapter, we have shown that the financial channel of contagion of the global crisis toward Argentina has not been as harsh as previous crises had proved to be for peripheral economies. The main difference between this and previous global crises lies in the strength that Argentine external accounts were showing at the beginning of the crisis and the relative financial isolation of the local economy. As a result of the restructuring of the public debt and the political decision not to appeal to international markets for financing, by 2007 the country had a low level of external indebtedness, especially when

compared to GDP or its export capacity, two variables that had shown large expansion in previous years. In the same sense, the rapid accumulation of international reserves up to 2007 allowed the country to stand in a comfortable position to cope with any speculative run on domestic currency. However, this financial isolation, whereas it was important to avoid possible negative effects derived from the international crisis, it has also impeded the country from benefiting from larger incoming FDI flows and low international interest rates.

The main channel to enhance international reserves and finance the high level of imports that Argentina's industrial growth required was a permanent trade surplus supported by a remarkable growth in exports of agricultural products and derivatives. However, the outflow of currency in the form of capital flight and the remittance of profits increased sharply after the crisis with severe impacts on external accounts. As a result, the rapid deterioration on balance of payment forced local authorities to instrument a set of measures in order to reduce currency outflow, mainly by increasing restrictions on the foreign exchange market and diminishing imports through non-tariff measures and taxing credit card purchases abroad. These measures helped to contain capital outflows—especially in the first years after implementation—but introduced new constraints to investment and growth, since manufacturing activities in Argentina require a high level of imports, because its operation and foreign capital have a very strong presence in the most dynamic productions.

The commercial transmission channels of the economic outcomes derived from global crisis were highly significant for Argentina (as they were in the rest of the region). There are, however, no signs of a significant drop in the demand for Argentine goods and services, despite the slower economic growth registered by the country's major trading partners—as it was shown for Brazil and China. The major declines in exports recorded in 2009 and 2012 seem to be explained by the severe droughts that affected the country in those years, reducing crop yields significantly and most exports of agricultural and derivative goods. Also, on a lower but still important level, hydrocarbon exports volumes decreased after 2008, following the implementation of restrictions on fuel sales in response to increasing energy problems in Argentina.

The main mechanism regarding commerce through which the international crisis affected the dynamics of Argentina's economy was the major changes in relative international prices. The increase in commodity prices associated with the crisis—following major speculation

and a weak dollar—led to a very favorable performance on the terms of trade for Argentina, due to the heavy weight of agricultural and derivative goods in its export basket. This significant improvement in the terms of trade, unlike what happened decades ago, was the main factor that allowed the country to keep financing its import requirement needs associated with the expansion of the manufacturing activity. After the global crisis, agricultural production became even more important to maintain the levels of the current account surplus, which is one of the pillars of the economic model.

This means that the outbreak of the international crisis has helped to reinforce the structural relevance of traditional sectors in Argentina. It is also expected that the chances of modifying Argentina's place in the international labor division and gaining access to the world market as an exporter of higher value-added products with elevated technological content, have decreased in the current crisis scenario, because international competition grew more difficult, and markets tend to be smaller. Despite that, the real impact of the crisis on the country was not as severe as in the previous global crisis; the trends associated with the international crisis shaped a scenario in which the structural change in Argentina is even more difficult than before.

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4

The Impact of the Global Economic Crisis on Brazil from 2008 to the Present

Paul Cooney and Gilberto Marquez

4.1 Introduction

In this chapter, we begin with a short introduction, followed by a summary of the crisis that most argue began in 2008, and although some argue that it ended in 2010, we consider it to still be ongoing, particularly in Europe. In any case, we first present a description of the main events associated with the crisis, which is increasingly referred to as the "Great Recession." Then, we present a summary of the mortgage crisis in the United States, the financialization of the global economy, and in particular, the role of fictitious capital, in an overall analysis addressing accumulation and profitability for global capital.

In the third section, we turn toward Brazil, and examine the impacts of and responses to the global crisis in Brazil. This section is broken up into several sub-sections. The first will examine the overall macroeconomic impacts, and also the attempts by the PT governments (Lula da Silva and Dilma Rousseff) to introduce countercyclical policies in order to reduce the recessionary impact. We will examine recent changes, beginning with the period of the *Plano Real* in 1994, considering financial flows, including foreign direct investment (FDI), into and out of Brazil. It is important to examine how the latter affects Brazil's external vulnerability, and what recent governments have done to reduce it. This is then followed by a sectoral analysis of the Brazilian economy, examining shifts in industry,

agriculture and other major sectors, such as mining. In particular, we examine the relevance of the related processes of deindustrialization and reprimarization, which have been taking place in Brazil in recent decades. To a significant degree, these processes are a result of the particular insertion of the Brazilian economy through the period of neoliberal globalization and the fundamental role played by the transnational corporations (TNCs) and the WTO. The last subsection we consider is the impact of the crisis on Brazilian workers and the poor or socially excluded. In this context, we examine the benefits of several social policies, such as the *Bolsa Família*, but also recognize their limitations.

The fourth section will carry out an assessment of the near future for Brazil, considering the impact of the crisis and Brazil's external vulnerability. We also assess the efforts on the part of the government to introduce countermeasures to reduce the future vulnerability of the Brazilian economy to external shocks, whether this were to be a second financial crisis or an eventual recession in China, which would have immediate impact on the main exports of Brazil's economy. Lastly, we provide our final considerations or conclusions with respect to the impact of the crisis on Brazil and what the near-term future portrays.

4.2 Brief Summary of the Global Economic Crisis in General

4.2.1 The Trajectory of the Crisis in 2008

The global crisis became evident for the entire world as of September 2008, with the US government takeover of Fannie Mae and Freddie Mac, the collapse of Lehman Brothers, the forced sale of Merrill Lynch to Bank of America, and the rescue of AIG. As credit markets worldwide were drying up, the US mortgage crisis was the catalyst that triggered the most serious world economic crisis in decades. Subsequently, the real economy was strongly impacted, causing major declines in investment and employment, and then leading to recessions in many countries across the globe. Although the worst of the first phase has clearly passed, not all is rosy when considering growth rates, especially in Europe, but in general, the fear of recessionary trends across the globe is still felt at the beginning of 2015. Nevertheless, the jury is still out on the prediction by Shaikh that this constitutes the beginning of the first depression of the twenty-first century.[1]

4.2.2 The Mortgage Crisis followed by a General Crisis of Credit[2]

As of the 1980s, the shift to neoliberal policies and the laissez-faire ideology came to dominate economic policies across the globe. During the last three decades, one of the main components of this neoliberal phase of capitalism has been financial liberalization. There have been a number of key changes and policies facilitating this in the United States, such as the elimination of the Glass-Steagall Act under Clinton in 1999 and manipulation and control of the interest rate, especially during Greenspan's tenure, among other changes in the structure and laws that govern the financial sector. US banks and financial institutions took advantage of financial deregulation, and began a paradigm shift, which began with Reagan back in the 1980s.

As a result of the problems of profitability during the crisis of accumulation during the 1970s, a clear shift from industry to finance took place which lead to an excessive dominance of the financial sector. Of note is the increase of the proportion of US investments in the financial sector, growing from an average of 15% between 1960 and 1975, followed by a marked rise to 27% in 1989 (Brenner, 2006), while profits of financial institutions as a percentage of total corporate profits grew from 21.1% in 1979 to 41.2% in 2002 (Kotz, 2009: 311). As a result of deregulation over recent decades, the US financial market underwent an unprecedented expansion, and as a result of new forms of financial architecture, there was an increasing tendency to pursue risky investments. A major result of deregulation was the new modus operandi of controlled asset bubbles and busts, which the US government facilitated in a major way. The bubble and bust that they lost control of was the housing and mortgage market, to which we now turn.

The US housing market underwent significant changes during the last quarter century, starting in the early 1980s. What had been a relatively straightforward relation between commercial banks and home buyers turned into a labyrinth of investment banks, hedge funds, pension funds, and in particular, the securitization of mortgages. Banks began to sell packages of mortgages to a range of banks and investment firms. The expansion of mortgage backed securities (MBS) involved high levels of risk as a result of a perverse logic between major financial firms and the agencies supposedly monitoring their risk. Established firms, such as Merrill Lynch, Lehman Brothers, Morgan Stanley, and others were receiving good grades for their MBS, in spite of what should have been the contrary, in order for

agencies such as Moody's to remain as clients of such major financial entities. This aspect was crucial in the construction of the house of cards that eventually came tumbling down and provided the catalyst for the current crisis. This became possible due to the low rates of interest and the unprecedented growth of US housing prices, escalating by over 100% between 2000 and 2006. Given the insatiable greed and unscrupulousness of financiers, eventually this led to the development of the subprime market, offering teaser rates to attract clients, and then charging much higher rates of interest to clients who were unlikely to be able to pay. One does not need a PhD in economics to realize that this was not a good idea, but alas, several aspects of the mortgage market seem to defy economic logic.

The category of subprime—colloquially known as "NINJA mortgages"—is associated with buyers who have no income, no job and no assets, namely those individuals without a credit history and thus at high risk for a mortgage. These corresponded to individuals or families who had remained outside of the housing market, given their high risk of being able to pay back a mortgage. Nevertheless, financial firms that engaged in risky ventures more and more chose to pursue such clients, because of the higher rates of interest that would kick in after a few years. Since mortgages were being packaged and sold in groups of up to a thousand, the actual risk of them not paying off a mortgage was less relevant to any individual financier, given the importance of receiving fees, and being less concerned about the likelihood of mortgages really being paid off.

Therefore, the securitization of mortgages facilitated the expansion of the high-risk subprime mortgages, and thus increasing the vulnerability of such investments. In general, this expansion was made possible because of the exponential growth of housing prices and thus, not surprisingly, the housing market entered into crisis as prices started to reverse and begin their precipitous decline. As a result, the securities market lacked buyers, and thus began the credit crisis, especially once major firms such as Merrill Lynch and Lehman Brothers could not even obtain short-term loans to improve their liquidity.

The first phase of the crisis occurred when there was a general sense that securities in general had seriously underestimated the risks involved in so many dubious investments. This became a clear signal for the credit markets, not just in the United States, but also across the globe, given the great extent to which finance had been globalized after three decades of neoliberalism. The second phase began when the holders of securities realized that they were not going to

receive the expected interest payments but would be having trouble finding buyers for their securities. As a result of a rush toward selling securities, the value of these titles plunged. In fact, the lack of confidence spread way beyond the subprime market and extended to the securities market in general, followed by capital markets, including major international banks. The third phase of the crisis was when such a vertiginous collapse in the securities and credit markets came to affect the real economy, and firms across the globe found it difficult to obtain credit.

The situation continued to worsen as the surviving financial institutions strongly restricted credit, and not only firms were unable to obtain the finance they needed, consumers were also faced with a worsening situation, and needed to cut back, especially with respect to durable goods purchases. Thus, the impact for both firms and consumers meant that the worldwide credit crisis impacted the real economy to such an extent that a world recession had begun, and was shortly thereafter described as the "Great Recession." At this point, it is necessary to go beyond the manifestations and unfolding of the crisis to consider its root causes. In order to achieve this, it is necessary to examine the concepts of fictitious capital and unproductive labor, which came to have increasing relevance, given the strong expansion of the financial sector in recent decades.

4.2.3 Finance Capital, Fictitious Capital and Unproductive Labor

It is necessary to distinguish two types of finance capital: one which provides credit directly to enterprises engaged in production, and a second type which is primarily speculative and corresponds to the concept of fictitious capital, to be elaborated below. It is worth noting that the use of the term "finance capital" is distinct from the term used by Hilferding in his classic work by the same name—*Finance Capital* (1910)—which he defined as the fusion or combination of banking and industrial capital, a dominant phenomenon at the turn of the twentieth century. Throughout the current neoliberal phase of capitalism, there has been an increasing autonomy of the financial sector with respect to the productive sector, and the current reference to "finance capital" is in clear contrast to the phenomenon analyzed by Hilferding.

The dominant aim of the capitalist system is the accumulation of capital through the drive for profits. In order to achieve this, capital must generate surplus value and then realize it, in order to valorize existing capital, as this is the basis of capital accumulation. Capital

that generates surplus value is not any type of investment, but specifically corresponds to production of new use values and exchange values. Therefore, activities such as trade and finance, though often essential for the overall functioning of the capitalist system, do not produce any new use-values or generate surplus value. Rather, they involve the transfer of ownership of previously existing commodities, not the generation of new ones.

The labor employed by capital that generates surplus value is referred to by Marx as productive labor. The concept of productive labor; was not first invented by Marx, but has a history going back to the Physiocrats and Adam Smith. Marx further developed the concept by identifying that which is clearly specific to the capitalist mode of production, and therefore, what is productive for capital. In this regard, in order for labor to be productive for capital, it needs to be (1) exchanged for capital, (2) produce new use values (production in the broad sense) and (3) generate surplus value. In the context of empirical research, there will always be many gray areas, or situations which are difficult to define as productive labor or unproductive labor a priori. But the difficulties in empirical analysis should not deter Marxists from using and analyzing this fundamental category, as many researchers, most notably by Shaikh and Tonak (1994),[3] have done.

Banks or firms that provide loans to capitalist firms engaged in production obtain interest as a portion of the surplus value generated by these firms, and though they are not generating any new value or surplus value, they are essential for the functioning of the modern capitalist economy. Therefore, the activity of lending money to productive firms is necessary for these productive firms to produce commodities and to create new surplus value, which is the basis for the sundry forms of surplus value in a capitalist society: be they profits, interest, ground rent, taxes, and so on. However, finance that does not have a direct connection with the production and circulation activities of new use values is not only unproductive, but is, in fact, parasitic, from the viewpoint of the capitalist system as a whole.

Such financial activity simply purchases existing assets, and thereby obtains the right to a regular payment, such as dividends, mortgage payments or other titles that have no direct connection to productive activities. It is this type of financial activity that Marx identifies as fictitious capital, since it is not capital in its true sense, which, by definition, generates surplus value, the fuel which runs the motor of capitalist accumulation. Therefore, though such activities

may generate voluminous profits for individual capitalists, they are not contributing, but rather are detracting, from the overall process of capitalist accumulation. One must distinguish between such activities in themselves and subsequent use made with their returns, which *could* be used for future investments in the real economy. In such an instance, such investments would no longer be functioning as fictitious capital. The dominant form of fictitious capital, is when the lender obtains a title based on an original loan, and then this is often sold to another, achieving a short-term gain, as is the case for many of the financial derivatives in vogue today.

In summing up, fictitious capital is not productive capital that produces new value and surplus value; instead it is merely a title which gives its owner the right to appropriate a part of surplus value already produced in society. The current phase of capitalism, which is characterized by the predominance of finance capital in relation to productive capital, has led to the excessive expansion of fictitious capital, resulting in a declining percentage of investment in the real economy, on the one hand, and the creation of speculative bubbles and busts on the other.[4] During much of the 1990s and 2000s, these bubbles and busts seemed to be controllable, given the support and "management" by the US government and the Fed; however, the bust of the housing bubble, one that evidently got out of control, has revealed the Achilles heel of this neoliberal phase, as the world economy came to experience its worst crisis since the 1970s, if not the 1930s. At this point, we turn to examine the impacts on Brazil as a result of this crisis.

4.3 Impact of the Crisis on Brazil

In this section, we seek to identify the most salient impacts on the Brazilian economy, as a result of the crisis that began in 2008. We will start by examining the more general overall macroeconomic aspects, considering GDP, the situation of exports and imports, and the credit market. From this, we will also examine the overall impact on finance and the banking sector, examining the particularities of the three main banks with strong ties to the government, namely the BNDES,[5] *Banco do Brasil*, and *Caixa Econômica*. In addition, the issues of foreign direct investment and debt will be addressed. Subsequently, we will turn to examine the sectorial implications of the crisis, considering industry, agriculture, mining, etc. In this regard, it is of interest to examine whether the twin tendencies of deindustrialization and reprimarization in Brazil during recent decades were relevant in terms

of the response and results of the crisis on Brazil. Lastly, we consider the impacts on workers and the poor of Brazil, as these tend to be the hardest hit in times of capitalist crises across the globe, and this crisis was by no means an exception.

4.3.1 Overall Macroeconomic Impacts

The crisis that began in 2008 tended to impact the credit markets most notably and thus impacted local investment and the labor market. Secondly, trade was affected, as many countries were concerned with ensuring things were in order at home, and thus tended to insure internal demand, leading to a restriction in the demand for other countries' exports. Therefore, the majority of countries impacted by the crisis implemented countercyclical policies, aiming to stimulate internal demand and ameliorate the most negative impacts of the crisis. The period of time for such fiscal stimuli clearly had to have a clear limit. This would depend not only on the severity of the impacts and the nature of the response or results of such policies, but also on fiscal equilibrium and political stability or infighting. Let us turn to an examination of the impact on GDP in Brazil (figure 4.1).

As can be observed in the above graph, the growth rate of GDP for Brazil since the turn of the century has been far from stellar, in contrast to what many an analyst or mainstream global newspaper would have you believe. During the period of Lula's government, from 2003 to 2010, this percentage was 4.0%,[6] and during the government of Dilma, from 2011 to 2014, it was slightly more than 2%, less than the decade of the 1980s, which is associated with a major national economic crisis.

On the one hand, there were only 2 years of negative growth—2003 and 2009—both –0.2%, but there were a total of 9 years where the growth rate remained below 3%. In fact, Brazil´s GDP growth was below both the world average and the average for Latin American economies[7] over this period. In 2009, it is evident that the crisis came to impact the Brazilian economy negatively, though it was only –0.2%. Nevertheless, with the exception of the rebound in 2010 that reached 7.5% growth, the subsequent years have been troubling, especially in 2012, when the growth of the Brazilian economy was an anemic 0.9%. This is an important problem, given the fact that Brazil grew less than the world average and less than the average of all "developing" countries, especially after 2008. In relative terms, Brazil remains further and further back. This can be explained, in part, by the low levels of investment, whose average is also below the world average.

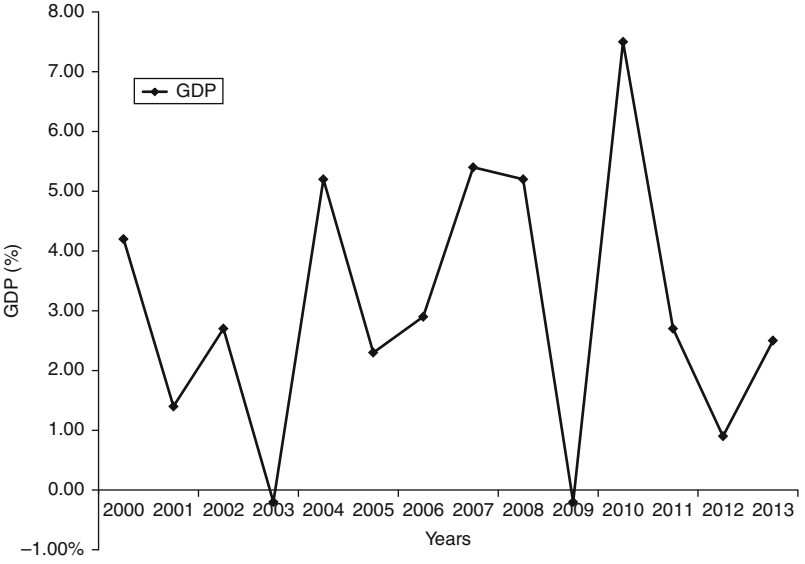

Figure 4.1 Growth rate of Brazil's GDP, 2000–2013.
Source: Brazil's Central Bank, 2014.

A major impact for most countries was the decline in trade, given depressed world markets, as did Brazil, especially the reduced demand for primary goods, as reflected in the decline in the world prices of commodities. This has become much more important for Brazil, given the reprimarization tendency within the Brazilian economy since roughly 2000.[8]

4.3.2 Aggregate Demand

In table 4.1, one can observe the growth of the main components of aggregate demand, for the following selected periods: (1) 2007.I–2008.II; (2) 2008.IV–2009.IV; (3) 2009.IV–2012.I. In this regard, we observe that private consumption grew at 6.8% for the first period, and then dropped down to 3.2% with the arrival of the crisis, and rebounded to 5.4% for subsequent years. Government consumption was growing at 4.5% for the first period, dropped down to 1.9% for the second period, and then was 3.4% for the third period. Investment was most negatively affected; it was growing at a healthy 13.6% prior to the crisis, and then went to a –12% at the height of the crisis, before

Table 4.1 Growth rates of the components of GDP, Brazil (%)[a]

	2007.I–2008.I/II	*2008.III/IV –2009.III/IV*	*2009.III/IV –2012.I*
Private Consumption	6.3	3.2	5.4
Government Consumption	4.5	1.9	3.4
Investment	13.6	–12	11.1
Exports	4.7	–8.5	5.1

[a] The data employed here was obtained from the Master's thesis of Cardoso Ferraz (2013) and the roman numerals are referring to the four economic quarters.

Source: IBGE/SCN.

rebounding to 11.1% for the third period considered. Lastly, exports were growing at 4.7% prior to the crisis, then dropped to a –8.5% during the crisis, and returned to 5.1% in the subsequent years. Later in this chapter, we examine the trade situation in greater detail.

4.3.3 Counter-Cyclical Measures

The main set of countercyclical measures employed by the Lula government in order to confront the crisis or minimize its negative impacts were (1) a stimulus aimed to increase bank credit; (2) a restructuring in the banking sector to guard against a serious increase of insolvencies and to prevent weaker or smaller banks from going bankrupt; (3) stimulating demand through tax breaks, in terms of both income tax reduction and incentives for purchases; and (4) providing support to employees through the expansion of unemployment insurance. In reference to the third item, given the decline in exports, the government made efforts to increase internal consumption through a number of tax breaks, the most significant effort being tax incentives for automobile purchases.

In spite of the increase in government spending of 3.7%, the overall GDP declined by 0.2%, in 2009. Other notable declines were a drop in industrial production by 5.5%; a reduction in the agricultural and livestock sector by 5.2%; a decline in gross capital formation by almost 10%; and a decline in exports by 10.3%. Other notable negative impacts during 2009 were seen in manufacturing, which declined by 7% in 2009 and construction, which declined by 6.3%. A more detailed sectoral analysis will be carried out later in this chapter.

There were a number of measures carried out by the Lula government in order to address problems of liquidity and the credit market. Concerns with global credit markets began at the height of the crisis in September 2008 and continued throughout 2009. The Brazilian government auctioned government bonds—some earmarked for letters of export in order to finance exports, or for lines of credit for exporters—and also through the use of international reserves from the Central Bank.

4.3.4 Role of BNDES

There was a very clear increase in the participation of the state banks, such as BNDES, Banco do Brasil, and the Caixa Econômica Federal; in fact, between 2008 and 2009, their participation grew from 36.3% to 41.5% out of the total of loans made by the financial system in Brazil. This was in spite of efforts on the part of the government to encourage a greater role for the private sector in providing new loans. The BNDES, which had increased its total credit by 35.3% in 2009, and which corresponded to 61.6% of the total credit earmarked or promoted, within that year represented 9% of GDP. During 2009, credit made available by the BNDES increased by 50%. In spite of the privatizations that took place in the Cardoso years and changes carried out by neoliberal policies, the permanence of these state financial institutions came to constitute an important tool for state intervention in the credit market during the crisis.

In terms of providing credit when many markets were dry or extremely cautious, the BNDES was crucial for certain sectors of the Brazilian economy. It should be mentioned that, as in previous years, the BNDES played a key role with respect to the Program for the Acceleration of Growth or PAC.[9] The latter has provided substantial support for infrastructural programs, mainly oriented toward the extraction and export of primary goods. For example, the construction of hydroelectric dams was strongly tied to the high demands of electricity by the mining sector, among other uses.

In spite of a notable participation by the state sector, and in particular by the public banks, there are those who question the efficacy of the government's measures. According to Araújo and Gentil (2011), the fiscal and monetary anti-cyclical measures (e.g., fiscal tax breaks for consumption) adopted by the government to confront the crisis were timid and late, when compared with other countries. They consider the speed and intensity of the response by the Lula government to be less than in other Latin American countries. Another critical

view, Reinaldo Gonçalves', argues that the Lula government presented itself as one pursuing national development, when it had significant continuity with the neoliberal policies of Cardoso. There were clearly breaks from the orthodoxy of the Cardoso governments, such as the *Bolsa Família*, and the increased role of the State, especially with respect to infrastructure. Nevertheless, Gonçalves is correct in pointing out the measures of fiscal exemption and support provided for TNCs' operating in Brazil, even in the middle of the economic crisis (see Gonçalves, 2012, 2014).

4.3.5 Foreign Sector: Trade

We now turn to an examination of the impact on foreign trade for Brazil, considering the exports, imports and net exports for the period of 2000–2013 (see figure 4.2). There is a solid growth of exports from

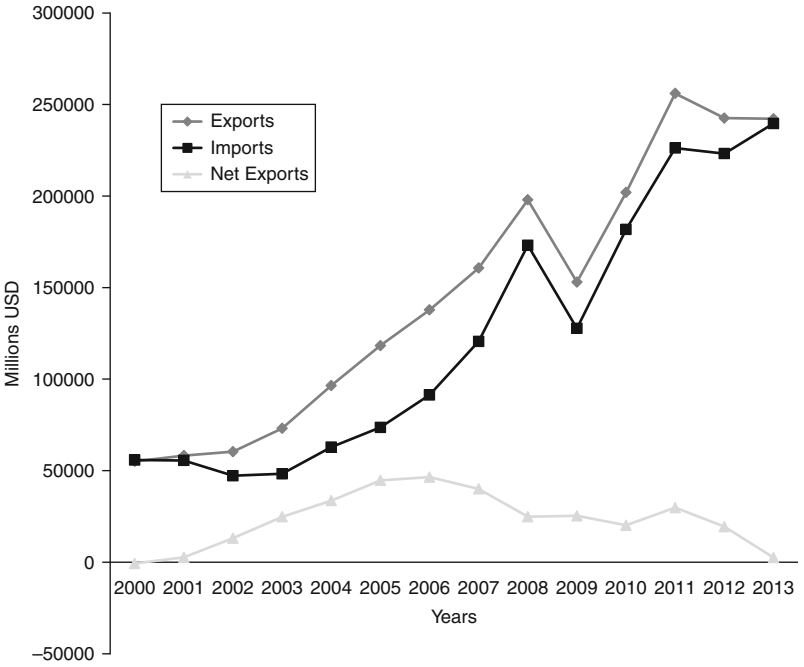

Figure 4.2 Brazil's exports, imports, and net exports, 2000–2013.
Source: Ipeadata, Banco Central do Brasil, 2014.

2000 to 2008, increasing by almost 300% (US$ 143 billion) and then followed by a clear drop of US$ 45 billion in 2009. After that, there appears to be a return to normal, with growth of over US$ 100 billion, or 66%, by 2011. However, from 2011 on, exports dropped off and seem to stagnate. In the case of imports, we can observe the following: a slight decline in the early 2000s but followed by a strong growth trajectory. The net result is that imports increased from US$ 56 billion to US$ 173 for the period 2000–2008. There was then a drop of US$ 46 billion in 2009, before a recovery reaching roughly US$ 240 billion by 2013. The graph of net exports shows a movement from just negative in 2000 to a high of US$ 46 billion in 2006, followed by a downward trend that became negative again, and the latest data show a value of –US$ 4 billion for 2014. Nevertheless, there was no marked change for 2009, right after the crisis.

4.3.6 Finance Sector

Let us take a look at shifts in investment for Brazil, considering overall investment as a percentage of GDP. As can be seen in figure 4.3 below, there was a noticeable drop off, of approximately 3% between 2008 and 2009, but as of 2010, it rebounded to 20%, continued a slight but clear upward trend, and has stayed above 20% since 2010. In addition to the issue of investment, it is relevant to examine the behavior of the interest rate as well as that of the exchange rate for the three periods: one leading up to the crisis, one during the crisis, and one afterwards, through to the present.

In figure 4.4, a marked increase in the rate of exchange can be seen from 1994 on, until it peaks in 2002, at 3.5 R$ per dollar. This is followed by a decline to below 2 R$/US$ until 2006, followed again by an increase to over 2, and then declining back to below 2 by 2009. Since that time, there has been a steady, though slow, increase, passing two R$ per dollar in 2012 and continuing upward. Thus, there was no marked shift as a result of the crisis. Even though the US dollar could have tumbled seriously in September 2008, the emergency meeting of the G7 insured the backing of the United States and its currency, in order to prevent such an occurrence.

Let us now turn to another key monetary indicator for Brazil, namely the rate of interest. In figure 4.5, one readily observes the strong downward tendency for this rate of interest since 1996, in spite of the fact that this has been the highest rate of interest on the globe in general since that time. The policy of maintaining a high rate of interest is designed to continue to attract financial flows, and this is one

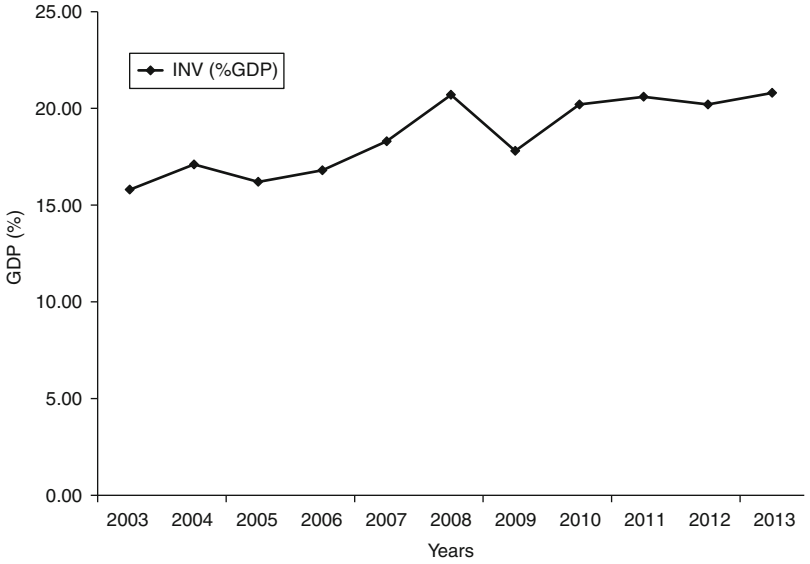

Figure 4.3 Investment as percentage of GDP, Brazil, 2000–2013.
Source: Ipeadata, 2014.

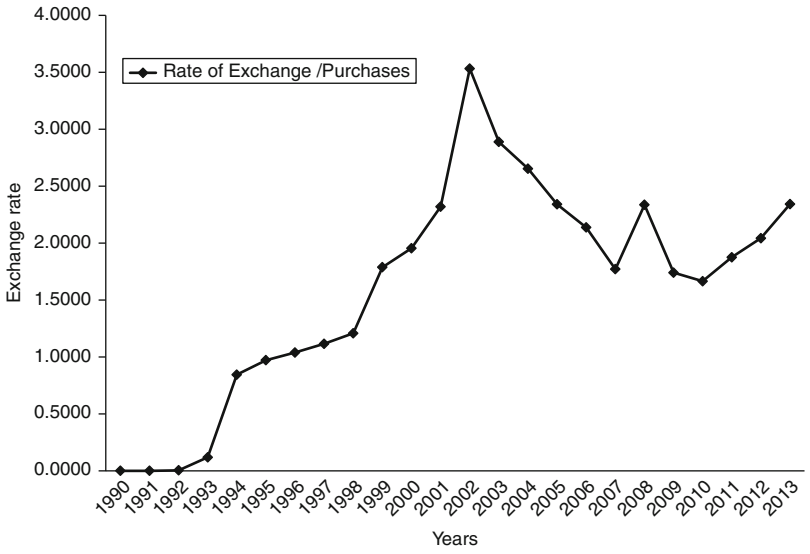

Figure 4.4 Exchange rate R$/US $ (1990–2013).
Source: Ipeadata, 2014.

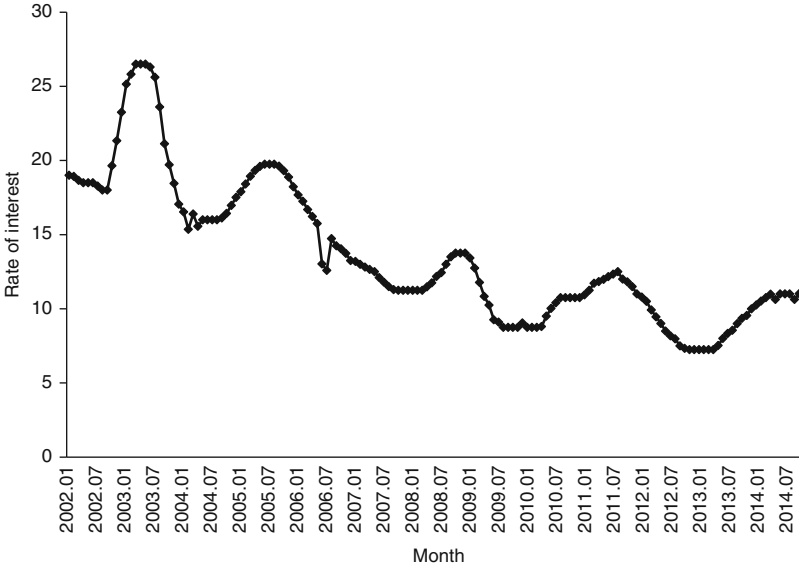

Figure 4.5 Brazil's rate of interest (SELIC) 1996–2014.
Source: Brazil's Central Bank, 2014.

of the clear neoliberal policies from the Cardoso government that has still been maintained. In order to try to improve the credit market, a significant policy change was the reduction of the principal interest rate in Brazil, known as the SELIC.[10] This rate was lowered through 2009, from 13.43% down to 8.75%, and did not increase again until the second quarter of 2010. This shift downward reflects the general global trend after the outbreak of the crisis in 2008, and in particular, the case of the United States, where the interest rate achieved historically low levels.

In general, Brazil has been attempting to reduce its very high rate of interest, given some of the criticism by those defending industry, as well as by consumers. Given such high rates of interest for capital locally, and the subsequent strong *real*, the situation has been quite difficult for manufacturing. Between the problems of the higher cost of borrowing and the exchange rate, which make exports more difficult, it is not a surprise that the process of deindustrialization has continued.

4.3.7 Stock Market

At the beginning of the crisis, the local stock market, the *Bovespa*, registered a drop of 60% between May and October of 2008; there had not been such a decline since 1994. For the year as a whole, stocks showed a decline of 41.7%. For the subsequent year, 2009, there was an encouraging recovery, with an overall increase in stock values of 82.7%.

As for most countries, the finance sector was of great concern, given the shock to global credit markets in 2008 and 2009, and the surge in instability and lack of confidence, even among the global giants of world finance. Fortunately, for many developing countries, the worst was the last quarter of 2008 and the first half of 2009, with a return to relative normalcy by 2010. In Brazil, there has been a policy of increasing reserves in recent years, anticipating a potential crisis, and recognizing the risks of promoting a liberal financial environment by pursuing financial speculators via their interest rate policy. In general, one could argue that they weathered this particular storm in reasonable fashion, with respect to most financial indicators. Nevertheless, their particularly high current account—third in the world in absolute terms—combined with a shift from a positive to a negative trade balance, which may continue to worsen, and rather weak growth are clear reasons for concern regarding Brazil's external vulnerability in the near future. There were also certain concerns that existed prior to the crisis, which have continued or were exacerbated. Consider, for example, the problems of industry, and the processes of deindustrialization and reprimarization, to which we now turn.

Sectoral Impacts[11]

In considering the main sectors of industry—namely, minerals, manufacturing, construction and utilities (electricity, gas, and sanitation)—the impact of the crisis varied. The most strongly affected was manufacturing, and this is related to declines in investment and exports. As can be seen in table 4.2, the results are for three periods: (1) 2007.I–2008.III, (2) 2008.III–2009.II, and (3) 2009.III–2010.II.

Mining grew at 4.3% for the first period, and then declined by 4.5% during the height of the crisis, but rebounded strongly by the second half of 2009, reaching 11.3% growth. In the case of manufacturing, prior to the crisis, the quarterly rate of growth was 5.8%, but this plummeted to –11.2% during the crisis, though it recovered to

Table 4.2 Industry and its sub sectors: Average quarterly rate of change, Brazil (%)

	2007.I–2008.III	*2008.III–2009.I/II*	*2009.III–2010.I/II*
Mining	4.3	–4.5	11.3
Manufacturing	5.8	–11.2	10.7
Construction	6.7	–1.9	12.5
Electricity, gas, water and sanitation	5.1	1.0	7.8

Source: IBGE/SCN.

10.7% for the third period considered. Construction had been growing at 6.7%, and was not as badly impacted, though it dropped to a negative –1.9% and returned to 12.5% for the third period, even better than prior to the crisis. There is concern, however, that Brazil may have its own housing bubble to confront in coming years, given the incredible increase in prices and rents for certain cities. Lastly, the utility sector was growing at 5.1%, and declined to 1%, but recovered to a strong 7.8% for the third period.

As Cardoso Ferraz argues, industry as a whole, not just manufacturing, had a growth of 9.5% from the third quarter of 2009 through the fourth quarter of 2010, which is clearly a strong rebound. Construction utilities, which include electricity, gas, water, and sanitation, were sectors less negatively impacted by the crisis. In the case of industry, there was the impact of the decline of investment, combined with a weaker world market—not just the G7, but also China—as a result of the drop in demand of the G7. Nevertheless, Brazil, in general, overcame this by the middle or end of 2009. There were other problems prior to the crisis which remain relevant, especially given Brazil's generally weak growth in recent years and the continued shift away from industry toward the primary and extractive sectors, namely the process of reprimarization.

We now turn to look at the breakdown of GNP in percentage terms of value-added for the three sectors: agriculture, industry, and services (see figure 4.6). It is clear that services dominate, as in most countries at present, and approached 70% in 2013; in fact, services did not experience an overall negative impact, only subsectors thereof. Agriculture experienced a slight decline, but only for certain quarters, from the end of 2008 until the second quarter of 2009, while industry

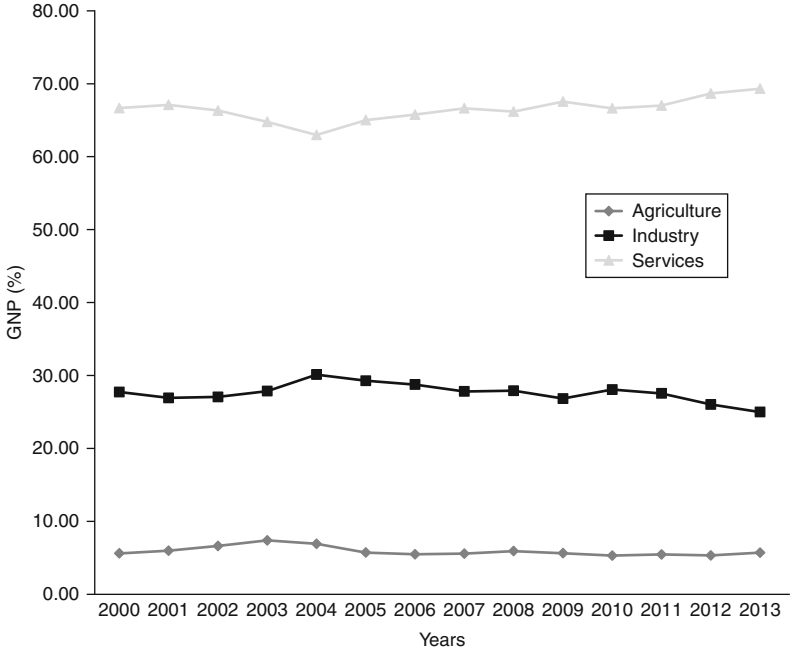

Figure 4.6 Brazilian GNP value added breakdown, 2000–2013.
Source: IBGE/SCN.

had a greater decline, going from 27.9% in 2008 to 26.83% in 2009, though it rebounded to 28.07% in 2010. The discussion of industry will be clearer once we present the disaggregated data below.

In figure 4.7, the sector for industry is broken down into four subsectors: construction, mining, manufacturing, and utilities. Construction was rather steady, oscillating around 5% between 2000 and 2013, with a slight increase after the crisis, going from 4.9% in 2008 to 5.25% in 2009, and up to 5.65% in 2010. In the case of mining, there was a general increase for this period, from 1.59% in 2000 up to 4.27% in 2012, though there was a decline from 3.24% in 2008 down to 1.83% in 2009, but recovering to 2.97% in 2010. In contrast, utilities showed a general decline for this period, going from 3.4% in 2000, down to 2.34% in 2013, and with minimal change between 2008 and 2010. Last, but not least, is the case of manufacturing, which exhibited a notable decline for this period. Manufacturing initially increased from 17.22% in 2000 up to 19.22% in 2004, followed

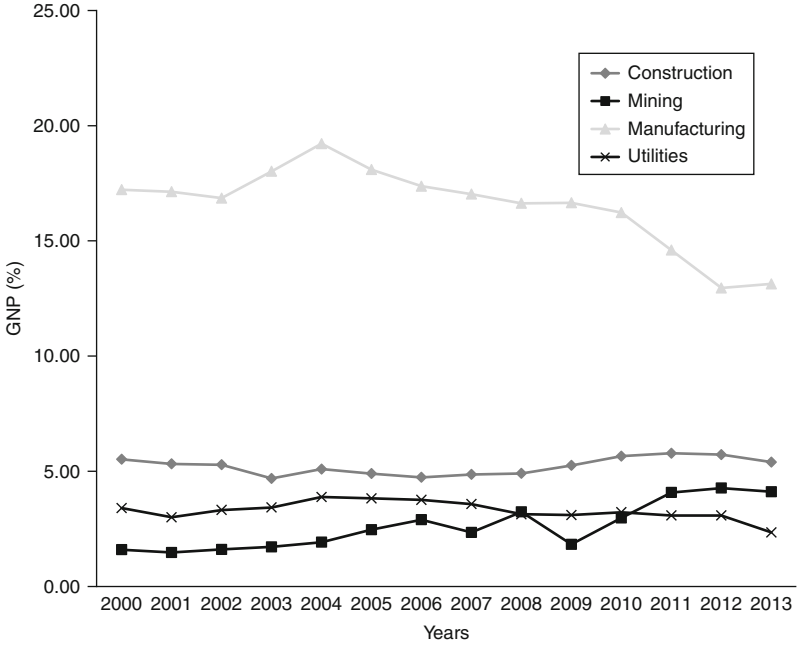

Figure 4.7 Brazilian industrial GNP value added breakdown, 2000–2013.
Source: IBGE/SCN.

by a significant decline to 12.95% in 2012, and with minimal change between 2008 and 2010.

This notable decline in the period considered reflects a long-term trend that has been taking place with respect to manufacturing in Brazil since 1986, namely the tendency of deindustrialization. Thus, this shift is not a direct result of the crisis, though the latter may have contributed to the reinforcement of this tendency. In figure 4.8, value added by manufacturing, as a percentage of GDP, is presented for the period 1947–2012. The highest level attained was 35% in 1986, followed by a downward tendency, then bottoming out at just above 15% in 1998. This was followed by a slight recovery to just below 20% in 2005, but then it has fallen in recent years, dropping to 13.25% in 2012. Although there is a solid decline of manufacturing, as seen in figure 4.8 and also in the value added percentage in figure 4.9 for the period 2008–2010, we would argue that this is just a continuation of a trend that has been present over a couple decades, and not a specific result of the global crisis.[12] In brief, this pattern is

Figure 4.8 Value added by Brazilian manufacturing industry (%GDP), 1947–2012.

Note: The term manufacturing industry is the closest equivalent to the category used in Brazil called *Indústria de Transformação*.

Source: IPEA, 2013.

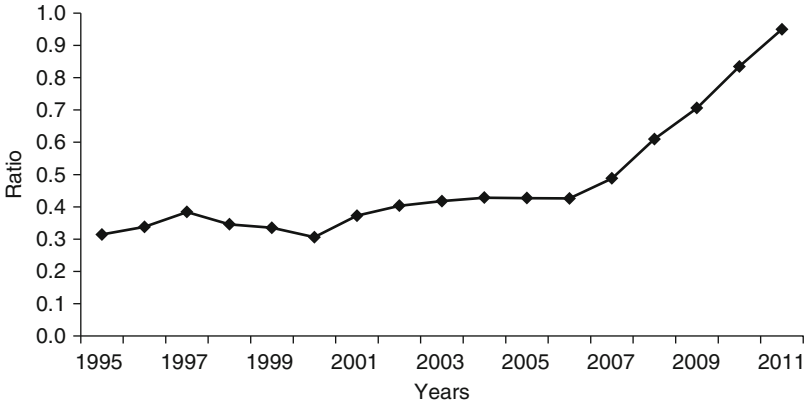

Figure 4.9 Ratio of primary/industrial exports in Brazil, 1995–2011).

Source: Based on data from MDIC, 2012.

a reflection of the neoliberal turn of the 1990s with Collor de Mello and Cardoso.

The shift away from manufacturing and toward agriculture, livestock farming, and other primary or extractive sectors, is referred to as "reprimarization," and as can be seen in figure 4.9, there has been a steady increase in the primary exports of Brazil in contrast to manufacturing or industrial exports, with no shift occurring during the period 2008–2010. The latter indicates that the crisis did not produce this trend, and that it has been taking place independently and over a number of years. In fact, given the shift upwards since 2006, this reflects an increasing dependence on exports to China, more than to any other country. China did not come close to any recessionary behavior; it only experienced an 8% or 9% decline in growth to 7.5% as a result of the crisis. This implies that for Brazil and other Latin American countries, the impact on the demand for their exports was minimal, given their current diversification of export markets. Of course, this will be more of a concern in the future, if China does have a recession. This will be elaborated upon further in the next section.

4.3.8 Impact on Workers

As can be seen in figure 4.10, the declining trend in unemployment from 2005 through 2012 is interrupted with a shift back upward after

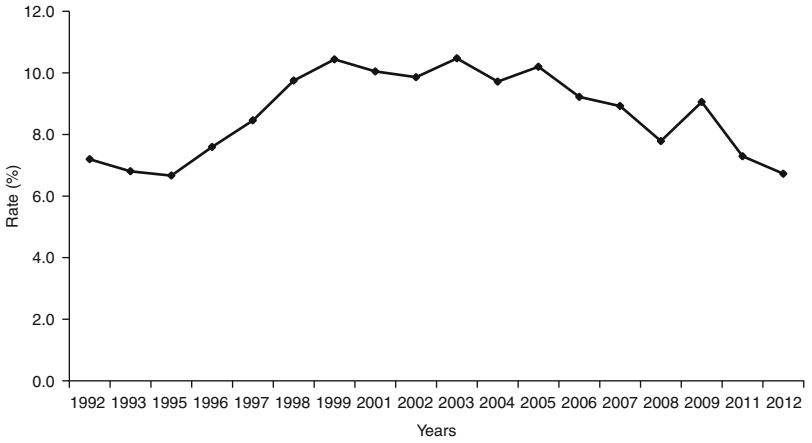

Figure 4.10 Rate of unemployment in Brazil, 1992–2012.
Source: IBGE, 2013.

2008, going from 7.8% up to 9.1%. For some reason, IBGE, the main statistics institute of Brazil does not have the data for 2010, but as of 2011, the downward trend continued. Although the shift downward of unemployment suggests an encouraging sign for the economy and workers seeking employment, one must be cautious, given the fact that people who give up hope are considered no longer a part of the labor market or an economically active population, as absurd as that is. This implies that they are no longer included in the unemployment measure, and thus the unemployment rate underestimates the real level of unemployment. In addition, if a person answers that they worked once in the last month, even for an hour, they are considered employed. Therefore, in much of the world, the official statistics on unemployment and underemployment have moved downward, in part due to methodological adjustments, and thus seriously underestimate the problem of unemployment for capitalist economies, and particularly during periods of capitalist crises.

In figure 4.11, one can observe that the rate of informal employment in Brazil oscillated between 56% and 58% during the years 1992–1999. However, after that, it began to decline, arriving at 48% in 2009. On the one hand, there has been a significant decline of approximately 10% of the EAP (economically active population), but on the other hand, almost 50% of the EAP still has informal employment, which means they are not included in programs for social security, unemployment insurance, and retirement; benefits to which they should be entitled as workers in Brazil. In spite of the official decline in informal employment, there are major states with rates as high as 70%, such as Pará. Moreover, the process of worsening

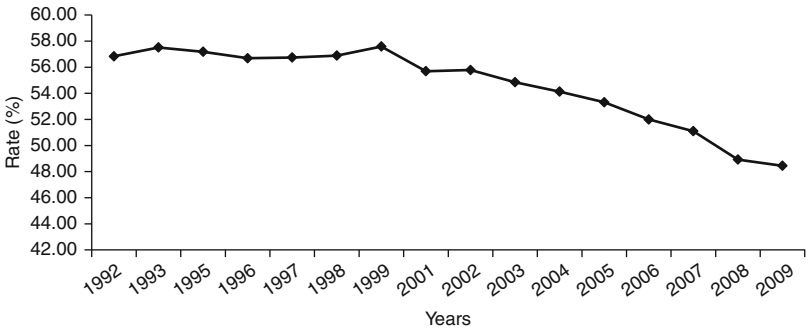

Figure 4.11 Rate of informal employment in Brazil, 1992–2009.
Source: IBGE, 2013.

and precarious conditions for workers has advanced in Brazil, where workers who have been unemployed for some time, are forced to be contracted under worse conditions and with lower wages. On average, the new jobs created offer worse conditions and lower pay than those previously available.

4.4 Assessment of the Near Future for Brazil

4.4.1 Current Trajectories of Reprimarization and Deindustrialization

The economic crisis reinforced and deepened certain tendencies already present in the Brazilian economy. This was the case with both deindustrialization and reprimarization.[13] Numerous authors have pointed to the concerns for Brazilian industry, although it has become more recognized in recent years, including within circles of the PT. Gonçalves (2012) carried out a critical evaluation of the recent shifts in the Brazilian economy. He argues that, in spite of many who consider the recent PT governments to be developmentalist, or promoting new developmentalism, they are actually the opposite, or, at the very least, they maintain a significant continuity with the neoliberal policies of the previous government of Cardoso.

Gonçalves argues that by using the index of 100% for 2002, manufacturing industry reached 119.3% in 2007, dropped to 112.7% in 2009, and recovered the following year to reach 123.6%. It turns out that these values are clearly less when compared to agriculture and livestock production[14] (119.3% in 2007, 120.8% in 2009 and 128.6% in 2010), and especially compared to mining (129.1%, 132.3%, and 153%, respectively). These sectors were important in order to avoid a notable drop in GDP, and at the same time, were becoming much more significant in terms of the positive trade balance for Brazil.

The last two decades have witnessed the movement of the loss of space for the Brazilian industrial exports, a phenomenon that intensified with the outbreak of the crisis in 2008. Thus, the total value of the basic goods exported has come to approach that of the manufacturing products (see figure 4.10). In 2002, these corresponded to 56.8% of Brazilian exports, more than double that of basic goods. In 2007, these percentages were 54.2% (manufacturing) and 30.1% (basic goods); 49.4% and 34.7% in 2009; and 45.6% and 38.5% in 2010, respectively. Based upon these conditions, and correlated with other elements that we have presented, we conclude that the dependency of the Brazilian economy has increased as a result of the crisis, even

though the present tendency has been evident for a couple decades. In summary, the current insertion of Brazil in the world economy is a reflection of the recent trajectories of reprimarization and deindustrialization, accompanied by the increasing importance of finance and, subsequently, speculation.

A major factor contributing to this trajectory, in which Brazil is far from alone, is the outstanding growth and expansion of China since the turn of the century. This has led to a major increase in the prices of commodities, and thus, the increased possibilities of exporting soy, beef, minerals, etc. As a result, the tendency toward deindustrialization has become coupled with the tendency of reprimarization, and thus constitutes a structural shift in the Brazilian economy. The shifts since the early 1990s, and then the implementation of the neoliberal *Plano Real* under the government of Cardoso, and the push to attract finance capital, laid the groundwork for these tendencies.

4.4.2 Potential Scenarios

The greater concern is for the next stage of the crisis: in other words, a more serious recession, if not worse, once the deep-rooted problems of an excessively finance-based global economy come to the fore in another moment of global crisis. Between the problems of hidden toxic assets, excessive debt, and eventual recessionary trends, the point will be reached when even China enters a recession. There has already been serious decline in recent years with respect to the prices of a number of *commodities*; just consider soy, which had been above or around US$ 500 in late 2013 but declined to below US$ 400 per ton during 2014, and continues downward, dropping below US$ 350 as of August 2015. There have also been concerns given the declines in certain mineral prices, such as iron. These are all just harbingers of what should be expected in the short to medium run. In the history of capitalism, there has never been the case for primary products dominating manufacturing goods for extensive periods of time with respect to terms of trade.

At present, the world economy still seems a bit off kilter, especially among the G-7 economies, and even the IMF has produced its most dismal forecast in a long time. This increases uncertainty, reduces confidence, and causes fears to grow that another crisis, maybe worse than the first, may hit in the near future. No economist—neither a neoliberal, nor a Marxist—has an infallible crystal ball, and echoing the argument of Harvey, many a crisis has been deferred or shifted spatially or temporally. Nevertheless, another crisis, given the

problems of the global economy, and in particular, finance, is a reasonable bet.

In contrast, one can refer to the still amazing growth rates of over 7% that China continues to achieve; however, when they had been growing at 10% or more for several years, there was more euphoria and confidence. We all know that, in part China, is growing less rapidly because they are dependent on exports to the G7, so Europe's economic doldrums and the United States' lukewarm recovery imply China's trade situation is not as propitious as it was prior to the crisis of 2008. In early 2015, their central bank had to inject money into their financial markets, given the movement of capital out of China and that combined with their stock market declines and currency devaluations in the third quarter of 2015, suggest that not all is rosy for the Asian giant. Then there is the issue of what the root cause of the crisis of 2008 really was and if that issue has been resolved. In our opinion, the issue is not resolved, and the semi-stagnant world economy is in a holding pattern, without an economic global leadership committed to change— away from speculative finance—and redirecting the course of the global economy for the near future. The dominance of financiers within the economic hierarchy and in high positions of governments continues to be a problem. They are not about to elect to eliminate themselves from the halls of power unless there is a serious political/economic crisis that forces them out of power.

It is our view that only another acute crisis will actually bring abut change, even if it means improving the conditions of accumulation, but reducing the bloated financial sector of the global economy. There is a need to recognize the limits of finance in terms of capitalist growth, in spite of the fact that the dominant classes will not be thinking about the need to generate surplus value, but simply about sustainable growth. In any event, there is a very real possibility China will eventually experience a capitalist recession, and when it does, there is no doubt that commodity prices, not to mention a number of other markets, will take a serious hit; the question will be for how long and how serious the impact will be on Latin America countries, and in particular, Brazil.

4.5 Conclusions

As a result of the global crisis that began in 2008, Brazil took a hit and experienced a decline in exports and problems with investment, credit, and employment, but fortunately, this did not last that long, because the negative growth rate for 2009 was followed with a

rebound in 2010. Nevertheless, there are other processes, as we discussed, that are relevant to recognizing why Brazil is not able to grow robustly, nor truly pursue a developmental project to benefit the great majority of Brazilians in a significant manner.

Nevertheless, in spite of the half-year of recession, and thus a –0.2 rate of growth in 2009, Brazil was able to bounce back in a serious way with a GDP growth rate of 7.5% in 2010. So, the short run assessment is that Brazil was sufficiently prepared to limit the impact of the crisis. In a certain sense, it is logical that Brazil would be less negatively impacted by a crisis that still left its second largest trading partner, China, rebounding to 8% growth. Countries such as Brazil, given their insertion in the world economy, were not nearly as impacted as Europe has been.

However, there is concern over a serious slowdown and an expected decline of 1.5% of GNP for 2015. In fact, Brazil has had growth rates below the average, not just for Latin American countries, but for "developing" countries, and in spite of a peak here or there, it has displayed anemic growth at times; consider the 0.9% growth in 2012, and the decline in certain key commodity prices, such as soy and iron. Confidence with respect to the future of Brazil´s economy has declined notably and has become exacerbated by the political crisis of the PT and the threat of impeachment of Dilma Rousseff in just the first year of her second term. Beyond the current political crisis, the economic problems are in part tied to the increasing role of the sector linked to reprimarization, namely agriculture, livestock farming, mining, and the energy sector. As is historically the case, the primary goods sector has much greater volatility as a whole compared to manufacturing, given the dependence on climate, but also given the imperialist interests over the centuries to dominate manufacturing, or at the very least manufacturing technology and profits. In this regard, it is our view that the current trajectory being pursued by Brazil is not in the best interest of the Brazilian population, but it is in the interest of the elite of Brazil, with their strong ties to agroindustry, other extractive industries, energy and finance; especially since it is this elite that constitutes the emerging, but real, transnational capitalist class, even if they only constitute its second tier.

Notes

1. See interview on November 12, 2009 with Anwar Shaikh in *Página 12*.
2. Much of the current section is derived from the excellent piece on the US mortgage crisis presented by Moseley (2008) at the SEPLA conference in Buenos Aires in October 2008.

3. Also see recent work done by Mohun (2005, 2014) and Paitardis and Tsoulfidis (2012).
4. See Aquino and Cipolla (2008), for an excellent analysis regarding the role of fictitious capital in the current crisis.
5. BNDES stands for *Banco Nacional de Desenvolvimento Econômico e Social*, which in English can be translated as the National Bank for Economic and Social Development.
6. After the government changed the methodology for calculating the GDP, these percentages were shifted upwards.
7. Marquez and Nakatani (2012).
8. The current trajectory of the Brazilian economy encompassing the tendency toward reprimarization combined with deindustrialization will be further discussed below in the discussion on sectoral impacts.
9. The title is the following in Portuguese: *Programa de Aceleração do Crescimento* (PAC).
10. The key interest rate for Brazil is referred to as the SELIC (Sistema Especial de Liquidação e de Custódia), which roughly translates into the Special System of Liquidation and Maintenance.
11. The data and analysis of this section are based in part on the thesis of Cardoso Ferraz (2013).
12. For more on this discussion of deindustrialization and reprimarization in Brazil, see Trindade et al. (2015)
13. There have been several authors that have worked on the issue of deindustrialization, see Bresser-Pereira (2007, 2008), Oreiro and Feijó (2010). The discussion on reprimarization has increased more in recent years (see Trindade and Oliveira, 2014, and also the text mentioned above, Trindade, Cooney and Oliveira, 2016).
14. The term *agropecuária* in Portuguese refers to both agriculture and livestock farming.

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5

Boom and Bust in Colombia 1990–2013

Guillermo Maya Muñoz and Daniel Restrepo Soto

5.1 Introduction

Following the "lost decade," the 1990s in Latin America (LA) begin with the political will of its elites to impose a neoliberal model based on the reforms of the Washington Consensus. These measures enhanced free markets for goods, services, and capital and aimed to reduce the size of the government and its influence by privatizing public assets of state-owned enterprises and balancing their macroeconomic accounts. At the same time, the institutionalization of independent central banks and other modalities, such as currency boards, to keep inflation under control, like in Argentina, was adopted all over the region.

Colombia was not immune to this process: "Colombian elites were anxious, without avoiding to become globalists by reflex."[1]After all, in the last 50 years, the rich countries have pushed developed countries to integrate into the global economy,[2] and they did not wait for their response to external and internal advice on changing development strategy and of economic growth.

The government of Virgilio Barco (1986–1990), with the program "Modernization of the Colombian Economy" (1990), launched the openness policy of the Colombian economy, which is not merely a commercial opening to the outside, but a whole program of economic liberalization. The program included reduction of the role of the state in the economy, strengthening market forces and subordinate to the

price mechanism to allocate resources, privatization of productive activities, implementation of laws and regulations to stimulate foreign investment, flexible labor relations, and so forth.

The main objectives of this program were overcoming structural barriers to economic growth, improving employment and income conditions, and upgrading the welfare of the population. Agosin and Davies (1996) describe the Colombian economic reform process as dramatic because of its speed and depth.[3]

President Cesar Gaviria (1990–1994) deepened trade and financial liberalization. Tariffs were reduced to 9%–11%; the Colombian Constitution Act was reformed, granting independence to the central bank (Banco de la República); roads, ports and state assets were privatized; and Act 100 was enacted, pensions and health care were privatized, while the public pension system (ISS) was eroded, and the private pension system (AFP) and private health system (EPS) emerged. Gaviria's motto was "Welcome to the Future," but instead it was a return to the past, before even the small scale welfare state was enactedd.

Under the government of Ernesto Samper (1994–1998), despite its critical anti-globalization rhetoric, the neoliberal reforms applied by its predecessor continued without major disturbances. However, between 1998 and 2002, the conservative government of Andrés Pastrana had to deal with an economic crisis, engendered in previous years, by low inflation, high unemployment, and low growth (negative in 1999).

The two consecutive periods of Alvaro Uribe (2002–2010) followed the same direction. His administration built on economic liberalization and development of the mining and crude oil (petroleum) sectors, intending to boost investors' confidence, social cohesion, and democratic security. Juan Luis Londoño, the labor minister, reformed the labor law, openly favoring employers: working daylight time was lengthened from 6:00 a.m. to 10:00 p.m., and overtime payments for nighttime work, extra-time work, and work in holidays were reduced, too.

Uribe's policy favored big businesses, with tax breaks for investments in fixed capital and tax stability contracts; FTAs were signed to easily access markets in America, Asia, and Europe with the "smell of guava" (natural resources), since the manufacturing sector was in disarray, and road infrastructure was grim. Industrial investors survived as assemblers of imported parts acquired at cheap prices. Finally, during Juan Manuel Santos' administration (2010–today), the

government deepened the model with reforms in the pension system and health care, while the mining locomotive runs over communities and the environment.

"The three major components of the liberalization reform between 1990 and 1993 included trade liberalization, elimination of almost all of the FDI regulations, and the reform of the exchange rate."[4] After adopting an exchange rate band system in 1994, a flexible exchange rate regime, with some interventions, was put into place by 1999.

Finally, restrictions were eliminated on foreign direct investment (FDI) and on the limits of profits remittances, as were some sectorial restrictions, except for national defense (Maya, 2003).

This chapter is about the Colombian economy in the last 24 years, which underlay the two recessions that have affected the country. The chapter is structured in eight sections: first, an introduction, which sketches the policies that were to reign during this period. In the second section, the behavior of GDP, employment, wages, and prices is analyzed. The third section is about the revival and boom of Colombian mining activities, which is a process that put the Colombian economy back in the past. The fourth section is dedicated to the China factor, because the boom in the mining sector cannot be explained without mentioning China. The fifth part explains the deindustrialization process in the context of globalization and financing, which led the Colombian economy to a new, highly concentrated income distribution. The sixth section is dedicated to the monetary dictatorship, which was brought about by the so-called central bank independence, while the seventh section analyzes the last recession of 2008–2009. Finally, in the eight part we sketch some conclusions.

5.2 GDP, Employment, Wages and Prices

Since 1990, the Colombian economy, as shown by the GDP growth, has had several ups and downs with different characteristics. A first period represents a cycle of expansion until 1995; a second one, between 1995 and 2002, depicts the worst recession that has taken place in Colombia in its modern history, with a great dip in 1999, and a slight recovery in 2002; a third period of recovery was between 2002 and 2007; from a fourth period, between 2008 and 2009, a fifth period is defined with an expansion cycle until the present, as shown in figure 5.1.

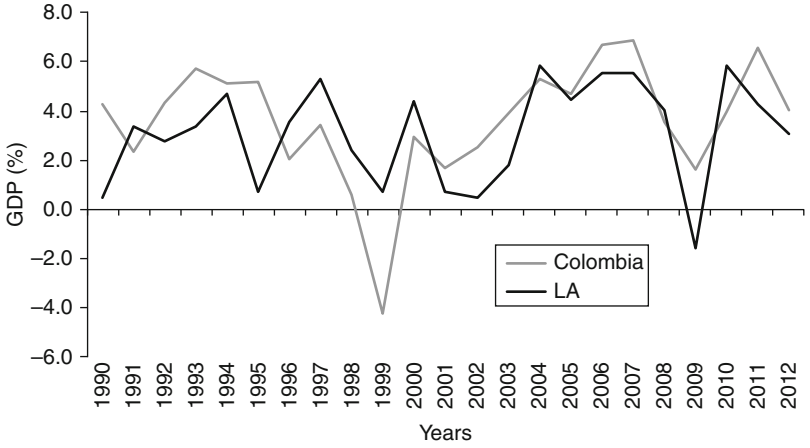

Figure 5.1 GDP rate of growth, Colombia (%).[5]
Source: ECLAC.

The 1999 recession in Colombia, with a –4.5% decline of GDP, was more severe than the Latin American average (figure 5.1), while the 2009 recession, which experienced a 2% GDP decline, was not as strong as that of LA. However, the event of 1999 exceeded the recession of 1931, when the GDP rate of growth was –1%. Actually, the sagging of 2009, although important, does not reach the negative zone. Industrial production contracted –7.0% (1999) and –5.6% (2009), with very low growth rate of —0.8%—in 2008. Our hypothesis is that the crisis of 2008–2009 in Colombia was milder than in the rest of South America because its economic links with China were less important than the ones registered by other countries of the region as Chile, Brazil, or Argentina.

Likewise, unemployment rates in Colombia and in LA (figure 5.2) were consistent with the behavior of GDP, although in the case of Colombia, the unemployment rate exceeded that of LA.

Besides, Colombian policymakers had struggled to reach an unemployment rate of one digit, not evident in figure 5.1, as this took place only as of 2014. On the other hand, the unemployment rate has become the mirror of the annual growth rate of GDP as shown in figure 5.3.

As for wages, between 2004 and 2011, comprising most of the presidency of Alvaro Uribe (2002–2010), average wages did not increase despite good economic performance, according to ILO[6]. However, Salomon Kalmanovitz, a central banker, still believes in

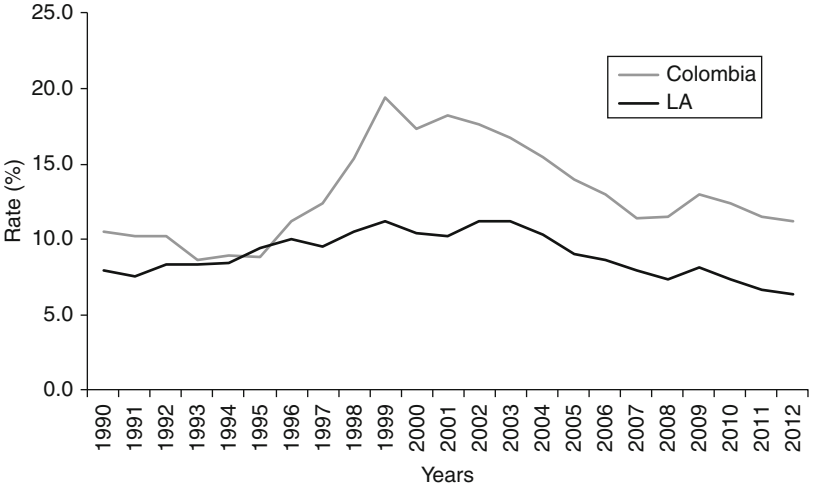

Figure 5.2 The unemployment rate, Colombia (%).
Source: ECLAC.

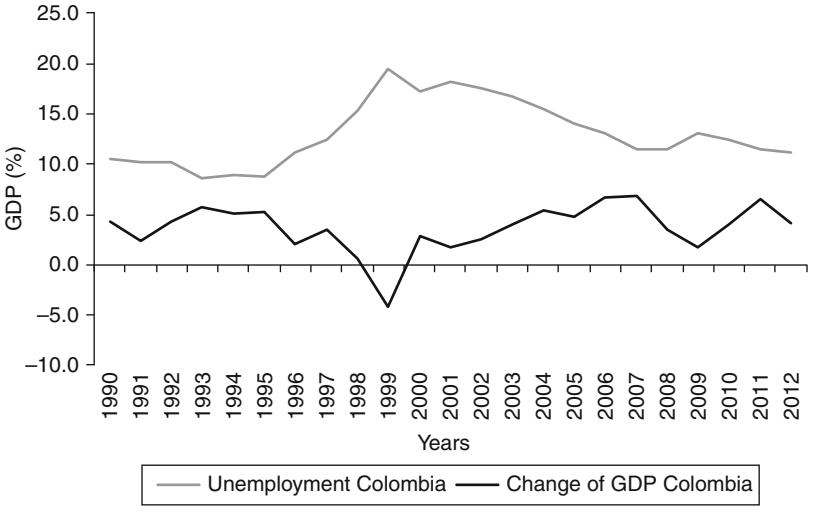

Figure 5.3 GDP rate of change and unemployment rate, Colombia (%).
Source: ECLAC.

complacency: "Real wages rose throughout the downward trend of consumer prices between 1997 and 2006."[7] Of course, he said this in 1999 when the unemployment rate was at its highest and the unexpected rate of disinflation was astonishing, with a great difference between the actual inflation rate (9.23%) and the inflation target rate (15.0%).

Uribe was the author of Act 50 (1990), which eliminated the chained retroactivity, year by year, of a monthly salary bonus for a year of work (layoff) for the full years of working for the same employer. He was also the draftsman of Act 100 (1992), which privatized health and pensions, and as president, he signed Labor Act 789 (2002), which reduced surcharges for additional work, night surcharges etc. It was a class war against workers. On the other hand, being a trade unionist in Colombia is a dangerous activity, as almost 3,000 trade unionists have been killed between 1977 and 2013.

Similarly, when observing inflation (figure 5.4), there is an abrupt, fast drop of the CPI from 30% in 1990 to 9.23% in 1999, well below the target of 15%. This was the result of a sharp drop in demand, expressed by the rate of –4.5% of GDP due to a strong contractionary monetary policy. The fall in inflation in Colombia was stronger than the LA average, which is reflected in the behavior of GDP and employment.

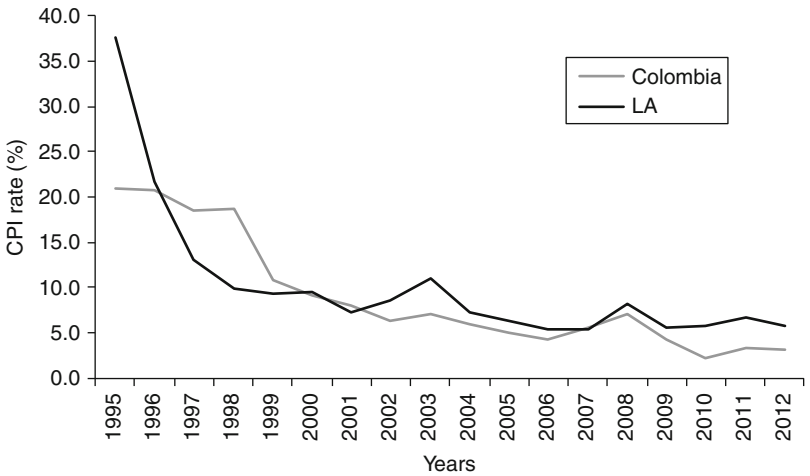

Figure 5.4 Inflation (CPI) rate, Colombia (%).
Source: ECLAC.

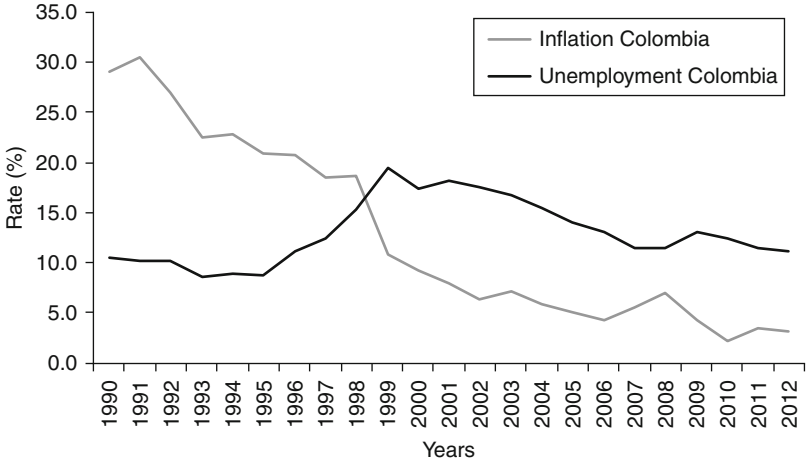

Figure 5.5 Colombia: inflation and unemployment rates (%).
Source: ECLAC.

The inflation rate in Colombia fell from 30% in 1990 to less than 5% in 2015. However, this process was accompanied by a depression in 1999. The rate of GDP was negative (–4.23%), and the unemployment rate rose to an astonishing 20%. It has come down to one digit only in 2014.

The relationship between inflation and unemployment in Colombia during the period 1990–1999 (figure 5.5) showed trends similar to a Phillips curve: the inflation rate was low, but unemployment raised. However, from that year until the present, both inflation and unemployment fell in tandem.

5.3 Revival and Boom of the Colombian Mining sector

From the last decade of the twentieth century until the first decade of this century, the situation of the mining and energy sectors in Colombia changed drastically. Changes in the share of mining income on GDP, exports, foreign investment, royalties, etc., have changed the way both operate due to the new fiscal regulations of 2010, prepared by the Colombian Central Bank, the Ministry of Finance, and the DNP (National Office of Planning).[8]

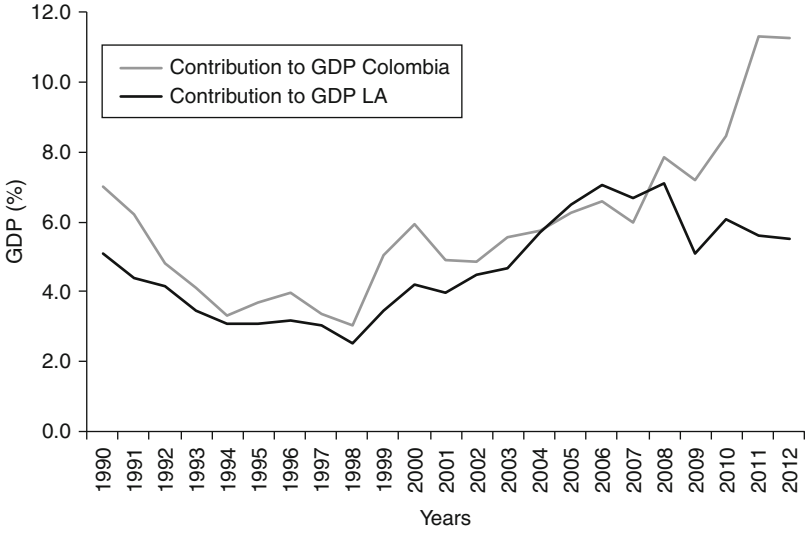

Figure 5.6 Shares of mining and quarries to GDP, Colombia (%).
Source: ECLAC.

During the 1990s, mining and oil operations in the country were declining. There were a few projects exploring oil fields, but they did not present a promising picture. On the other hand, oil self-sufficiency began to deteriorate. Between 2000 and 2004, the mining GDP showed a modest growth of 1%, while other sectors of the economy, such as industry or commerce grew at rates of 5%.[9] Figure 5.6 shows the expansion of mining and quarries in the Colombian GDP versus the sector in Latin America, being much stronger in Colombia than in LA from 2007 on.

What has the Colombian government done to stop such deterioration? "The Government redesigned the institutional structure of the crude oil (petroleum) sector with the creation of new entities and the design of policies to improve this sector's competitiveness."[10]

Several factors were responsible for energizing the sector:

> The new institutional environment, along with the expansion of external demand and the increasing international price of crude oil revitalized crude oil production in the second half of this decade. (Furthermore) the National Hydrocarbons Agency (ANH) was established by the 1760 Act of 2003, which is responsible for managing and regulating the sector's resources, ensuring equal contractual conditions

for different operating companies in the country, and promoting competitiveness in the exploration and production of oil and gas.[11]

As a result of this, "The mining GDP, including crude oil activity, has been increasing since the middle of the decade and in 2009 recorded a rate of growth of 11.3%.…Thus, mining has increased its share of GDP from 4.9% to 5.3% in 2009. Moreover, oil has increased its share relative to the mining GDP to just over 60%."[12] The integration of the Colombian mining sector with the international economy is a fact.

The expansion is determined "by the increased demands of the global economy (especially from China), and the price cycle. (Besides) in 2002, mining exports amounted to US $ 4,548 million, a 38% stake in the total country exports. Export sales increased to $ 16,612 million in 2009 and its share was 51%."[13] That is, the mining sector currently represents 5.3% of GDP and accounts for about 51% of the country exports. Notice that mineral exports represented only 0.4% of the annual total, between 1975 and 1984.

Crude oil is the most important export for the mining and energy exports. In 2002, crude oil represented 21% of total exports and 25% in 2009. Coal exports, on the other hand, increased 5.46 times from US $ 991 million to US $ 5,416 million between 200 and 2009."[14]

Consequently, foreign direct investment (FDI) in the mining and energy sector has increased considerably in Colombia (figure 5.7),

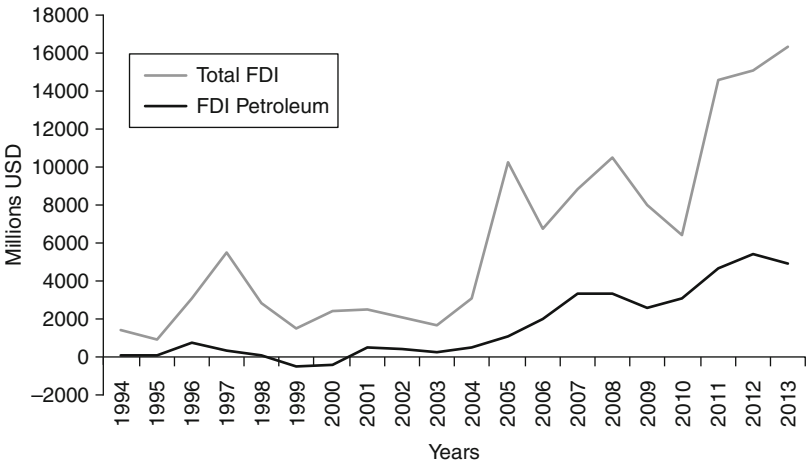

Figure 5.7 Colombia: total FDI and FDI in crude oil (petroleum) (US $ millions).
Source: ECLAC.

from a share of 21% over the total FDI to a share of 43% between 2000 and 2009.

Meanwhile, "the FDI in the oil industry went from negative in 2000 to a 37% share of total FDI in 2009, thus the oil industry became the second sector with the largest FDI participation after mining and quarries."[15] According to "the Ministry of Mines and Energy, the stock of foreign investment estimated in the crude oil (petroleum) industry amounts to US $ 54,000 million between 2008 and 2015 and $ 8,000 million for other mining products"[16] (figure 5.7).

The production forecast of "coal, ferronickel and gold show significant increases. Using information from the Ministry of Mines and Energy, coal production is estimated to increase from 84.000 million tons in 2009 to 116.000 million in 2019."[17] As a matter of comparison, 4.9 million tons were produced in 1980.

Likewise, for the production of gold, "mean increases of 6% per year…are calculated, reaching 88 tons in 2019…That is, 2.83 million troy ounces, while 510.400 were produced in 1980. As for nickel,…forecasts…allow to expect an increasing trend going from 60,000 to 107,000 tons between 2010 and 2019."[18] There is not data for nickel production by 1980.

In terms of exports, "coal volumes increased 51 million tons sold in 2004 to 119 million in 2021. The ferronickel exports, which registered 124,000 tons in 2004, could rise to 170,000 tons by 2020.…Finally, the gold, which recorded exports of 1,560 thousand troy ounces in 2004 could increase to 3,293 thousand troy ounces by 2021."[19]

In the midst of the current boom in mining and crude oil, one of the keys to Santos' government program, exports of raw materials and commodities such as oil, coal, and minerals accounted for 65% of total exports in 2010, and the production growth rates of oil, coal, and gold, were 68%, 36% and 35% respectively.

These high growth rates are explained not only by increased export volumes, but also by rising prices. Between January and December of 2011, gold went from $1356.4/ ounce to $1641.84; crude oil (WTI) rose from $89.51dollars per barrel to $98.61, and coal in the Australian market went from US $ 141.94/ton to $117.49, though it was US $54.95 in January 2007. However, nontraditional exports, such as manufacturing and flowers, grew 18% despite the exchange rate appreciation of the peso.[20]

This expansion in exports has been supported by foreign investment in the mining and oil sectors. However, this investment, mostly capital-intensive, does not have strong linkages with domestic production

processes. If the Drummond company is taken as an example, the argument can be understood: "The US multinational Drummond invested over 1,600 million dollars over the next two years [] to build two ports and the extension of a railway line… One is a port for direct loading with capacity to import and export (…), the construction of 120 km of railway line will add 60 km and finish with a double lane road (…) Colombia will have an ability to export more than 100 million tons of coal from the Cesar territory."[21]

This investment is simply the development of an enclave economy without major connections to national production, and job creation is very low. "While the working population has increased, the share of the mining sector in total employment has remained between 1% and 1.7%. This participation is quite modest for a sector that accounts for more than half of the country's exports (and much of the foreign investment)". On the other hand, "between 2001 and 2012, the agricultural sector has created 223,000 new jobs, industry 517,000 jobs, manufacturing and mining barely 81,000 jobs."[22]

In this sense, "a profile of (economic) growth was configured: It is concentrated in areas that do not irrigate the benefits to the rest of the system, that do not generate quality jobs, and which smother sectors that are able to do so" because of the appreciation of the exchange rate of the peso, according to Sarmiento[23].

Now, we can ask ourselves how many taxes and royalties are paid to the Colombian state by those multinationals? According to Pardo[24], "the Ministry of Finance drew attention to excessive exemptions contained in the Tax Code, while Guillermo Rudas found that such exemptions accounted for at least 49% of what the companies paid in taxes in 2009". Likewise, "the General Comptroller of the nation (CGR) concluded that tax deductions for mining have been increasing markedly since 2004, noting that for the case of coal, it exceeded the value of taxes in 2007". We are paying them for taking Colombian riches for free.

According to Guillermo Rudas, looking at the national accounts, the mining sector should have paid 15.5 billion pesos in taxes while they paid only 6.4 billion. The remaining 9.7 billion are a combination of tax breaks that are not required of mining, given the high world market prices, and simple tax avoidance or tax dodging. In the case of coal, between 2002 and 2010, these companies had to pay a tax rate on earnings of 35%, but only paid 8%.[25]

What happened? In 2003 it was possible that "state enterprises (…) engaged in mining could deduct their paid royalties from their

income taxes as all companies in the industry. (...). ASOMINEROS (mining enterprises syndicated) and ANDI (National Association of Industrial Entrepreneurs) took the window of opportunity and argued in 2005 that, by the principle of equality, private companies could enjoy the same privilege that the public sector mining companies does. DIAN (Colombian IRS), which at the time was unconditional ally of large taxpayers, accepted the complaint on behalf of private companies."[26]

The ANDI brings together the Colombian and foreign companies working in Colombia, since the only criteria taken into account is geographical location. Therefore, its national adjective has no meaning.

Consequently, public finances are resting on growing royalties due to higher commodity prices, while the public debt is increased, thus relieving the foreign tax burden on national and foreign firms and without higher tax efforts by the productive sector.

As a partial conclusion, the Colombian economy has become a natural resource-dependent economy, while its manufacturing sector has lost participation in both production and exports in a process of premature deindustrialization, a pattern that Rodrik has recently observed in emerging countries.[27]

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5.4 The influence of China

The world economy is changing, but many of these changes originated in China, and these changes are overwhelming. Even after the 2007 global crisis, "from 2007–2013, China grew a simply staggering 43%, while the US grew a paltry 0.6% and the EU shrank 0.7%."[29]

According to the World Bank, the country is the world's leading exporter, the first producer of manufactured goods, and the second largest economy in the world, measured in current US dollars. In 2009, China was 64.4% of the US economy, but it will be 29% larger than the US economy by 2050.[30]

Chinese demand for commodities, minerals, oil, food, and industrial raw materials is impressive. China consumes 53.2% of the world's cement, 47.7% of its iron ore, 46.9% of its coal, 45.4% of its iron, 41.3% of its zinc, and 40.6% of its copper. As for agricultural and

livestock commodities, the figures are quite high as well: the demand for pigs is 46.4%, eggs 37.2%, rice 28.1%, soybeans 24.6%, wheat 16.6%, and oil 10.3%. Thus, the high rates of growth in China's economy have an explanation: An overwhelming demand for commodities due to a rise in foreign and domestic investment, and strong domestic consumption.

The impact of Chinese demand on commodity prices has been remarkable. Between 2004 and 2008 an unprecedented bubble was observed in the price of commodities. The 25 most actively traded commodities doubled their prices, and 8 of them beat their prices widely: diesel (1313%), nickel (1273%), crude oil (1205%), lead (870%), copper (606%), zinc (616%), tin (510%), and wheat (500%).

These rising trend in prices resulted in boost to the terms of trade for South American countries. The prices of exports, mainly commodities, grew faster than import prices. Between 2003 and 2010, the terms of trade index, taking 2003 = 100, went up to 219 for Venezuela (this is explained by oil prices), 181.5 Chile (copper prices), and 142.4 in the case of Colombia (mining and energy). Similarly, the high growth rates of GDP are also explained in large part by this phenomenon.

The IMF explanation for the growth in these commodities' prices, especially food, is a traditional one—supply and demand, the latter being the lead on prices, with a laggard supply—"Consumers in developing countries are enriching and changing your diet: relying more on high-protein foods such as meat, dairy products, edible oils, fruits and vegetables and fish."[31] On the other hand, the delay in agricultural research and the fall in world agricultural productivity are indicative of the decline of agricultural supply.

One of the conclusions of Jenkins (2011) on the China factor in Latin America is about the impact of commodity prices on the regional economy:[32]

> The increased value of Latin American exports to China was due in part to higher commodity prices caused by the growth of Chinese demand. It is clear that even at a conservative estimate; the indirect effect on world prices for the region was a strong source of additional revenue from exports that the direct impact of exports to China.

On the other hand, another explanation, which does not have to be antagonistic, but rather is complementary to the above argument, is the speculative element in the rising prices of commodities.

According to the *New York Times*, "the maneuvering in markets for oil, wheat, cotton, coffee, and more have brought billions in profits to investment banks like Goldman, JPMorgan Chase, and Morgan Stanley (…). Goldman and other firms won regulatory approval to buy companies that traded in oil and other commodities. Other restrictions were weakened or eliminated during the 1990s, when some banks were allowed to expand into storing and transporting commodities."[33]

5.5 Deindustrialization

Colombian manufacturing went down from 17% of GDP in 1990 to 12% in 2012. Colombia is getting deindustrialized as it has happened all over Latin America but below the LA average, in terms of GDP share (figure 5.8). The opposite happened with the financial sector which reaches 20% and is not acting as a provider of the production sector but rather as its master.

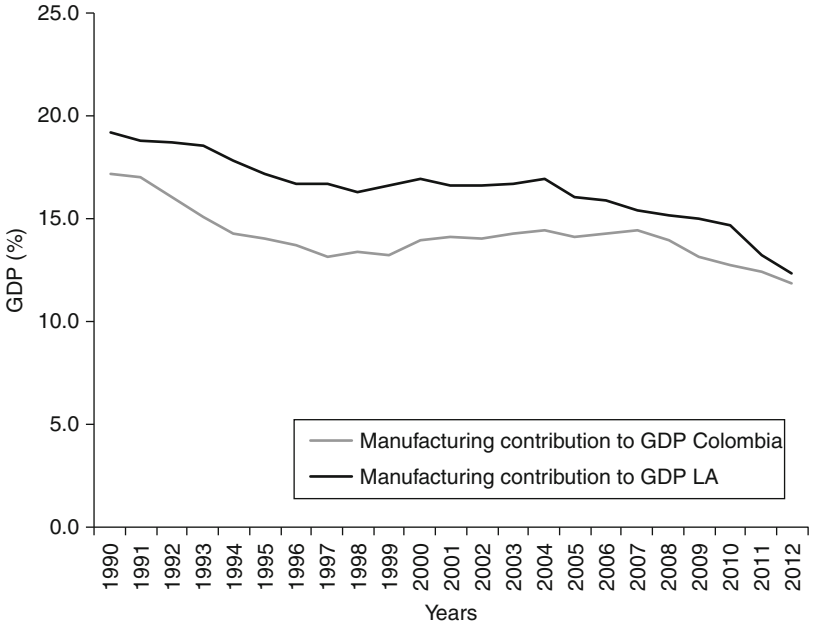

Figure 5.8 Manufacturing share to GDP, Colombia (%).
Source: ECLAC.

How do we explain that the banking and financial sector in Colombia is 18%–20% of GDP, while industry and agriculture—basic industries—together do not reach this percentage share? The basic fact is that the rate of return of the financial sector was not only higher than the growth rate of the economy, but also higher than in other sectors, in the nomenclature of Piketty (2014). Regarding the participation of finance, real estate, and other related activities to the GDP of Colombia and Latin America, the first activity is above the LA average (figure 5.9). This shows how important rent-seeking activities in the Colombian economy are.

Villabona (2014) states: "The profits of the banking sector in the decade under study (first of 2000) increased by 1035.9% between 2001 and 2009, from 318.5 billion pesos to 3.3 trillion respectively, while in the same period the consumer price index (CPI) increased only 52.8%."

In the case of Bancolombia, as an example,

> The largest (Colombian) bank was one with the highest rate of growth. Its assets grew from 6.9 trillion pesos in 2000 to 40.9 trillion in 2009, which means an increase of 485%.... With 393.9 billion dollars invested over a decade in this bank, it gets 5.2 trillion pesos as profits, more than 13 times the investment; it means a rate of growth of more

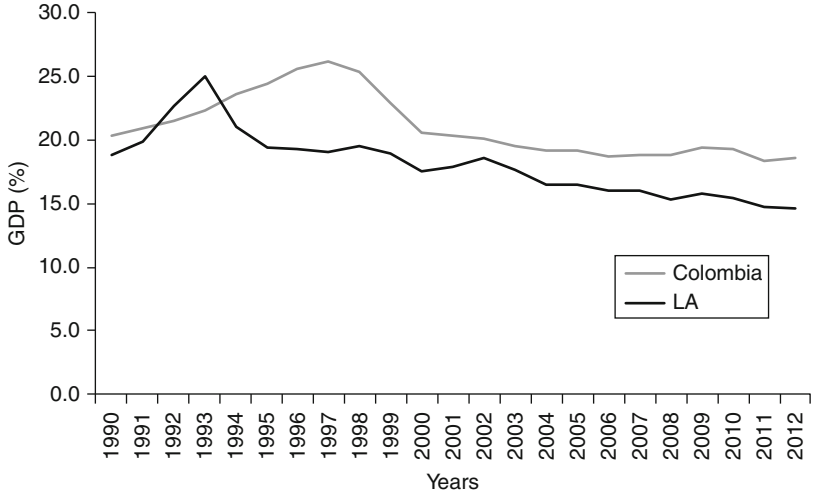

Figure 5.9 Share of financial, real estate and related items to GDP, Colombia (%).
Source: CEPALSTAT.

> than 1,300% in the period under consideration. This is unimaginable, even in businesses considered unlawful.[34]

On the other hand, the appreciation of the peso exchange rate not only hindered the growth of manufacturing, but also promoted the conversion of manufacturing exporters into importers. In some cases, they implemented *maquila*-style facilities, and others became distributors of imported goods that were previously produced domestically. According to Cabrera (2013), "The most noticeable change is industrial importers in the foreign trade sector. In the last decade imports went from USD $10,700 to USD $46,500 million. As industrial exports grew less, the negative trade balance of the sector increased from USD 5,800 to USD 35,100 million."[35]

As Mazda closed down its plant in Bogotá (2014), as many others firms have done such as Icollantas- Michelin, Kraft, Mondelez (Chiclets Adams, Trident, Sparkies, Certs and Bubbaloo), Bayer (medicines), etc. ; headlines are a guide to the deindustrialization process that has been going on in the Colombian economy including the relocation of foreign firms as has been noted. Although Mazda is a Japanese company that assembles cars in Colombia, it is also a company with several Colombian auto parts suppliers in several cities.

The situation for the industry was so critical after 2009 that although the economy had reached a one-digit rate of unemployment, jobs were being lost in the manufacturing sector. The 13 major metropolitan areas of the country lost 84,000 more jobs between September and November 2013, than in the same period in 2012.[36]

On the other hand, Paul Krugman, despite being a critic of the Ricardian theory of comparative advantage, strongly recommended a primary specialization to Latin American economies, when he told Peruvians in a seminar: "Do not worry too much to create a country specialized in manufacturing activities. You already have all necessary resources to be successful."[37]

Krugman pointed out the successes of the primary economies:

> On the other hand, you have Chile, which is still an economy that exports much raw material, but whose economic policies have made it a successful country. What I mean is that it is not essential that a country is an exporter of manufactured products to be successful. The main thing is to have prudent economic policies and well run.[38]

Paradoxically, Krugman has been one of the most important proponents of the new theories of trade, which describe the real world

much better than standard theory (Ricardian comparative advantages of free trade, complementary goods), but seems to refuse to apply it in actual cases. Erik Reinert (2007) calls this inconsistency between theoretical conclusions and policy recommendation "Krugmanian vice," accusing Krugman of juggling "the assumptions of science for political goals."[39]

On the other hand, globalization policies, as well as the process of financing and returning the Colombian economy to the primary sector, have brought inequality in income distribution in the country. But, more importantly, these show the winners and losers behind such policies. The Gini coefficient increased from 0.47 to 0.58 between 1990 and 2011. The Gini coefficient in the distribution of land also increases from 0.70 (1980) to 0.86 (2010), revealing the undeniable existence of large estates, which expands violently and relentlessly.

Piketty (2014: 327), in his renowned book, refers to the distribution of income in Colombia:[40]

> Colombia on the other hand is one of the most unequal societies…: the top centile share stood at about 20 percent of national income throughout the period 1990–2010…This level of inequality is even higher than that attained by the United States in 2000–2010, at least if capital gains are excluded."

Besides, Colombia is ranked eleventh in the world, with the worst GINI in income concentration.[41]

5.6 The Monetary "Dictatorship"

The latest Political Constitution of Colombia of 1991 states that the Banco de la República (BR), the Colombian central bank, is independent from the government. Since then, the BR has had the sole goal of guaranteeing price stability, regardless of other objectives, such as employment, growth, income distribution, etc. Economic orthodoxy states that achieving price stability automatically produces more jobs and more growth. However, it has not happened. Colombia grew more in the pre-reform period than after it.

In this regard, the general policy of the government should be subject to the achievement of this goal in coordination with the BR. The government, elected by popular vote, should have to design a program aim to achieve price stability policy—the monetary discipline and high interest rates—which could lead to unemployment and worsening income distribution, as it has happened in the past 20 years.

However, members of the BR board have always maintained that an employment goal is beyond their limits. This is a matter of the labor market, and technical change. It's not a monetary issue.

The exchange policy is also subject to the price stability goal (art. 16, Act 31/92), which regulates the BR independence. What happened to the nominal and real exchange rates (figure 5.10) in the past 20 years was not by chance. The value of the dollar went down from 2,800 pesos to 1,750 currents pesos in the last 11 years. In a deflationary environment, the real appreciation of the exchange rate is a result, hurting the entire exporting sector, but especially those producers who compete with cheap imports. The cheap dollar has been functional to foreign investors and debtors who became indebted in dollars and then repatriate their rising profits in dollars. Similarly, the large national economic groups that are expanding abroad are also beneficiaries of the revaluation, whose international expansion plans would become difficult to implement with the process of the exchange rate devaluation.

The government was left at the mercy of the banking sector, paying high interest rates to finance fiscal deficits because the credits—pure emissions on behalf of the government—were prohibited, unless the full BR's junta agreed to do so. This means, in practice, that the Political Constitution surrendered monetary sovereignty of the state, conferred by the nation, to the sovereignty of the banks. The

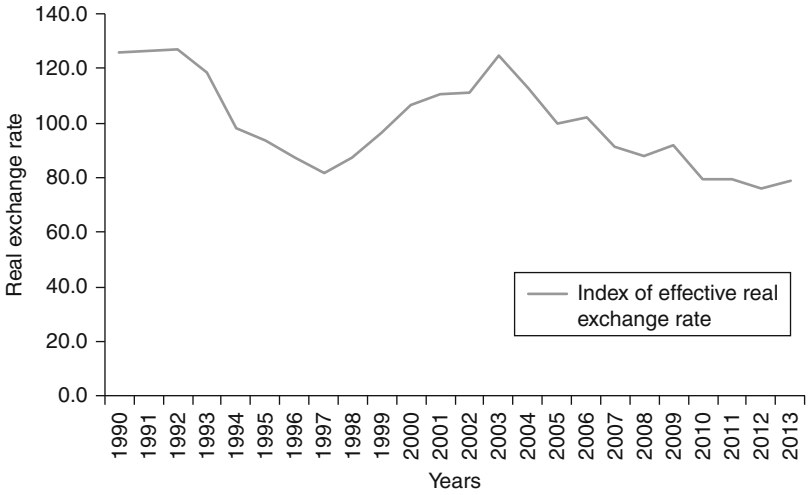

Figure 5.10 Index of effective real exchange rate, Colombia (y/y).
Source: ECLAC.

government could only borrow from banks or through open market operations. There was no other way.

Colombia's inflation rate has fallen from 30% in 1990 to less than 5% today. However, this process was accompanied by a sharp recession in 1999. The rate of GDP was negative (–4.23%), and the open unemployment rate was 20%—the largest in its entire history—and it was at one digit by 2014. Moreover, income distribution worsened, and today it is one of the worst in Latin America.

On the other hand, the BR was to blame for the great mortgage crisis of 1999, which preceded and triggered the great crisis of the Colombian economy in 1998–2002. In the 1990s, the BR had extremely high interest rates in order to defend the exchange rate band, cool inflationary pressures, and thus achieve the targets for inflation according to plan.

To this policy of high interest rates (figure 5.11) the BR added, for mortgage policy, a change in methodology for calculating the UPAC (a unit of account for mortgages), which was linked to inflation, in which housing loans were expressed. The BR changed the inflation link to the UPAC for the interest rate on deposits of 90 days or DTF (resolution 24 BR 1994). This modification was enough to break the financial stability of households and put them in a financial distress.

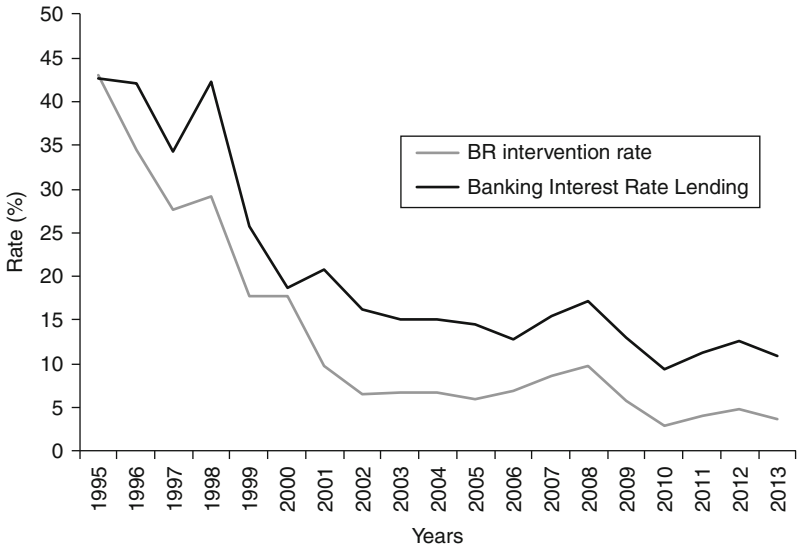

Figure 5.11 Banking interest rate and central bank intervention rate, Colombia (%).
Source: BANREP and World Bank data.

This decision of the BR Junta and its policy of high interest rates led thousands of debtors into bankruptcy, and they had to surrender, ultimately, their homes as payment because their incomes could not accommodate the increasing mortgage rates. While the financial costs of mortgages, tied to DTF and measured on UPACs, skyrocketed, workers wages rose according to the targeted future inflation.

Due to the mortgage crisis, the Constitutional Court declared paragraph f of Article 16 of Law 31/92 unconstitutional, which had been regulated with resolution 24 of 1994, "considering that this mechanism increased debt obligations to the benefit of lenders and to the detriment of debtors."[42]

The judgment of the court forced to reassess new housing loans, and the government had to enact some relief, covering the difference between what was charged and what should have been charged, not with the UPAC linked to inflation, but with the calculation of the approved UVR, neither of which corrected BR's mistake at the fullest extent.

Fogafin, a financial relief state agency, helped the banks financially at the expense of Colombians taxpayers. Private banks did not return one peso they had overcharged to their customers. The BR caused a huge damage for the country with the amendments to the UPAC, but has not taken responsibility for it, while private banks and the financial system were the only beneficiaries.

But the most important factor that contributed to the appreciation of the peso since the downturn of 2008–2009 has been the monetary policy of the Federal Reserve (Fed): quantitative easing (QE). This involved buying bonds and securities backed by subprime mortgages at nominal prices, not market prices, reflecting the bursting of the housing bubble. The central banks of the major developed countries implemented similar actions.

QE operations are explicitly "naked" money supply operations, dollars taken out of nowhere, designed to boost stock prices, lower bond yields, and weaken the dollar, at zero or near zero interest rates. Meanwhile, banks obtained almost free deposits from customers, who saw their savings disappearing, while being excluded from the policy of zero interest rates. According to Krugman, this is what Keynes called the "euthanasia of the rentier."[43]

Moreover, QE operations affect the exchange rate against the dollar of emerging markets by appreciating their currencies. Large capital inflows at almost 0% have facilitated short-term gains by differences

in interest rates, or arbitrage, such as buying assets: financial instruments and real estate properties.

Since the completion of QE transactions was announced in June of 2013 by the Fed, expectations of higher interest rates and a stronger dollar have been transmitted to emerging countries, weakening their currencies, lowering stock values, and reversing flows of capital to developed countries, especially the United States. While at the international level, low commodity and oil prices are the new normal. In Colombia, as in other emerging countries, those trends are present.

According to Stiglitz (2003), if there are tradeoffs ("There is a tradeoff between the risk of rising inflation and an unnecessary increase in the level of unemployment"), an independent central bank is an anomaly in a democracy. In the case of an independent central bank, there should be at least "a mechanism to ensure that all involved voices and perspectives are heard."

For example, "in Sweden, the working class is represented at the central bank." However, the Federal Reserve of the United States represents a curious case, Stiglitz says, because "it is independent; however, it is dominated by figures from the financial markets… by entrepreneurs, while the voices of workers or consumers are virtually inaudible."[44]

From whom are central banks independent? From all citizens. This economy model is called "the invisible hand," manipulated by central banks to favor special interests and creating an increasingly concentrated financial system, which is much harder to control. In the United States, 70% of assets are under the control of the 2% of banks. They are too big to fail, too big to jail, and too big to develop an economic democracy.

Is the central bank independence a democratic one? Kalmanovitz (2011), who was BR's co-director for 12 years, says yes.[45] However, although "the Federal Reserve and other central banks claim that their 'independence' is a" characteristic of a democracy, "rather this independence seems to be a transition to a financial oligarchy."[46]

5.7 Colombian Recession 2008–2009

The rate of unemployment, the rate of price growth, and the rate of growth of the GDP are the true tellers of how an economy behaves. In the case of the Colombian economy, it can be observed that the behavior of unemployment, prices, and the GDP are as expected with the phase of contraction and the phase of recovery: In the contractionary

period, the unemployment rate went up 11.2% (2007), 11.3% (2008), and 12.0 % (2009); while it went down to 11.8% (2010) in the phase of recovery, and it kept going down.

The rate of inflation (Consumption Index Price) went down in the contraction phase 5.7% (2007), and 2.0% (2009): the lowest rates of the last fifty years. Meanwhile prices went up 3.5% in the recovery phase (2010), and it stayed around this afterwards. Thus, the rate of GDP went down in the recession phase with 6.9% (2007), 3.5% (2008), and 1.7% (2009), while the GPD went up in the recovery period 4.0% (2010) and remains around that level.

The manufacturing sector declined 6.6% in the first half of 2009, much more severe than the 6.2% decline in the same period in 2008. Car assembly firms' activity fell 31.1%, food products 13.1%, and clothing 13.9% over the previous period, June 2008.[47]

As a result, those figures show both the mild severity of the recession and its brevity.[48]

Besides, this recession and subsequent recovery are related to the external sector, especially with the behavior of commodity prices. The Working Group on Commodity Prices, which works under the auspices of the Kiel Institute, points out that

> during summer 2008 the long-lasting boom in commodity markets came to an end. The HWWI[49]-Index peaked out in early July, and the prices of virtually all commodities included in the forecast have fallen substantially in recent months. The turn of the price trend in commodity markets is mainly due to the deterioration in the global macroeconomic environment. (AIECE, 2008)

Besides, "changes in the index are dominated by the development in oil prices due to the high weight of more than 60%this commodity."[50]

On the other hand, the appreciation of the dollar played its part. "Another factor contributing to lower commodity prices has been the recovery of the US dollar which actually started at the same time—in early July—when the prices of a number of commodities and especially the oil price peaked and began falling."[51]

But the AIECE points out that in 2010, commodity prices had a recovery:

> Average dollar prices of non-energy commodities almost reached their previous peak in July 2008 by autumn 2010. The real prices of non-energy commodities declined only temporarily as well. The significant

> price level shift during the first decade of the twenty-first century is interpreted as largely reflecting the rise of the commodity-intensive Chinese economy. Also energy prices rebounded quickly from the lows in the recession, but have stayed well below their record highs reached in mid-July 2008. (AIECE, 2010)

Specifically, "after a period of stability for crude oil prices fluctuating in a 10-dollar range since late 2009, crude oil has been traded at over $80 US dollars per barrel, triggered by the weaker dollar. However, the world oil balance is still in surplus."[52] This means that China's demand for commodities is back.

According to Sarmiento (2008), in the case of Colombia,

> The epicenter of the debacle is the external sector. The revaluation cracked exports and domestic production of raw materials. External sales of nontraditional products in September fell 5% in value and 20% in tons. If falling prices of commodities in international markets and contraction in exports to the United States and Venezuela caused by the global crisis is added, it is not difficult to imagine that the current account deficit will reach 4.5 % of GDP.[53]

Thus, the components of aggregate demand are underperforming: Consumption is lagged, as well as investment, and exports plunged afterwards. So, what did the Colombian government do to help the economy besides external (non-government caused) recovery of commodities prices?

The central bank carried out an expansionary monetary approach. Open market operations were done in order to spread liquidity to the economy, and interest rates charged to commercial banks by the central banking authority were reduced. It was an anti-cyclical monetary policy, according to Mesa et al.[54]

On the fiscal policy side, infrastructure investment was prioritized, which represents a total increase of 10.7% of GDP; expenditure in social investment rose by 42%, and a rise of 7% in the productive support program was implemented. This means an anti-cyclical fiscal policy that added 1.5% of GDP to the total fiscal deficit of 4%.[55]

Those policies and the recovery of commodity prices in international markets made the recession of 2008–2009 mild and short-lived.

Finally, it is worth mentioning that, as a result of the confrontation between President Alvaro Uribe (Colombia) and Hugo Chavez (Venezuela) in 2009, trade flows between the two countries were cut.

Thus, the Venezuelan government canceled the purchase of 10,000 vehicles assembled in Colombia and a number of imports totaling 1,100 million dollars, while Chavez promised "zero" purchases in Colombia. To implement this policy, the Venezuelan government signed trade agreements with other South American countries. As in the Argentine case, their government run quickly and without remorse: "we do not take away anything from anyone" to sign an agreement with Venezuela.[56]

5.8 Conclusion

The rate of inflation in Colombia has fallen from 30% in 1990 to less than 4% today. However, this process was accompanied by a depression in 1999: GDP growth rate was negative (–4.23%), and the open unemployment rate was 20%.

The 2008–2009 recession is linked to the fall in international commodity prices, but it has been surmounted by expansionary fiscal and monetary policies. Nevertheless, the primary sector has become larger in the Colombian economy, showing the fragility of such change on its trade and production integration with the world economy.

In terms of economic policy, in this context, the Colombian authorities faced recession in the style of Herbert Hoover, quoting Krugman (1999): "Raising taxes, cutting spending and raising interest rates."[57] That is, inadequate policies are used to end the crisis, as happened in the 1999 crisis, when the whole IMF's vade mecum was applied. Although an expansionary fiscal policy has been applied in 2008–2009, it was done principally through debt financing, while monetary policy has been accommodating to the QE fed policy.

The big difference between the Colombian 2009 crisis and the 1999–2002 crisis is that now the Colombian economic cycle is linked to high commodity prices due to the rise of the primary sector of the economy and China's increasing demand for these goods. Also by 2014, the demand for natural resources commodities began to show weakness, tied to the weaknesses of the Chinese economy and the rest of the world.

In general, the Colombian economy since 1990 has been subject to a high demand for mineral and agricultural commodities by international markets. This led to deindustrialization, low inflation, exchange rate appreciation, high unemployment, low wage growth, and high inequality.

Since the change of the economic model in LA, from the model of import substitution to the export and foreign capital flows-based model, the recession and recovery phases show that the economic cycle is synchronized more with the external factors, now ruling over domestic factors, such as commodity prices, and the Chinese factors, external capital flows, and reactive policies of the Fed (FFR). The latter is being carried out in order to manage the dollar and maintain its hegemony, as the dollar is increasingly weakening as a means of exchange and as an international reserve currency, compared with the United States' Federal Reserve, which has become the superhero of the US financial system, managing monetary bailout programs at any cost.

In this environment, internal countercyclical policies are in a very weak position to have multiplier effects, without making substantial changes in the system of the international economy ties. Emerging and underdeveloped countries' central banks are subject to FED policies: There is no autonomy any longer to manage exchange rates, while tax rates and fiscal policies are subordinated to the grades assigned by international rating agencies.

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6

The Global Crisis and the Chilean Economy

Claudio Lara Cortés

6.1 Introduction

The global crisis that erupted in 2008 is unlike any other crises experienced in Chile and Latin America, because, among other things, it unfolded differently. In effect, it started in the financial markets of the United States, then spread to other advanced economies, and finally to the emerging ones, causing what is now known as the Great Recession. At first, many economists thought that the crisis would end in the developed countries, without affecting supposedly solid and protected economies. Echoing this idea, Chilean Finance Minister Andres Velasco repeatedly stated that the Chilean economy was "bulletproofed" against the international crisis.

Once it was demonstrated that such optimism was completely unjustified, the idea that "our country was yet another victim of the global financial collapse" emerged. According to the experts, Chileans had suffered the negative consequences of external shocks, particularly a financial shock and a demand shock. This is the most widespread view on the crisis and its impact on the Chilean economy.

This chapter aims to discuss these opinions based on the historical conditions of the "Chilean model." Its starting point is the description of external shocks stemming from the decrease of world trade and the drop in capital flows, as well as the instruments (increased fiscal spending and cuts in interest rates in terms of monetary policy) implemented by the government to counter them. However, they could not prevent the Chilean economy from entering a severe recession in late 2008.

In the second section, the discussion regarding the international reserves of developing countries is reviewed, showing a direct link between these and the rise of financial markets that led to the housing bubble. At the same time, an ever-closer relationship was constructed between both local banks and financial institutions and their US counterparts, enabling the rapid spread of the crisis.

The third section analyzes the existing conditions of the accumulation pattern of Chile- export (copper) and the financial sector—that allows the accumulation of international reserves and causes the appreciation of the peso for long periods of time, with its corresponding impact on the reprimarization of the economy.

Finally, the fourth section concludes by considering the very slow recovery and high volatility of the global economy, which Larry Summers recently branded as "secular stagnation." Today, a large mass of liquidity travels the globe as a result of monetary stimulus measures implemented by the central banks of developed countries. In this extremely uncertain and stormy horizon, our economy has been experiencing a continuous slowdown that weakens the driving forces that have sustained the accumulation model: credit and export growth along with the reproduction of the workforce. However, the most novel news at the moment may be that the economic model has begun to be seriously question the economic model, both in social and political terms.

6.2 Describing the External Shocks of the Crisis

According to the view of mainstream economists, Chile took advantage of the growth cycle experienced by the world economy for several years in the 2000s, and by early 2008 was "well prepared to deal with the world financial turmoil" (De Gregorio, 2008: 29). This is so because "the macroeconomic framework that has been built since the mid-1980s and consolidated in the 1990s has been increasingly effective at managing external shocks and providing macroeconomic stability. The main elements are

(1) A responsible and predictable fiscal policy which guarantees public sector solvency and smoothes the spending out of copper income. A policy that was sometimes questioned for being too strict is revealing its merits;
(2) Monetary policy is conducted by an independent central bank which uses an inflation targeting regime supported by a floating exchange rate;

(3) Increasing trade openness, allowing for the diversification of import and export markets;
(4) A solid financial system, with competitive and well-capitalized banks, appropriately regulated and supervised. (De Gregorio, 2008: 29)

In this sense, it is regrettable that this boom phase of the Chilean economy and its structured macroeconomic position were interrupted by the financial crisis through two types of related external shocks: demand shock and financial shock.

In fact, for the period between the second quarter of 2004 and the first quarter of 2008, Chile had the distinctive trait of accelerating economic growth, with an average rate of 6.1% per year, which became the best consecutive four years during the previous decade. The booming world market played a key role, particularly by the coinciding of two phenomena that had not taken place simultaneously since the 1970s: the high prices of raw materials and exceptional external financing conditions.

Under these conditions, the Chilean economy tackled the outbreak of the global crisis with less vulnerability, but failed to prevent the violence of the external shocks that affected precisely the two pillars that allowed the boom phase. Given the greater degree of openness that characterizes the Chilean economy today, the most severe shock comes from abrupt contractions in world trade. As a result, exports and imports have gone down substantially since late 2008.[1]

The decline in exports was driven both by a fall in the prices of exported products—especially commodities—as well as decreased physical shipments due to the adjustment in aggregate demand around the world. Meanwhile, the strong slowdown in imports has been related to the decline in prices in the advanced economies, but also there has been a restriction in the volume of imports: the effect of lower domestic consumption and inventory shrinkage. Additionally, the price ratio between the products that Chile exports and imports (terms of trade) worsened in 2008 and in 2009.[2]

Another one of the aforementioned external shocks is related to the decline in capital flows to Chile, due largely to the wave of panic that engulfed the creditors following the bankruptcy of Lehman Brothers. In the end, this inevitably affected the activities of the financial system, as well as the appearance of restrictions on access to external financing, decreased liquidity due to the reduction in bank loans to Chile, and the tightening of credit conditions in the domestic market due to the presence of foreign bank branches affected by the crisis.

All this will result in a significant outflow of capital, causing a loss of reserves in the country and increased volatility in the exchange rate.

The result of these two external shocks altered the growth trend in the economy. GDP growth fell from 4.6% in the third quarter of 2008 to only 0.2% in the last quarter of the year, ending the year with an average of 3.2%, as table 6.1 shows. In the first quarter of 2009, the economy experienced the first fall of the decade of 2.1%, which continued into the next three quarters.

The clearest reason behind the fall in GDP can be found in the reversal suffered by the investment cycle in the third quarter of 2008, just when it was in full ascent.[3] Measured as gross fixed capital formation (including both the private and public sectors), investment was down by 15.9% in 2009 (see table 6.1).

Moreover, the situation was complicated even further by significant increases in unemployment. In previous recessions, the rise in unemployment took some time to materialize from the moment it was first perceived (as in the Asian crisis of 1997). However, this time something was different, because "in the present crisis the effect was instantaneous and the decline of some variables was stronger in Chile than in the United States "(Estrategia, 5/18/09). This is an indication of the speed with which business owners have resorted to massive layoffs, almost doubling the figure of November 2008 in just a few months. The Department of Labor reported an astounding 1,516,325 notice of termination letters in the country in 2009, equivalent to almost 25% of the employed labor force.

Beginning in late 2008, a rapid increase in unemployment was seen to be following an upward trend until the April-June quarter of 2009. At that point, the unemployment rate again crossed the double-digit

Table 6.1 Chilean economy: Macroeconomic data (% annual variation)

	2004	*2005*	*2006*	*2007*	*2008*	*2009*
Real GDP	6.2	6.3	4.3	4.7	3.2	–1.0
Domestic demand	8.1	11.4	6.4	7.8	7.4	–5.7
Gross fixed capital formation	11.7	24.7	2.9	12.0	19.5	–15.9
Exports	11.8	6.1	5.5	7.8	3.1	–6.4
Imports	18.0	20.4	10.5	14.3	12.9	–14.6

Source: Central Bank of Chile.

barrier to reach 10.7%, according to the National Institute of Statistics (INE in Spanish). Then this index recorded several decreases, closing the year with an annual average of 9.7% (Lara, 2011: 12).[4] In contrast, the decline in the employment rate has been particularly strong. In turn, lower employment rates reflect a limited female participation in the work force, despite the increasing female employment during the crisis. A further sign of the labour market's underlying weakness was an increase in self-employment. In fact, in 2009 this increased by 3.9%, reversing a negative trend predominant in previous years (Table 6.2).

Nevertheless, most of the adjustment of the labour market appears to have taken the form of job losses, rather than in real earnings. "The relatively smaller scope for adjustments on the earnings margin during the 2008–09 crisis may have increased the relative importance of adjustments on the employment margin compared with the past" (OECD, 2010a: 118). At any rate, this does not mean that there have been reductions in real wages throughout 2009, particularly in March, June and October. As a result, table 6.1 shows that domestic demand growth (mainly private consumption) has suffered substantially, declining by more than the OECD average.

Faced with rapidly deteriorating activity and increasing unemployment, "*Banco Central de Chile* reacted vigorously in the first half of 2009 by reducing the interest rate from 8.25% to 0.5% and finally taking non-conventional measures, such as reducing short term debt issuance and establishing a term liquidity facility" (OECD, 2010b: 10). The delay in action was due to an extreme concern with reducing inflation, which was bordering on double digits. Without abandoning its intention of maintaining low inflation, the central bank "facilitated the appreciation of the peso to levels clearly below its long term

Table 6.2 Trends in labor market outcomes in Chile (population age 15 and above, not seasonally adjusted)

	1995	*2000*	*2005*	*2007*	*2008*	*2009*
Employment rate	50.8	49.1	50.4	51.0	51.7	50.5
Unemployment rate	7.3	9.7	9.2	7.1	7.8	9.6
Participation rate	54.8	54.4	55.5	54.9	56.0	55.9

Source: OCDE.

trend, causing a disincentive for exports and the manufacturing sector which substitutes imports" (Sanfuentes, 2009: 3). Also, after the collapse of Lehman Brothers in the United States, the Chilean government adopted a series of credit-related measures seeking to provide incentive to banks and other financial institutions to restore the flow of loans.[5]

The government was quicker to implement successive fiscal packages that were applied in order to tackle the crisis:

> The packages were comprised of temporary measures in favor of public investment, a cash allowance for low-income households, tax reductions and a temporary increase in subsidies for training programs. In addition, some permanent measures were introduced, including an extension of unemployment benefits to workers with fixed-term contracts and a wage subsidy for young, low-wage workers. (OECD, 2010b: 10)

Excluding the recapitalization measures mentioned above, the package provided an overall stimulus of some 1.8% of GDP.

The application of those fiscal packages resulted in an unprecedented increase in government spending, achieving an accumulated increase of 20.6% between January and September of 2009. Its funding came from the surplus in foreign currency saved abroad during the past few years.[6] By the way, the effects on the economy of that initiative were not entirely immediate.[7]

The slump in activity and copper prices, along with the fiscal measures, saw the 2008 fiscal surplus of more than 5% of GDP move to a deficit of around 3½ per cent of GDP in 2009 (OECD, 2010a: 10). Notwithstanding the recent deterioration of the budget balance, Chile continues to enjoy the benefits of low debt and positive net financial assets. It can thus afford to keep some of the fiscal stimulus measures in place in 2010 to provide further support to domestic demand.

In short, neither the historical increase in fiscal spending, nor the drastic cuts in the monetary policy rate could prevent the economy from suffering a severe recession. Moreover, this situation makes it clear that not only are there serious difficulties in having active and flexible economic policies in the country, but also that the very theory of "external shocks" is unable to explain the magnitude, extent, and duration of the recessionary cycle that affects our economy. This is not to mention the nature of the present global crisis and its forecast. In what follows. we intend to examine these various aspects, starting

with the accumulation of international reserves, in an effort to contribute to the clarification of the issues raised.

6.3 From the Accumulation of Reserves to the Credit Explosion

According to a long tradition in economics literature, external or international shocks have had a strong influence on growth and business cycles in Latin America.[8] Hence, there is the concern regarding the sharp fluctuations of capital flows and the need to implement different policies in order to protect against sudden outflows and mitigate exchange rate adjustments. The one that best fulfills that purpose is the accumulation of international reserves, among others.

Since the early 2000s, several Latin American and Asian countries had steadily accumulated reserves, but in the case of Chile, this process followed a rather flat course until 2007. This situation did not seem to particularly worry the president of the Central Bank of Chile, José de Gregorio, who perhaps had doubts on how to use the reserves or thought there was a contradiction between maintaining high levels of international reserves and adopting a floating currency (Table 6.3).

With regard to the first point, after the financial meltdown of 2008, Gregorio recognized that "most economies did not use much of their reserves during the crisis." Additionally, based on a comparative analysis, he argued that, in the Asian crisis, "the change in reserves was not so different from that which occurred during the subprime crisis," and in "both crises, the average change was between 0 and half a point of GDP, a very low number." He concludes, "this seems to confirm the fact that reserves are accumulated but not widely used, indicating that reserves are a way to deter financial speculation, rather than being a safety net to use against liquidity problems" (De Gregorio, 2011a: 9).

Table 6.3 Net international reserves in Chile (millions of USD)

2004	*2005*	*2006*	*2007*	*2008*	*2009*	*2010*	*2011*	*2012*	*2013*	*2014*
16,016	16,963	19,429	16,910	23,162	25,373	27,864	41,979	41,650	41,094	40,447

Source: Central Bank of Chile.

In relation to the effectiveness of foreign exchange intervention, the author concedes that it "mitigates exchange rate adjustments," but notes that it "only has temporary effects." Resorting again to comparison, but now with regard to foreign exchange, he deduces, "there were significant depreciations in both crises, but during the Asian crisis these tended to persist longer" (De Gregorio, 2011a: 9).

If we accept this relativization proposed by Gregorio regarding the limited use of reserves and the transient effects of foreign exchange intervention, we are left only with the deterrent role of reserves. In other words, the theoretical problem is reduced to a mere quantitative issue of levels and costs: according to Gregorio, the large "debt" of "our profession" is to "determine the optimal or adequate level of international reserves" (De Gregorio, 2011b: 1).

Of course, the mainstream debates about this alleged debt do not go further than proposing a series of "not so robust" indicators and, alternatively, introducing a measure of the social costs of reserve accumulation (Rodrik, 2006). They are not concerned with the many implications that this strategy has had on various aspects of global finance.[9]

From this perspective, one of the neglected issues—and that is most relevant—is related to the fate of the reserves. It should be noted that since the early 2000s, the central banks of Asia and some Latin American countries have invested much of their reserves in US treasury bonds.[10] These purchases had a significant monetary impact when they helped push down long-term yields on those bonds, which in turn fostered an environment of low interest rates. Thus, the basis for the housing bubble and the ensuing global financial and economic crisis was established. In other words, there is a direct connection "between the prevailing boom conditions in the financial markets of the United States during the 2001–2007 period and the international reserves of developing countries," as well as between them and the "US housing bubble" in particular (Painceira, 2009: 16).

Similarly, it is important to highlight the fact that this accumulation of reserves corresponds to a specific period of global capital flows that differs from that which took place in the previous decade. The latter was characterized by abrupt reversals of cash flows, current account deficits, and a succession of financial and currency crises in the emerging economies. Now the issue is to attain reinsurance for the possibility of a sudden capital outflow and at the same time, actively and increasingly participate in global financial markets. For this reason, since the early 2000s. capital has tended to move from

developing countries to the financial centers of developed countries, contrary to the conventional theoretical claims of financial liberalization. During this period, the southern economies have gone on to become net exporters of capital.

Many analysts thought that the subprime crisis would put an end to this period, but that did not happen. It is true that global capital flows violently shrunk after the collapse of Lehman Brothers—affecting the economies of the South—but its subsequent recovery is surprising. Specifically, it occurs in less time than that observed in other post-crisis periods and at a faster pace, which even lead to breaking the historical record set in 2007. Concurrently, from then on, we can observe a dramatic increase in the international reserves of these countries.[11]

In the case of Chile, net capital flows follow a highly unstable trajectory for the years prior to the crisis and subsequently amount to extremely high levels. However, hidden behind these tendencies are even higher levels of activity and volatility in flows moving into and out of the country. In terms of its composition, inward FDI now takes on an increasingly marked predominance, increasing its distance from the investment portfolio. At the same time, the country's international reserves more than doubled from $16.91 billion dollars in 2007 to $41 billion dollars in 2013.

Finally, another issue worth mentioning is that the accumulation of reserves in Chile—like in many developing countries—is being accompanied by a rapid increase in domestic debt. This is mainly because the central bank has a strong commitment to monetary sterilization; in other words "the pesos that are issued to buy dollars are withdrawn by issuance of debt" (De Gregorio, 2011b: 79). In fact, since the beginning of floating exchange rates in our country in September 1999, there have been four episodes of intervention to address currency appreciation.[12]

The consolidation of bank lending in Chile is quite evident during the 2003–2007 growth cycle, averaging a 17% real increase, which quadrupled GDP growth in this five-year period and comfortably exceeded historical averages (almost double the GDP). Both bank and non-bank related household debt is largely responsible for this dramatic growth, especially consumer debt.[13]

But this impressive dynamism in the credit market suffered a sharp slowdown in late 2008 and 2009. Since the crisis erupted in the US financial markets, banks and other financial institutions with direct links to them—as was the case in Chile—suffered great disturbances.[14]

However, it can be said that Chilean banking suffered more from the lack of liquidity due to the repatriation of capital toward "headquarters," which foreign banks operating in the country carried out as the crisis deepened in advanced economies. Thus, the Great Recession revealed that foreign banks are also a source of vulnerability, and their risk was not greater, thanks to the timely intervention of the central bank.

In late 2009, amid tighter conditions, the local credit market began to revitalize with a lot of strength, resulting not only in an increase in the volume of loans issued, but also a widespread increase in its use. In other words, along with the growth of total household debt, an expansion occurred in average debt and in the number of households with some form of debt.[15] In turn, it should be noted that the increase in mortgage debt was particularly intense, with rates of around 8.0% per year (this is consistent with increases in housing prices), while the increase of consumer debt has been particularly extensive: that is, driven by a greater number of debtors.

In parallel, corporate debt has so far presented similar rates: banks being the main source of growth through commercial loans and external loans linked to FDI. On the one hand, the debt of non-financial companies was 94.1% of GDP in the first quarter of 2014, 16 percentage points above the value in 2010.[16]

On the other hand, and what is truly impressive in recent years is the explosion of debt associated with FDI, which reveals high double-digit annual rates and amounts to 12% of GDP in 2014, more than twice the 5% observed in 2011. Furthermore, it is important to note that the external debt of non-financial companies increased more than the internal debt, reaching over 30% of GDP.[17]

In any case, this lending boom is part of the profound changes that the Chilean financial market—as well as the rest of Latin America—has undergone over the past 25 years, an issue we will return to later.

6.4 Copper: Both a "Blessing" and a "Curse"

Both the capital flows coming out of Chile, as well as other emerging countries, and the accumulation of international reserves are largely a result of the significant trade surpluses experienced by these economies during the last decade. This is mainly due to the dramatic changes occurring in the international division of labor and ultimately, in the geography of global capital accumulation.

After the 1973 coup, the military dictatorship took ownership of the idea that future development in Chile should rest upon the export of goods deemed to have "comparative advantages," especially those linked to the exploitation of natural resources. However, it was only after the 1982–1983 crisis (and even more so after the "lateral" openness promoted by the Democratic coalition, starting in 1990) that economic policies were implemented that openly sought to encourage the development of export sectors.[18]

Since then, the country experienced an impressive increase in total exports, especially during growth cycles. Accordingly, the $68 billion dollars in exports recorded in 2007 exceeded by almost three times the amount in 2003. As a result, in terms of percentage of GDP, total exports increased their share from 29.3% to 41.2% during the same period, further increasing the country's level of trade openness and its dependence on world markets.

It is important to note that during this export boom, we observe an increase in the gap between export prices and quantities. While the latter reached 7% a year, export prices reached 22.1% per year. It follows that prices decisively contributed to the impressive growth of total exports recorded during these five years. The prices of mining exports, principally copper, are particularly influential in this case.[19]

Similarly, as a consequence of the high prices of exports, starting in 2003, the terms of trade began to grow steadily for five consecutive years, reaching just over 70%. This favorable scenario persisted until 2008, when due to the global crisis and the sudden decline in the price of copper at the end of that year and the next, the terms of trade fell sharply (Direcon, 2009).

The rapid recovery of copper prices triggered a new cycle of rising total export prices that became part of the last growth wave experienced by the economy as a whole between 2010 and 2013. However, unlike the previous cycle, the pace of growth in exports gradually lost momentum, therefore significantly reducing their impact on the GDP, and causing trade surplus to fall to very low levels.[20] Surprisingly, this downward trend in foreign shipments occurred when copper prices reached their all-time high: an average value of US $3.585 per pound between 2010 and 2013, according to data from Cochilco.

Interestingly, the reduction of the trade surplus in the current cycle neutralized dollar flow into the country through this channel, and thus the phenomenon known as "Dutch disease" occurred. Nevertheless, the strong appreciation of the Chilean peso, a symptom of this disease, has repeatedly manifested itself throughout this cycle, now due

to fundamentally financial and monetary reasons. That means that huge capital flows, especially foreign direct investment and growing currency speculation, push in that direction. Without a doubt, the policy of quantitative easing, driven by the Federal Reserve and the central banks of Europe and Japan, has contributed to this trend, especially while the interest rate differential that exists in Chile is very high compared to the low levels offered in developed economies.[21]

One of the mechanisms that has played a decisive role in the appreciation of the peso in recent years is called "carry trade," which are transactions carried out by foreign speculators in the region, particularly in Chile and Brazil, consisting of capitalizing on interest rate differentials in order to generate short-term profits.[22] From this it follows that maintaining high interest rates in pesos means attracting more carry trade and causing a rise in the peso for a long time, or the intervention by the Central Bank, through the buying of dollars, does not help, because it fails to reduce the interest rate differential, and if predictable components exist, this further intensifies the aforementioned mechanism.

Beyond the reasons behind it, the fact is that the appreciation of the peso for long periods of time has a harmful effect on exporters whose products do not benefit from higher prices. These are products from important sectors of the economy, such as agriculture, fruit, livestock, wine, forestry, commercial fishing, and industries that have mostly seen their exports and production levels drop. In reality, this monetary phenomenon helped to further solidify the primary nature (mainly copper) of the export structure in the country during the two most recent growth cycles of the economy, calling into question the publicized strategy of export diversification.[23]

By the way, these changes are expressed in the same way in the productive matrix of the Chilean economy, confirming the historical importance of mining—particularly copper—and the increasingly accelerating decline in manufacturing.[24] In fact, the negative trend of the latter continues in 2013 (falling to 10.9% of GDP), while mining maintains its contribution at a slightly lower level (14.1% of GDP), but yields first place to the business services sector, which currently accounts for almost 15% of GDP (table 6.4).[25]

Similarly, it is also necessary to consider that the appreciation of the peso and the weaker dollar not only have negative effects on large export sectors but also affect the import of goods and services. They have tripled the growth rate of imports in the last four years, and today have reached historic levels. Clearly, a greater imported supply—and

Table 6.4 Gross domestic product by main sectors in Chile (participation in %)

	2009	*2010*	*2011*	*2012*	*2013*	*2014*
Agriculture	3.6	3.5	3.7	3.6	3.2	3.3
Mining	14.2	17.4	16.2	15.2	12.3	12.3
Manufacturing	12.3	11.8	11.7	11.2	11.8	12.4
Services	70.0	67.4	68.4	70.0	72.7	72.0

Source: Central Bank of Chile.

at lower prices—makes it possible to maintain low inflation rates, a main priority of the Central Bank and the government's macroeconomic policy. But no one can ignore the fact that certain imported products can displace domestic production, whether in terms of inputs or final goods, thus undermining the country's productive capacity,[26] even more so if the growth rates of quantities imported have been persistently exceeding those of exports.

China has not only consolidated itself in the 2010–2013 period as the primary recipient of Chilean exports (mostly copper with 80% of the total), but also has become the second-largest supplier of our country's total imports.[27] However, it should be noted that behind that statistic lies the fact that the Chinese market provided 39% of the total imports of consumer goods that year, distantly followed by the United States (with 11% of the total) (Direcon, 2014). It is worth noting that the growth in trade with China is immediately responsible for the mutations occurring in the export structure and the production model of the Chilean economy: it reinforces the reprimarization of the export sector, strengthens the importance of mining, and now, contributes to the decline of the manufacturing industry, especially the one dedicated to the production of consumer goods.

Arguably, the symbol of this unbalanced trade is copper, whose price climbed to a record high in 2011, only to subsequently follow a marked downward trend. The last drop was in 2013 (7.8%), causing a reduction in copper exports and total exports. This has reopened the debate on the pricing of raw materials and copper in particular.

The conventional position that the emergence of the demand generated by China and other Asian nations would be the only causal factor in determining the price of raw materials has been losing ground in favor of theoretical proposals that suggest taking into account the development of the financial products market, which uses commodities for store-of-value, hedging and portfolio

diversification. This market would lead to real speculative bubbles that have rested upon rising commodity prices and their volatilities. An investigative work by Gilbert published by UNCTAD, identifies three clear bubbles in the copper market: in 2004, 2006 and 2008, respectively (Gilbert, 2010).

To these successive copper bubbles we must add 2011's, the year in which investors were seeking higher returns, especially in the commodities markets, following the flood of money injected by the Fed into the market and prevailing low interest rates in developed countries.[28]

While both the reduction in copper prices and the slowdown of copper exports are noticeable, the serious problems that this situation exposed in large-scale copper mining are also of concern. First of all, mining remains a very profitable business and continues to attract significant FDI inflows, but the evolution of profits in this sector is conditioned by the ups and downs of prices in international markets. This has been one of the main reasons why profits have risen since 2003 and have remained high since then, but recently minor drops have been observed. Second, and no less troubling, is the increasing loss of competitiveness suffered by the copper industry, due to an increase in labor and energy costs (Cochilco, 2013).

Additionally, open pit copper mines have been heavily exploited, and the industry is gradually shifting toward underground mining, which implies a higher cost. Finally, the scarcity of water resources remains a problem in areas where large mines operate, affecting domestic water consumption and the consumption for other productive uses (agriculture, etc.). This has awoken dissatisfaction in important sectors of the population who live around or in the very same mining areas.

6.5 An Uncertain and Stormy World on the Horizon

The financial crisis of 2008 was not a mere decrease of activity in the financial sectors of the advanced economies. It was, rather, a crisis of a capitalist globalization pattern that exploded in the United States, even though it is founded upon the growing expansion, complexity and deregulation of finances. It converges with a systematic crisis that had already been taking shape. Even when seen strictly in terms of its economic dimension, it presents several particularities. Suffice it to

say that "it has already been five or six years (2008) since Europe and the United States are immersed in a crisis that some believe to be the prelude of a prolonged period of quasi-stagnation or of a very slow global recovery" (Ibarra Muñoz, 2014).

This seemed to be confirmed by the data submitted in October by the IMF regarding the growth projections of the global economy, where downward adjustments are now the norm. The Eurozone and Japan have now entered a new recession; only the United States has seen a positive outlook and closed 2014 at a modest 2.2%. Meanwhile, projected growth rates for China are below what the world expects from the Asian giant. The latter is seen as the engine of the global economy, especially since, as of this year, it has become the world's largest economy, corrected for purchasing power parity.[29] Being its main trading partner, these projections truly worry economic policymakers in Chile. But the least promising news comes from Latin America, where Brazil—the main destination of Chilean investments—is predicted to not grow by more than 0.3% this year, and predictions for Argentina are that its economy will shrink by 1.7% (IMF, 2014).

As a net result of the low growth rates in advanced economies and the slowdown in the emerging ones, the volume of international trade has not been able to recreate the rhythm of growth experienced in the 1987–2008 period (7% annual growth), resigning itself to annual rates equivalent to less than half of that (3% between 2008 and 2013). It will be difficult for global trade to recover the dynamism of that first period, placing serious obstacles in the way of exporting strategies, like those applied for over three decades in our country.

In early 2014, the imminent withdrawal of the quantitative stimulus by the Federal Reserve was seen as the main threat to emerging economies. However, this summer the European Central Bank (ECB) announced the introduction of a series of monetary stimulus measures. They are aimed to address the deflation phenomenon that gradually ensnares the economies of Europe, and to open up a renewed interest in Latin American markets. It is estimated that the ECB plan could partly offset the withdrawal of the monetary stimulus in the United States and contribute to maintaining a cycle of high global liquidity, which could favor the Chilean economy, as it is deeply intertwined with global financing.

It should not be ignored that this mass of liquidity has led interest rates to the verge of 0%, so they can go no further. The destruction of value that could have been caused by a crisis like this has been avoided through early intervention by central banks around the world. But

the crisis that began in 2008 is still claiming the destruction of at least part of accumulated wealth in different varieties of financial, real estate, and business assets. Unless this changes, the slow recovery and high volatility of the global economy, the serious problems faced by the international financial and monetary systems, and the systemic nature of the crisis will persist.

In this extremely uncertain and stormy environment, it is difficult to estimate the projected growth rate of the Chilean economy.[30]. The truth is that since July 2013, our economy has been experiencing a sustained slowdown, although with a slight climb in February of this year. However, those reports cited reveal that it is in a stage of decline much more complicated than the one existing prior to the earlier crisis (table 6.5).

First, a sharp decline in the rate and amount of investment can be seen, along with the postponement of numerous projects.[31] One of the main factors behind this is the end of the investment cycle in mining, due to the decline in copper prices (and therefore lower expected profits), joining a structural phenomenon that begins to manifest itself in various branches of the economy: the overaccumulation of capital (table 6.6).[32]

Second, due to the decline in investments, the State is expected to handle 100% of public investments and facilitate new profitable capital investments in other areas, preferably in Latin America.[33] Consequently, investment decisions of large local companies (and some medium-sized ones) are increasingly becoming regional strategies.

Table 6.5 Chilean economy: Macroeconomic data (% annual variation)

						2014			
	2010	*2011*	*2012*	*2013*	*2014*	*Q1*	*Q2*	*Q3*	*Q4*
Real GDP	5.8	5.8	5.4	4.1	1.9	2.7	2.1	1.0	1.8
Domestic demand	13.6	9.3	6.9	3.4	–0.6	–0.1	–0.9	–1.5	0.0
Gross fixed capital formation	12.2	14.4	12.2	0.4	–6.1	–4.9	–7.8	–12.1	0.5
Exports	2.3	5.5	1.1	4.3	0.7	4.1	–0.4	–2.6	1.7
Imports	25.9	15.6	5.0	2.2	–7.0	–4.7	–9.4	–9.8	–3.9

Source: Central Bank of Chile.

Table 6.6 Saving—investment in Chile (% GDP, chilean current pesos)

					2014		
	2010	*2011*	*2012*	*2013*	*Q1*	*Q2*	*Q3*
Gross Capital Formation	21.1	22.3	24	23.6	21.6	22.3	22.2
National saving	24	22.5	21.7	20.5	23.5	20.7	18.3
Gross Fixed Capital Formation	21.1	22.3	24	23.6	21.5	22	

Source: Central Bank of Chile.

Third, despite improved terms of trade and the high prices of copper and other raw materials, the export sector lost significant momentum in the 2010–2013 period, thus reducing its contribution to GDP. Instead, domestic demand assumed a leading role in pushing the economy; however, this demand also weakened over the course of this year.[34]

Fourth, while this time there isn't an abrupt interruption in banking and other financing channels, certain limits on borrowing capacity start to emerge in the first quarter of 2014. In fact, it reached its highest level in mid-2014, both for companies (97% of GDP, the highest since 2005) and households (reaching 58.7% of disposable income, the highest since late 2008).[35]

Fifth, the dynamics of corporate borrowing highlight the impressive growth of the debt associated with FDI, contributing decisively to the increase of private external debt, which totaled US $133 billion by April 2014 (87% of total external debt). Opportunities for capturing external borrowing also proliferate through bonds issued on extremely attractive terms.[36]

Finally, as a counterpart to what happened with debt, it is noteworthy to highlight that household savings continued to shrink, until they represented 9.2% of disposable income in the second quarter of 2014, while the gross saving rate of the country suffered a new drop in the first few months, reaching 20% of GDP, the lowest since 1996, although it did recover slightly in the second quarter. Only the "forced savings" of wage-earning employees who capitalize private pension funds increased.

In short, all this points to a growing weakening of the two driving forces that have been behind the recent fluctuations (expansions and contractions) in the pattern of accumulation: credit growth alongside export growth.

In this cyclical development, loans and consumption came to occupy a privileged place at the table, instead of savings and investments. On the one hand, this allowed household spending to grow faster than wage income. Thus, household debt became an important source of extra effective demand. On the other hand, the growing gap between gross savings and aggregate investments was made up for by commercial loans and placement of securities, but mainly by retained earnings. These contradictions, which were amplified at the end of the respective growth cycles, especially in the more recent one, appear in the form of an imbalance between production and domestic demand (the former lags behind the latter), which tried to supplement by imports—an unsustainable situation since mid-2013.

However, the strong development of the global and local credit systems is not the only condition for the accumulation of capital; the reproduction of the labor force is also a major factor. The tendency to overaccumulate in recent years meant an increased absorption of labor, expressed by attempting to obtain the much talked about full employment and very low unemployment rates.[37] This growing demand for labor will put pressure on the increase of nominal and real wages, resulting in a contradictory effect on private consumption and financial circulation (favoring it) and on corporate profits (decreasing them) due to higher production costs. The latter tends to curb domestic production, but at the same time, it becomes a stimulus for the extension of capital toward more profitable regional markets.[38]

It should be noted that wage increases in the ascendant cycle of 2010–2013 significantly exceeded labor productivity rates, reversing a characteristic trend in this pattern of accumulation.[39] In copper mining, this phenomenon manifests itself most clearly. Thus, labor productivity has been unable to counter the effects of the accumulation of capital (high demand for employment and higher wages).

In summary, Chile's economy is going through a deeply contradictory slowdown, in the midst of a serious political and social questioning that is denting the legitimacy of the economic model.[40] The strategy of de-politicization (with the discourse of political neutrality and the imposition of autonomous public institutions) that has prevailed in the last four decades is especially the target of criticism and questioning. "Just like during the governments of Frei, Lagos and

Bachelet, in the Piñera government, the tension between politicians and technocrats have become evident" (Silva, 2012: 250), with the added factor that today, social demands have erupted in the midst of these tensions.

Notes

1. Thus, shipments abroad showed a 2% decrease in 2008 compared to the previous year, worsening over the first six months of 2009 (38% decrease), taking a radical turn from the expansion exhibited in the five-year period from 2003 to 2007. Meanwhile, import value also suffered a sharp drop, reaching an average of –35% in the first six months of 2009 compared to the same period in 2008, which is consistent with the adjustment in domestic consumption.
2. Terms of trade dropped 13% in 2008, and then 25%, in the first quarter of 2009.
3. In fact, when the crisis exploded in September 2008, investment in machinery and equipment showed a record 49.5% increase in twelve months. It continued with some inertia and showed an increase of 10.4% in the fourth quarter of 2008, but by the first quarter of 2009 the change was clear, showing a decline of 9.3% in twelve months.
4. The government's plan also contributed to the lowering of the unemployment rate, by creating an average of nearly 190,000 jobs during the last quarter of 2009 (Lara, 2012:13).
5. This includes CORFO credit lines (for investment, factoring, working capital, guarantee funds, export financing, debt rescheduling, amongst others), a capital contribution to *Banco Estado*, and a boost to FOGAPE. There were additional resources given to SERCOTEC, tax incentives and the recent approval by Parliament of the project that facilitates financial transactions (Sanfuentes, 2009: 4).
6. The central government had been accumulating assets due to higher copper prices. This is how roughly 18.1 billion dollars were paid to the Social and Economic Stabilization Fund (FEES in Spanish) between 2007 and 2008. During the course of 2009, withdrawals began taking place and reached a total of 6.936 billion dollars in September.
7. A significant part would finance the additional investments being made by CODELCO; in other cases they relate to investments in public works and housing; it also includes initiatives that are still being developed, while others were fast and efficient in their execution. What stands out is that the aforementioned 'packages' have remained within fiscal discipline, without violating, as far as one knows, the structural balance rule" (Sanfuentes, 2009: 4 and 5).
8. The most influential works in this respect are perhaps those of Diaz Alejandro in the eighties and Calvo and his colleagues in the last decades. Also neostructuralist writers who passed through ECLAC contributed to this tradition, as is the case of José Antonio Ocampo and Ricardo Ffrench-Davis.

9. There are mainly three proposed indicators: the ratio of reserves and imports, the ratio of reserves and short-term external debt, and the broadest of the three, the ratio of reserves and money supply (M2 usually). Alternatively, Rodrik proposes that the social cost of reserves needs to be measured, which would be calculated from the difference between the interest on short-term external debt (given that countries have reserves equivalent to at least short-term debt) and yield on international reserves (because these are invested in foreign assets).
10. Between March 2000 and June 2007, the share of 'foreign' central banks in such bonds increased from $0.5 trillion dollars to $1.5 trillion dollars (representing about 40% of the total).
11. Note that the most serious current estimates (2014) allocate $4 trillion dollars in currency reserves to China, $1.3 trillion to Japan, $2.2 billion to other Asian countries and $4.4 trillion to the rest of the world; in total, the currency wars have raised central bank reserves to $12 trillion. Apparently, central bankers are not very concerned with determining the optimal level of international reserves.
12. These occurred in late 2001 and 2002, then in 2008 (when the peso reached the lowest levels of the decade in the middle of the crisis), and finally in January 2011, when reserves as a percentage of GDP had also declined. In the 2008 intervention, while all reserve rates were falling, the Chilean currency's volatility had increased by 100% over the average of the 1998–2007 period.
13. According to Central Bank data, consumer debt increased its share in the composition of household debt between 2003 and 2007, from 40.1% to 43.4%; in contrast to mortgage debt which took on a lesser share.
14. After the almost instantaneous spread of the subprime crisis into the Chilean stock exchange, pension funds (AFPs) and Chilean banks shortly followed because of their close relationship with Wall Street. The problems were exacerbated when the crisis hit Wachovia, a US Bank that was one of the main partners of local banks and one of the largest providers of US dollar credit lines.
15. The Financial Survey of Households conducted by the Central Bank in 2011/2012 reports that 68% of households have some sort of debt, reflecting a 3.2% increase from the last comparable survey in 2007. It also indicates that the amount of household debt averaged 74.6% of annual income. This reflects a 6.7% increase compared to 2007.
16. From an international perspective, this debt "is greater than in other Latin American countries and greater than that of a group of countries with similar levels of GDP per capita" (*Banco Central*, 2014).
17. In turn, considering the totality of non-financial companies, the percentage of foreign-currency debt – both local and external—reaches almost 50% of total debt excluding the service sector, resulting in greater exposure to currency risk.
18. For the economic leaders of the dictatorship this meant ending the policy of import substitution industrialization that the country had known since the crisis of the 30s onward. While this was fulfilled in the first stage, the same

did not happen with the installation of an exports engine. This only occurs with the macroeconomic program of 1983–1984, which is a consequence of the commitment by the Chilean government to the IMF and international banking. Later, the successive governments of the Democratic coalition, who promoted "lateral" opening since 1990, reinforced this strategy. This policy meant that our country would assume a greater commitment to the negotiations of the World Trade Organization (WTO) and sign numerous economic agreements, placing Chile among the countries with the most trade agreements in the world.

19. The prices of mining shipments rose 363.1% in this period (copper, molybdenum and iron ore), while copper prices climbed from US $0.81 per pound in 2003 to US $3.22 in 2007, on average.
20. While in the previous cycle, exports tripled, now they are barely growing at 3.1% annually. As a result their percentage of GDP declined from 34.8% in 2010 to 27.6% in 2013. Meanwhile, Chile's trade surplus was $15.1 billion dollars in 2010, only to fall drastically to $3.4 billion dollars in 2012 and to a mere $2.37 billion dollars in 2013 (Direcon, 2014).
21. Within South America, Chile's case is one of the most significant. Total gross capital flows have tripled during the 2010–2012 three year period, during while the current account went from a surplus to a deficit. Additionally, the flow of foreign direct investment into Chile in 2012 was twice that of 2010.
22. Using the Chile/USA carry-to-risk ratio and the position of derivative operations by non-resident agents, a study by the Central Bank observed evidence of carry trade operations favoring the Chilean peso in July 2010 and July 2012, which may have influenced the appreciation of the peso in those months (p. 9 above).
23. Accordingly, in 2007 mining accounted for 64.8% of total foreign sales, while five years before it accounted for 42.8%. In contrast, the industrial sector represented almost half of the shipments early in the year 2000, whereas in 2007 it accounted for less than a third of shipments. By 2013, the picture does not change much for industrial exports, but mining goes down to 57.3%.
24. In 2008 mining was the most important productive activity. According to the Central Bank, it contributed to 15.3% of our domestic product, of which 91.2% was associated with copper. This was followed by business services (including leases and other services provided to businesses) and manufacturing, with contributions to GDP of 13.3% and 12.2%, respectively.
25. There has also been a significant increase in consumption-related activities, such as trade, construction and development and hotel/restaurant services (El Mercurio, 12/21/2013).
26. It should be noted that in this respect the import ratio (imports / (GDP + imports) has shown a steady increase since 2003, rising from 24.5% to 30.6% (third quarter of 2007), only to later gradually descend to 26.9% in 2013. This means that slightly more than a quarter of the existing supply in the country is imported.

27. During 2013, trade with China totaled US $34.9 billion, meaning 21% of Chile's foreign trade in 2012, and 22% in 2013. However, it is now imports that show greater dynamism (Direcon, 2014).
28. Speculators had allocated US $320 billion to commodities until 2010, a record according to Barclays Capital (Wall Street Journal, 11/10/2010).
29. Projections for China are 7.4% this year and 7.1% next year. According to the IMF's April report, it was expected that in 2019 this country would exceed the purchasing power parity of the US.
30. Proof of this is that the very IMF, in its report cited above, cut its forecast for 2014 from 3.6% to a meager 2%. For its part, the Monetary Policy Report (MPR) submitted in September by the Central Bank of Chile also reduced its estimate of domestic product from between 2.5% and 3.5% in June to 1.75% and 2 25% at the present time in October 2014.
31. As of June 2014 there have been four consecutive quarters of decline in investment, which is reflected in the lower weight recorded by gross fixed capital formation (GFCF) in total GDP, 23.8% in the second quarter (April–June), its lowest level in four years. Also, according to estimates by the Capital Goods Corporation, over 30% of the investment projects scheduled for completion this year are postponed (Diario Financiero, 07/23/2014).
32. The official portfolio of mining projects in Chile through to the year 2021 stands at US $112.5 billion. But the Mining Council has estimated that the actual project portfolio only adds up to US $30 billion.
33. During 2013, direct investment abroad led by local and foreign business groups (operating in Chile) reached the record sum of nearly US $19 billion, exceeding by far the figure from the previous year and 49% of this amount was destined for Brazil; the industrial sector being the one that receives the largest share.
34. Domestic demand suffered a sharp decline in the first half of 2014 due to the fall in investment spending and private consumption. The latter recorded a rise of 7.2% annually in the second quarter, the lowest annual growth rate since the second quarter of 2009.
35. Besides, the debt of IPSA firms is the highest in Latin America and of the last five years in Chile, having a debt / EBITDA ratio of 3.3 in March.
36. Mining companies are the most active in obtaining financing abroad, as their presence in the local stock market is almost nil.
37. The number of employed workers increased from 7,354,000 in 2010 to 7,904,000 workers in 2013, an upward trend that lasted until February 2014. Meanwhile, the annual unemployment rate declined from 8.3% to 6.0% in the same period (and was 5.7% in the last quarter of 2013, reaching a 15-year low).
38. Nominal wages grew by 23% in the last four years, and real wages grew by 12.4%.
39. The Res Publica group says that average labor productivity grew 0.1% between 2010 and 2012, but the Finance Ministry maintains that it grew by 1%. Although the latter figure is ten times the former, it is still low considering that Chile is ranked as the third OECD country where more hours are worked per year (2029 hours per worker) (El Mercurio, 07/29/2014).

40. As admitted by economist Claudio Sapelli of the Catholic University, home of the 'Chicago boys': "This is quite an incomprehensible situation. Even though Chile is the most successful country in Latin America, everybody is questioning everything that has been done and is thinking of going back to do things that have failed in the past. It is quite confusing, really" (La Tercera, 10/27/2013).

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7

The Impact of the Global Post-2007 Economic Crisis and Subsequent Lethargic Performance on Cuba's Economy

Al Campbell

7.1 Introduction

The intent of this chapter is to consider the impact of the post-2007 global economic crisis and the world economy's subsequent lethargic performance (the global economic crisis)[1] on Cuba's economy. Before indicating exactly which parts of that book-sized task will be specifically discussed in the restricted space available, it is necessary to highlight two considerations without which nothing about any aspect of Cuba's current economic performance can be properly understood: its central economic (and social-political) goal, and its current engagement in a medium-term deep transformation of its economic institutions and practices.

The impact of any external factor (in this case, the global economic crisis) on any given society is not only the result of the nature of that factor itself. Rather, the impact is the result of the interaction of the external factor with the internal conduct of that society, and in particular, the society's reactions to the external factor. It is precisely in regard to two aspects of its internal conduct during the crisis that Cuba differs markedly from most, and in one aspect, essentially all, other countries.

The first essential consideration for understanding Cuba's conduct during, and in response to, the global economic crisis is its

overarching goal for all its social policies: the construction of socialism. Notwithstanding that over the last two decades a broad debate has opened in Cuba over exactly what their desired socialism should look like,[2] this commitment generates restrictions on what sorts of policies Cuba is willing to consider for confronting the crisis. Three recent examples illustrate how this central commitment affects the economic policies adopted. When, at the beginning of the 1990s, Cuba entered its deepest economic crisis by far since the beginning of the Revolution in 1959, its output shrank by more than 35% in three years. The standard capitalist response to such a downturn, of course, would be massive layoffs (as in the similar-sized contraction in the Great Depression in the United States), thus effecting the standard capitalist procedure of transferring as much of any economic difficulties as possible onto the workers. Cuba, on the contrary, for years maintained the employment of a large majority of the workers that the crisis had made under- or entirely unproductive, and who could not find alternative employment, at full or near-full pay. Though seldom noted, there exists a meaningful rough estimate of the quantitative extent of this anti-capitalist policy. The Economic Commission for Latin America and the Caribbean estimated that of the roughly 3.5 million workers in the state sector in 1998, about 700,000—or 20%—were surplus[3] (CEPAL, 2000: 253). A second example is that in the face of that same crisis, with its draconian drop in government revenue, Cuba rejected the standard capitalist austerity policies of cutting government spending on fundamental social services To the contrary, the state maintained its defense of social equity on the basis of universality and free basic social services, in the first place in health care and education, and actually marginally increased spending on them. A final example consists of Cuba's shock-project between 2002 and 2004 to improve the productivity in its sugar industry by closing the least productive half of its mills. 100,000 workers were laid off, but contrary to the capitalist approach of leaving these people to their individual ability and luck to find work, regardless of their skills and the condition of the labor market, the Cuban government ensured that every one of them found new employment, supporting them, if necessary, with a year or more of vocational retraining (Pollitt, 2004).

Everyone from Fidel[4] to champions of a restoration of capitalism in Cuba[5] agree that many "capitalist-like" or actual capitalist measures were adopted in Cuba over the 1990s and 2000s. From the first such measures in the early 1990s to today, the government has consistently and frequently declared that despite the potential capitalist nature of

these measures, (1) Cuba remains committed to the construction of socialism, just as before, and (2) the operation of these mechanism will be, unlike with their operation in capitalist systems, regulated and restricted in such a way and to such an extent that they will be prevented from imposing the logic of capitalism on the functioning of the economy. The government argues that because of this, the potential of these measures to promote the restoration of capitalism, a danger it explicitly recognizes, will not be realized.

A particularly clear and forceful recent re-expression of this position[6] was made by the current president of Cuba and first secretary of its influential Communist Party, Raúl Castro. Referring to both his election as president in 2008 and to a popular referendum from 2002, he said,

> They did not elect me president to restore capitalism in Cuba nor to surrender the Revolution. I was elected to defend, maintain, and continue perfecting socialism, not destroy it.…In the year 2002…8,198,237 citizens, almost the entire voting age population, signed a request to this Assembly to promote the constitutional reform that ratified the Constitution of the Republic in all its parts, and declared irrevocable the socialist nature and the political and social system contained within our fundamental law. (Castro, 2009)

It is universally accepted by both advocates and opponents of socialism in Cuba that the present process of economic and social transformation is strongly influenced by (though far from determined by) the ideas of Raúl, so it is appropriate to take such statements by him as important indicators of government policy. However, a more socially direct, and by the nature of the way it was arrived at, socially broader,[7] presentation of the same position can also be seen in the recently adopted "lineamientos" (guidelines). As indicated by their name, these are intended as guidelines for the unfolding economic and social transformation. Here the same central commitment to the construction socialism is forcefully indicated by opening the entire set of guidelines with the phrase "the system of socialist planning will continue being the main way to direct the national economy" (PCC, 2011: 4).

The second consideration that is essential for understanding the impact of the post-2007 global economic crisis on Cuba's economy is that the country was already engaged in a thoroughgoing process of economic transformation for over 15 years when the crisis broke out.[8]

This will turn out to be very important for economically understanding the empirical results of this investigation. A first empirical result is that the Cuban economy has slowed significantly in the post-2007 period. Given the well-known degree of openness of the Cuban economy, the first expectation would be a causal relation from the world's slowdown to Cuba's. A careful consideration of the main channels by which the world's slowdown would slow Cuba's growth, however, indicates that this is not the case, as will be shown in this chapter. This implies some major internal reasons must have been acting to generate the observed slowdown. Recognition of the sweeping nature of the economic reordering going on in Cuba is necessary in order to understand why its economic growth has significantly slowed at the same time as the world slowdown, without the latter being its cause.

Within a framework in which these two considerations are kept in mind, this chapter will consider the impact of the post-2007 global economic crisis on Cuba's economy. It will first look at three macroeconomic indicators, starting with the standard growth of GDP. Next, while the ability to generate sufficient foreign exchange, which is essential for domestic production as well as consumption, is a constraint on the development of many underdeveloped countries, Cuba's foreign exchange constraint to its post-1990 entire economy is well known to be particularly important and severe.[9] Hence, a second macroeconomic indicator considered will be Cuba's balance of trade. Finally, foreign direct investment (FDI) has the potential to dramatically increase a country's rate of growth and development, if it is constrained to actually benefit the host country, even as it makes profits for the home country and not simply plunder the former, as often is the case. Cuba is currently engaged in major legal and institutional changes to attempt to sharply increase the amount of FDI it attracts. While data on this is necessarily restricted because of the unremitting efforts by the US government to disrupt all Cuba's international economic relations, this third important macroeconomic indicator will be considered to the extent possible.

Following this, the chapter will consider the impact of the post-2007 global economic crisis on (only for reasons of space) two particular sectors of the Cuban economy. Notwithstanding that, this author always stresses that the key to Cuba's future lies with its improvement of its domestic economy; given the topic of this book and this chapter, the sectors considered will be two that are centrally important to Cuba's international economic performance. In particular, and in line with the comments above, they are centrally important to its

generation of foreign exchange, and thus are key channels by which the global crisis could affect Cuba's economy. Nickel production and tourism will be considered.

7.2 Macroeconomic Indications of the Impact of the Global Economic Crisis on Cuba's Economy

The most commonly used (and overused) empirical indicator of an economy's performance is the growth of its GDP. In line with the topic of this chapter, most of the data given will only go back to shortly before the onset of the crisis to look for crisis-induced changes. For the GDP, the data given will go back to the beginning of Cuba's "Special Period" in 1990, when its previous economic model, which was thoroughly integrated into the Soviet led Council for Mutual Economic Assistance, crumbled, and a fundamentally new economic model (with both fundamental continuities and fundamental changes) had to be built. This will allow us to avoid the error of considering Cuba's post-2007 performance only in comparison to its immediately previous performance during the mid-2000s, years that were known for being exceptional growth years (notwithstanding bubble-based) for both the world economy[10] and the Third World economies in particular. Rather, we can also compare Cuba's recent performance to its performance over the entire time period that it has been engaged in building its new economic model. See figure 7.1.

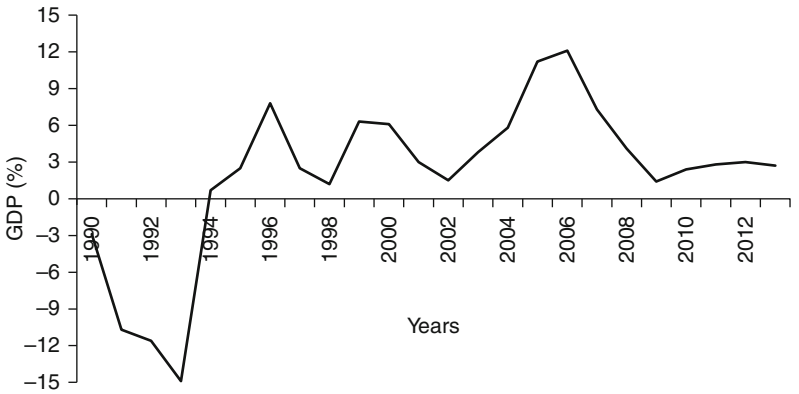

Figure 7.1 Cuba's GDP growth.
Sources: ONEI (2014), ONE (2009, 2003, 1999, 1998).

From the first full year of its recovery in 1995 to 2003, the rate of growth under the newly developing model averaged just under 4%. Over the four boom years immediately preceding the crisis, from 2004 to 2007, growth averaged just over 9%. Hence, while the post-2009 average of just under 3% is not as cataclysmic a deterioration as a comparison to only the years immediately preceding the crisis would imply, Cuba's performance during the post-2009 world-recovery years has to be seen as weak even by comparison with the first 9 years of the newly forming model that preceded the boom years.

Given Cuba's very open economy and its weak performance since 2011, a reasonable first hypothesis would be that the sluggish performance of the world economy since 2011 has been centrally responsible for Cuba's recent weak performance. A careful consideration of the main channels through which such an effect from the world economy would influence the Cuban economy, however, will suggest that, contrary to such expectations, the current world slowdown is having only a minimal effect on Cuba's economy.

In line with Cuba's strong dependence on imported goods, not only for consumption but for its overall economic performance as indicated in the introduction, the next indicator to look at to consider the effects of the post-2007 world economic crisis and subsequent anemic recovery would be its imports. See figure 7.2.

Figure 7.2 Cuba's imports and exports of goods.
Sources: ONEI (2014), ONE (2011).

Comparing figure 7.2 to figure 7.1 gives a first indication that the crisis and subsequent slowdown of the world economy, while not irrelevant, were not central to Cuba's slowed post-2007 economic growth. While the crisis began to unfold in the advance economies in 2008,[11] Cuba in fact was able to achieve a sharp increase in its imports. But contrary to what its economic dependence on imports would suggest, its GDP growth nevertheless continued the slowing that had begun in 2007. From its record 12.1% growth in 2006, it dropped to 7.3% in 2007, and then to 4.1% in 2008.[12] The slowing at that point, however, could be considered essentially only a return to its average growth rate of around 4% from 1995 to 2003 indicated above.

Cuba's imports dropped sharply in the global recession year of 2009 from the previous year. Given that the previous year was an emergency-induced outlier, as just explained in footnote 12, a better measure of the effects of the world-contraction on Cuba's imports would come from comparing 2009 to the years immediately before 2008. 2009 was about 12% below 2007, 6% below 2006, and 17% above 2005. The world-contraction did indeed negatively impact Cuba's imports (this conclusion will be reinforced momentarily by consideration of exports), but much less than its drop of 37% over the previous year would suggest. Cuba's rate of growth continued its fall, down to 1.4% in 2009.

The world economy rebounded from its –2.1% contraction in 2008 to 4.1% growth in 2010,[13] a rate comparable to its strong performance years of the mid-2000s. While not up to the outlier year of 2008, Cuban imports returned to just above the level of 2007, and above the boom years immediately preceding that. As expected, this was reflected in Cuban growth that year, which increased by more than 70% over 2009 to 2.4%. But it was an increase on a low base number: the return in 2010 to import levels of the mid-2000s left the rate of growth of the Cuban economy far below its immediate pre-2007 growth.

After 2010, the link between Cuban imports and its rate of growth became markedly still weaker. Figure 7.2 shows imports jumping in 2011 to the level of the 2008 outlier for imports, and then staying there, and even slightly increasing. Growth did increase, but only marginally, despite the significant import increases, reaching 2.8% and 3.0% in 2011 and 2012, respectively. In 2013, imports increased another 7% to set a new record (for the recent period), but the rate of growth of the economy actually fell back to 2.7%.

The limit on imports in an economic slowdown typically comes from the drop in what a country can export, and hence the money available for importing.[14] Figure 7.2 shows that the lethargic world growth rates of 2.8, 2.4, and 2.2 % from 2011 to 2013 did not slow Cuba's export growth at all in 2011, and after that caused only a marginal reduction. We have already seen that the link of Cuba's imports to its rate of growth, while it did exist, was increasingly weak in the post-2009 world economic recovery. Here we see a second aspect to the weakness of the effect of the current world slowdown on Cuba's economic growth. Its exports of goods, one contribution to its ability to import, was only weakly affected by the sluggish world economy.

Since early in the 1990s, Cuba has been primarily covering the deficit in its trade of goods shown in figure 7.2 with a surplus in its trade in services. Figure 7.3 shows the immediate pre- and post-2007 behavior of these balances.

The limited effect of the post-2007 world economic crisis on Cuba's net export of services is apparent in figure 7.3. Over the nine years graphed from before the crisis to 2013, Cuba almost doubled its net exports of services. While the data shows a clear impact of the world-contraction year of 2009, overall the gains were quite consistent over time. The post-crisis gains in fact occurred at a slightly faster rate

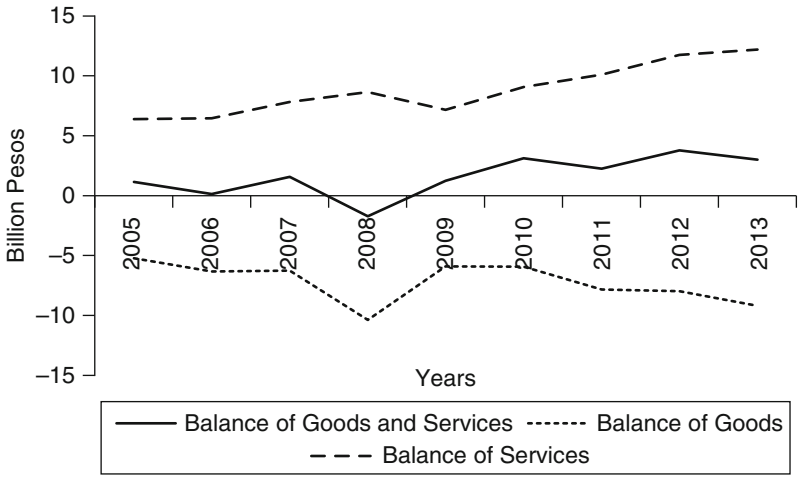

Figure 7.3 Cuba's balances of goods and services.
Sources: ONEI (2014), ONE (2011).

than the pre-crisis gains, though of course a part of that more rapid expansion was simply the recovery from the brief contraction.

Through 2010 then, the growing net export of services allowed Cuba to maintain a net import of about six billion pesos of goods (excepting the jump in the hurricane year of 2008, indicated above). In the last three years, that has climbed to about eight billion pesos in 2011 and 2012, and nine billion pesos in 2013, all while maintaining a positive overall net goods and services trade balance. Current discussions among Cuban academics and in its press suggest that the surplus in the trade of services and the excess in goods imports over goods exports (figure 7.3) might both fall some this year, and possibly also the important level of imports of goods themselves (figure 7.2). The overall pattern of a surplus from trade in services financing a major excess of imports of goods over what Cuba's export of goods would support, however, seems certain to continue to be an important characteristic of the Cuban economy over the near-term future.

Prior to 1990, Cuba's primary sources of foreign support for its growth, development, and capital accumulation were loans on favorable financial terms and development aid from the Soviet Union. In particular, this meant Cuban ownership of what was developed. Following the sudden implosion of the USSR, FDI into Cuba took off from almost nothing, with its initial form shaped by the very specific economic conditions that existed then in Cuba. Subsequent economic changes, both internal and external, then continually reshaped both the conceptualization of FDI's role, and Cuba's policies toward it. The discussion concerning FDI has continued right up to when this chapter is being written in late 2014, debating both the issue of how to treat it, and what role is seen for it in the new Cuban economic model, which is being developed today.

Cuba actually passed its first legislation enabling FDI into Cuba in 1982,[15] though prior to the crisis of the early 1990s, this yielded extremely minimal results. It was important, however, in that it established elements of the frame for considering and allowing FDI that have continued up to today, with parts of that frame currently under social debate. Broadly, the criterion for allowing particular FDI into Cuba was that it would help Cuba's long-term growth and development (and not just provide immediate jobs and perhaps foreign currency earnings). More specifically, the four things Cuba generally considered most important for a an FDI project to be useful was that it would provide improved technology, productive capital, and markets for exports, and/or produce import substitutes. FDI was specifically

considered to be something that (only) complemented or supported the essential task for national economic development: the development of the domestic economy. The neoliberal "export promotion" view that tended to see FDI as key for a Third World country's overall economic growth and development, or at a minimum "the motor," was consciously rejected. The conceptual requirements that were developed for considering FDI were not some peripheral exercise, but rather were carefully applied in considering every FDI proposal.[16]

During the implosion of Cuba's economy from 1990 to 1993, economic survival was the key consideration for all its economic policies. While in theory FDI was then still regulated by Decree Law 50 and its concepts, in practice almost any capital inflow that would do much of anything to activate the large stocks of idle physical capital and labor (and was not clearly contrary to Cuba's continuing goal of building socialism) was accepted.

With the economic situation of prolonged recovery that began in earnest in 1995, Cuba made two adjustments to its FDI policies and practices from the first half of the 1990s. First, in September 1995, it replaced Decree Law 50 with a new FDI law, Law 77, and later the accompanying Resolution 5290 of the Executive Committee of the Council of Ministers in 2004. The procedure for FDI was improved, and in particular, the bureaucratic barriers to FDI were reduced, though most international capital still found Cuba's procedures inefficient and slow by international standards. For our concerns, the most important aspect of the new law was that it continued the two central aspects of the previous law: FDI was to be allowed in Cuba only if it fulfilled some clearly specified functions that would promote Cuba's economic growth and development, and every proposal for FDI would be extensively vetted by both economic and political bodies to be sure that it in fact did so. The other major adjustment was more of a change. Now that Cuba no longer so desperately needed any capital inflows it could get, it began to review all existing and newly proposed FDI more rigorously in accord with what the law said it should do. The result of this was that the number of new FDI proposals that were not accepted, and the number of existing FDI projects that were not renewed when their initial contract expired, increased significantly over the second half of the 1990s,[17] as will be mentioned again in the quantitative discussion of FDI.

Given the extraordinary permanent efforts by the US government to disrupt any FDI into Cuba that it can possibly influence, Cuba has never released even standard aggregate FDI figures in its national

accounts, not to speak of more disaggregated statistics. In many cases, such statistics could be easily used by the US government to determine who in the world was investing how much into what areas. Even the periodic indications in the press of the amount involved in some large investment agreements (ones that the Cuban feel are relatively safe from US disruption) are largely useless for economic analysis, as they indicate the total projected value of the investments and not the amount actually dispersed in each year. In the absence of this standard data, three quantities have been typically used to give an indication of the amount of FDI into Cuba: the number of international economic associations[18] (IEA), their total sales, and their contribution to Cuba's exports.

From their negligible base in 1990, IEAs exploded to approximately 200 in 1995 and 400 in 2000.[19] Two interacting changes took effect at that point causing the number to fall throughout most of the following decade to about 200 again in 2008. First, as just indicated above, from 1995 onward, Cuba began to review all applications for new or renewed FDI more rigorously, in accord with the existing law, than it had done over the first half of the 1990s. This increased the number of rejected FDI proposals, though the overall number continued to grow rapidly until 2000 because of the continually increasing number of proposals. Second, from the beginning of the 2000s on, Cuba shifted to favoring large FDI projects, which became available then, above all from Venezuela and a bit later from China,[20] over the multitude of small ones.

Data on the post-2010 sales and exports by FDI enterprises in Cuba is unfortunately not readily available, so we cannot consider the effect through those channels of the anemic world recovery on Cuba's weak economic performance in those years. Data on these is available for the beginning of the crisis up to the world-contraction year of 2009. As measured by sales of FDI enterprises, the effect of the crisis years was minimal. Sales from FDI enterprises went up from about 4 billion in 2007 to well over 5 billion in 2008 and only dropped back to about 5 billion in the world-contraction year of 2009. The effect on exports by FDI enterprises of the single world-contraction year of 2009 was stronger. Their exports that year dropped roughly 700 million pesos from about 2 billion in 2007 and 2008 (Quiñones 2013: 95; Pérez 2012: 219). While this is an important contraction, it is broadly consistent with Cuba's overall drop in exports, only indicating FDI enterprise exports were at that time a bit more than twice as sensitive to such a world downturn as Cuba's total exports. With total goods and

service exports of about 12.5 billion pesos in 2008, about six times the exports from FDI enterprises, these dropped by about 1.7 billion pesos in 2009, only about two and a half times the FDI enterprise exports contraction. With our interest in these as an indicator of the amount of FDI, and in the absence of detailed post-2009 data, but knowing of increased Chinese FDI and the major FDI project of the port of Mariel in that period, we can reasonably hypothesize that the world economic crisis to date has caused no major decrease in FDI inflows that would be another channel by which it could make important contributions to the current weak performance of the Cuban economy.

I will end this section with a comment on Investment Law 118, adopted March 29, 2014. It has some new aspects, though of course it is far too soon to know how these new aspects will be put into practice, or what their effect will be. The new law maintains the important anti-neoliberal approach of only accepting FDI proposals if they are deemed beneficial to Cuba's development goals. In this regard, it maintains the old criteria indicated above for being considered useful, such as importing new technology, bringing export markets, etc. It continues the process of trying to make FDI into Cuba more attractive,[21] and the process for approving FDI proposals less problematic for foreign capital.[22] It also, however, specifies some new additional goals for FDI involvement, lists two important prohibitions on FDI, and indicates a number of specific branches of the Cuban economy to be prioritized for FDI participation. Building the national industrial infrastructure is a new broad criterion for FDI, as is promoting cooperatives. The law specifically forbids the selling-off of state property to private interests, which played such an important role in the restoration of capitalism in Russia and the East Block,[23] and it specifically maintains (for now) the prohibition on foreign capital directly hiring Cubans by requiring that foreign enterprises hire Cuban workers through a state-run hiring agency. It specifically prioritizes FDI into agriculture, agro-industry, energy, mines, sugar, pharmaceuticals, biotechnology, and tourism. A final major change from previous FDI legislation is that Law 118 specifically allows for foreign joint operations with non-state entities. Given that co-ops are prioritized over private enterprises, one could expect that this might first affect the growing co-op sector. Given the nature of the private sector to find ways to obtain whatever advantages it can, however, one would expect that in time, this will also significantly affect the private sector.

But the biggest change is more amorphous, and at the most fundamental level – how Cuba views FDI. As opposed to being thought of as supportive of domestic economic development, FDI is now officially treated as one integral aspect of Cuba's economic development. Today there is a spectrum of positons on FDI in Cuban academia, think tanks, and government bodies. At the one extreme (leaving aside various very small oppositional groups that are simply for implementing neoliberal capitalism) are those whose focus is entirely on the increased growth and development such FDI could bring, often presented by comparing Cuban FDI and growth to that of places like Vietnam and China. This extreme of the spectrum of Cuban writings on FDI is characterized by an absence of consideration in their writings of how various different types of FDI, or degrees and natures of regulation of FDI, would have potentially different effects on Cuba's central development goal of socialism. At the other extreme are those who start their analysis of various possible types and modes of regulation of FDI, like any other development proposals, from a consideration of how it will serve or harm Cuba's overall development goal of building socialism. Just like the former, the latter hold that increased FDI is essential for raising Cuba's rate of growth and development to an acceptable level. There is almost no economist or politician in Cuba today who does not believe that increased FDI is one essential component of the new economic model being built. People on this latter end of the spectrum, however, are characterized by their continued attention to the need to develop procedures and modalities of FDI to guarantee that its increased role in the Cuban economy will leave Cuba, as opposed to the incoming FDI, in control of the Cuban economy.

7.3 The Impact of the Global Economic Crisis on Cuba's Tourism, Nickel Production and Agricultural Sectors

Section 7.2 began by observing that the most common indicator of aggregate economic performance, GDP growth, suggested that the entire Cuban economy might have been significantly slowed by the post-2007 world economic crisis and subsequent weak recovery. It then went on to consider the two major macroeconomic channels by which such a sluggish world economy could have effected the Cuban economy as a whole: imports of goods (and the related support for

that in the exports of goods and services) and FDI. The section found that the decline in these contributions to growth from the sluggish world economy were far weaker than the decline in Cuba's overall economic performance. This implies that the anemic world economy cannot be considered the prime cause of Cuba's recent weak performance. In this section, we will consider the same question by looking at the performance of Cuba's leading goods and leading service foreign exchange earners, nickel and tourism.

Export earnings from Cuba's leading export good, nickel, were sharply impacted by the world-contraction year 2009. They then rebounded with the strong world recovery in 2010, and then increased further in 2011, even as the world recovery became lethargic. Subsequently, however, Cuban nickel earnings have dropped sharply. Cuban national accounts list five specific subcategories of export earnings, with nickel included in (and dominating) "minerals." From 2005 to 2013, the earnings were 994; 1,347; 2,081; 1,434; 839; 1,151; 1,419; 1,011 and 711 million pesos, respectively (ONEI, 2011: Table 8.7 and 2014). To understand further what these numbers reflect concerning the impact of the world crisis on Cuban nickel earnings, it is necessary to look separately at the world price, the world demand, and the levels of Cuba's production of nickel.

After staying between $2 and $4 per pound from 1990 to 2002, the early commodity price increases of the mid-2000s first took it up to over $7 by 2004 and then exploded to a peak of over $22 in by May 2007. The collapse of this bubble was just as spectacular, losing half its peak value in a year and then continuing to fall to just above $4 by early 2009. It then rose through the world-contraction year of 2009 and the following two years to over $12, before dropping back to $6 at the beginning of 2014 (InvestmentMine, 2014 and International Nickel Study Group, 2014). So the low prices of 2009 certainly did contribute to the dismal earnings that year. In fact, although we will see that the level of production also matters, total nickel export earnings do loosely track the world nickel price.

Cuban nickel production was relatively constant during the price boom of the mid-2000s just discussed, as it was running at capacity (which was in general being slightly expanded, though small problems in one year or another would cause marginal drops). From before the crisis in 2005 to 2012, Cuba produced 3,433; 3,111; 3,333; 3,290; 3,949; 2,511; 2,443 and 2,084 million tons of nickel laterite, respectively (ONEI, 2011: Table 10.1 and 2014). Note that it achieved a production record in the world-contraction low price year of 2009

(because of marginal capacity expansion that year). After that, output problems began to appear. There was a sharp drop in output in the world-rebound year of 2010, and then further slight drops over the following two years, as the world economy, and in particular Cuba's important nickel markets in Europe and China, slowed.

But even the recent slowing of output cannot be convincingly attributed to falling world demand. Despite the overall sluggish world economic performance, the demand for nickel remained relatively strong. With the onset of the crisis in the United States in 2007, world demand dropped slightly to 1.32 million tons, then further to 1.27 in 2008, and 1.24 in 2009. But the world-rebound year of 2010 brought a jump in demand to 1.46, and that continued to rise to 1.57 in 2011, even as the world economy entered its current sluggish phase (International Nickel Study Group, 2014).

Cuba's current weak performance in nickel production[24] is one among many economic problems Cuba faces today. It cannot be convincingly attributed to the world economic crisis or its anemic aftermath. The current low level of nickel output in Cuba must be attributed primarily to internal production problems,[25] not to inadequate world demand or insufficient world prices.

In the last section, we saw that Cuba has financed its deficit in its balance of trade in goods, which it needs to obtain its necessary imports of goods in excess of its inadequate export of goods, through a surplus in its balance of trade in services. Hence, given the way the Cuban economy is structured today, the performance of its export of services is vital to its overall economic performance. Following from this, we next look at the impact of the world economic crisis on Cuba's largest service earner of foreign exchange, tourism.

While the topic of this chapter is the effects of the post-2007 world crisis on Cuba's economy, it will help us consider the latter's effect on Cuba via tourism to here briefly present Cuba's tourist performance from 1990 to the present. Over the decade of the 1990s, the foreign exchange earnings from an explosively growing tourism sector was Cuba's foreign exchange lifeline. In 1990, over 90% of Cuba's exports of goods and services were goods, with tourism making up just over 60% of the small contribution from service exports. By 2000, the percentage of goods in the total had dropped to less than 40, with tourism alone contributing over 45% of total export earnings. From 1998 to 2003, tourism was Cuba's largest source of foreign exchange. Subsequent to that, however, tourism's role as a source of foreign exchange fell from being the lifeline to being, along with

a small number of other goods and services, merely important. By 2009, exports of goods were down to less than 30% of total exports. But the explosion of other service[26] exports meant that, while tourism had accounted for almost three quarters of service exports in 2000, it was now only just over one-quarter (Quiñones, 2013: 103).

It would be a reasonable a priori guess that the post-2007 crisis and subsequent sluggish world economy would have significant negative effects on Cuba's tourism, an industry that is known worldwide as being income-sensitive. Figure 7.4 indicates that this reasonable guess would be wrong.

The explosive growth of earnings from international tourism, and the corresponding number of tourists that underlay it, continued from 1990 up to 2004. Its growth in both arrivals and earnings then went flat, two to three years before the world crisis. To be sure, the 2009 world-contraction is visible in the data, superimposed on the flat trend. But then growth in both arrivals and earnings resumed, not only in the world-rebound year of 2010 (which was not so much a rebound in the First World countries, which are the overwhelming source of Cuba's tourists), but also into the weak growth years

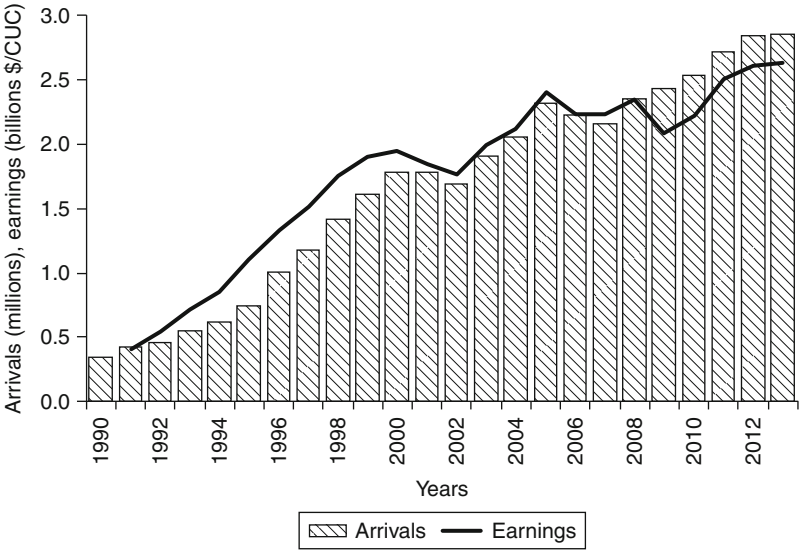

Figure 7.4 Cuba's international tourism, arrivals and earnings.
Sources: ONEI (2014), ONE (2009, 2003, 1998)

of 2011to 2013 that followed. As with the other major export just discussed, nickel, one can see some small indications of the effects of the world crisis and subsequent slowdown on Cuba's tourism. The data is clear, however, that the major changes in performance are not aligned with, and hence cannot be convincingly argued to come from, the crisis and subsequent slowdown.

7.4 Conclusion

Following the 2008—2009 world economic crisis and its one year rebound in 2010, the world economy has been lethargic. In 2009, Cuba had its second worst year of growth since 1995, and its growth since then has been weak in comparison to its own performance since 1995, even excluding the mid-2000s boom years. Given Cuba's known strong import dependency for its overall economic performance, and the need to support these necessary imports with corresponding exports, a reasonable a priori assumption would be that Cuba's current weak performance is a result of the impact on Cuba of the anemic world economic performance. A careful examination of the channels by which the weak world performance would be transmitted to the Cuban economy, the topic of this chapter, makes it clear, however, that notwithstanding some impact, the sluggish world performance is not a prime cause for Cuba's current weak performance.

While they are not the topics of this chapter, the chapter's conclusion of the minimal transmission of the sluggish world economic performance to Cuba immediately poses two related questions: why has the transmission been minimal, and what is the prime cause for Cuba's current weak performance? As a brief closing to this chapter, I will posit answers to both of these related questions, and indicate the empirical work that would be necessary to confirm or deny those hypotheses.

We saw in this chapter that Cuba has been minimally affected by the current lethargic world economy because it has been able to broadly continue, and sometimes even expand, its level of necessary imports and its inward FDI. It is hypothesized that this is so because an important part (though certainly not all) of both its trade and FDI relations are politically negotiated[27] with governments.[28] This partially insolates Cuba from the short-term time horizons of private capital that cause the rapid transmission of world effects to individual economies. Empirical testing of this idea would involve carefully looking at data on exports of goods and services and inflowing FDI (as

noted before, this latter is largely not available at present) by country and by type of arrangements, to see if this was indeed an important factor in Cuba's ability to maintain its exports and its inflowing FDI in the face of the world economic slowdown.

As numerous Cuban economists have indicated over recent years, sweeping economic reforms, even those that are both necessary and appropriate to dramatically improve a country's future performance, will necessarily disrupt existing economic practices and institutions, and thereby cause lower aggregate performance in the short term. Consistent with what this chapter demonstrates—that Cuba's very recent weak economic performance is not primarily the result of the anemic world economy—it is hypothesized that the sweeping economic reforms now unfolding are its primary cause. The simplest empirical test of this will be to see if Cuba's economic performance improves and maintains that improvement after several more years of reforms and the accompanying building of new economic institutions and practices. A more sophisticated empirical testing will involve looking at the change in the productivity of labor and the efficiency of the use of capital resources as Cuba's new economy consolidates.

Notes

1. The global economic crisis started in the US in 2007, and that country entered its "Great Recession" in that December. In 2008 the crisis spread first to the rest of the developed world, and subsequently to the underdeveloped world. The US officially ended its Great Recession in June, 2009, but that year registered a negative growth rate for the aggregate world economy. One could either argue that the global economic crisis ended in 2010 followed by a continuing anemic "recovery" or, especially as seen by the poorest quarter to half of the population of many countries, that the crisis has never ended. To avoid awkward and excessively lengthy locutions I will sometimes use the phrase "the global economic crisis" to refer to the crisis proper of 2008–2009 and the post-2009 "recovery" together.
2. The sharpest and socially broadest debates are about what is appropriate to do immediately and in the short-run to rapidly increase the standard of living in those dimensions in which it is (seriously) inadequate (given today's technological possibilities). The measures used to do this, however, must at the same time contribute to the medium- and long-term construction of socialism, and in particular not eventually end up taking the country back to capitalism. Notwithstanding this dominance of the short-term in today's discussions, by the nature of the issues these involve medium- and long-term considerations. One simple but important example to illustrate this point is

the discussion of what role if any is acceptable for private property in the means of production (and in which means of production) in the medium- and long-term construction of socialism, in connection with its current significant, though until now sharply limited, expansion.

3. This is also important for understanding the much commented on current proposal to eliminate 1 million jobs from the state sector, to be discussed below.
4. For a number of such quotes by Fidel see Campbell (2010).
5. See for example any of the many post-1990 books by arguably the best known American cubanologist economist, Carmelo Mesa-Lago. The title of his 1994 monograph reflected the common hope then among opponents of Cuba's project to build socialism, that these measures would go on to coalesce to restore capitalism (perhaps by the Chinese road): *Are Economic Reforms Propelling Cuba to the Market?*
6. This author has repeatedly noted in earlier works this position of the Cuban government which it has maintained throughout its post-1990 reforms, with numerous specific examples from those earlier times. See for example Campbell (2000: 189 – 193, 2008: 14 – 17).
7. The 291 guidelines that were originally proposed by a government commission were then popularly discussed from December 2010 until February 2011 in 163,079 public meetings attended by 8,913,838 participants (a number approximately the same size as Cuba's voting-age population, though the number includes a significant and not measured amount of double counting of individuals). In addition they were discussed in the National Assembly of Popular Power in December, at a joint meeting of the government, the Communist Party and the main mass organizations in March, at pre-congress meetings in all the provinces of congressional delegates and guests, and in the commissions at the Congress itself in April. 94 guidelines were left as originally proposed, 181 were modified, 16 were integrated with others, and 36 new ones were added, giving the final result of 313 guidelines. For a detailed 48 page discussion of every change including the reason for the changes, see PCC (2011).
8. Among not too many others in English, the following four books give what this author considers balanced accounts of aspects of these two decades of deep economic restructuring. By this is meant that they consider errors and shortcoming that occurred during the process, but they also consider what was achieved, and why the policies chosen were selected, including considering their relation to building socialism that as argued above has remained the overarching social goal for all Cuba's policies. See Campbell (2013a), Veltmeyer and Rushton (2012: Part III), Lambie (2010: Chapters 4 and 5) and Carmona Baéz (2004: Chapters 3–5). For a sharply different perspective see two of the most informational of the numerous English language books written from the perspective of, and whose analysis is strongly influenced by, a very strong desire to see a capitalist restoration in Cuba: any of the stream of books over the years by Mesa-Lago, but most recently Mesa-Lago and Pérez-López (2013), and Spandoni (2014).

9. See Campbell (2013b: 11) for references to four articles by Cuban authors that include discussion of this issue. Former Minister of the Economy and Planning José Luis Rodríguez (2013: 52) lists this as the first of "three critical economic imbalances" that, among the many issues that have to be resolved, are particularly important in the short term to improving Cuba's economic performance.
10. The World Bank gives world growth as around 4% from 2004 to 2007. After the world contraction in 2009 it bounced back to that level for one year before dropping to 2.8%, 2.4%, and 2.2% from 2011 to 2013, respectively (World Bank, 2014).
11. Recall that in 2008 a number of commentators in both the First and Third Worlds speculated that because of the nature of the financial trigger to the crisis, and the government spending and trade balance reversals (including building reserve buffers) that many Third World countries had effected after the speculative attacks on them at the end of the 1990s, that this might be the first world crisis to hit the First World hard and nearly bypass the Third World. In 2009 the crisis then spread to the Third World (above all via its trade relations with the First World), leading to negative aggregate global growth that year.
12. One important part of the jump in imports that year was Cuba's response to the massive destruction of three powerful hurricanes. Recall there are contradictory effects from such destruction on a country's economy. The destruction of capital (including especially buildings) does not enter into GDP accounts, and the mobilization of resources and society to replace those losses stimulates GDP growth. On the other hand, the massive direct losses to production, which in the case of Cuba above all involved huge losses in agricultural output, are all direct losses to GDP growth.
13. World Bank (2014).
14. A few Third World countries of course have capital/financial account inflows for some years with which they can finance imports above exports. Cuba's lack of access (or access only at very high costs) to international sources of finance, excepting finance generally tied to specific development project particularly from Venezuela and China, is well known, leaving their import capacity largely determined by their export capability.
15. Decree Law 50.
16. Proposals were first evaluated by economic bodies, and then passed onto be reviewed by political (government) bodies. Again, the overall central consideration was if they would contribute to Cuba's socialist economic growth and development. As one would expect from such a process, it was generally both extremely time consuming and extremely irritating to many potential foreign investors.
17. The majority of the refusals for new proposals and some of the proposed renewals were exactly for not corresponding to Cuba's development needs. The majority of the refusals for renewals, on the other hand, were that they had failed to meet the goals they indicated they would meet, which had been the basis of their previous acceptance as serving Cuba's development needs.

18. Officially called Asociaciones Económicos Internacionales, these are international joint ventures.
19. See Quiñones (2013: 95) and Pérez (2012: 216)
20. While those two sources came to dominate, they were far from exclusive. Two very well-known very large FDI projects are those by Sherritt in nickel (and to a lesser degree some other products) the recent investment from Brazil in the port and special economic development zone of Mariel.
21. For example, by making the tax treatment and property rights for foreigners in joint enterprises both more precise and more favorable.
22. For example, by reducing the number of the types of proposals that are required to go up to the Council of Ministers or Council of State for approval, and can hence rather be decided on by the relevant Ministries.
23. This is in fact to be allowed 'under exceptional circumstances' that promote the country's development and do not affect the political or social fundamentals of the State.
24. Another indicator of the increasingly relatively poor performance of nickel in Cuba's exports are its relative share of Cuba's total export earnings, again not only as the commodity boom ended in the mid-2000s, but of particular concern today. From 2005 to 2013 it earned, respectively, 46, 46, 57, 39, 29, 25, 24 and 18 percent of Cuba's total export earnings (ONEI, 2014 and ONE 2011: Table 8.7).
25. Beyond "problems," normal operating decisions also can cause important limitations. At the end of 2012 Cuba closed the 70 year old René Ramos Latour nickel processing plant out of efficiency considerations. It had an official capacity of 10,000 tons of unrefined nickel and cobalt, while the remaining two plants each had approximately 30,000 ton capacities. In 2014 the Ernesto Che Guevara plant underwent its most extensive maintenance/overhaul in its 28 year history, reducing its output to below 50% of capacity.
26. In the first place medical services.
27. There is no suggestion here of the common conservative fairly-tale that politically negotiated economic relations need be economically irrational, and nothing more than support for political allies. There is strong economic rationality benefitting both sides in all of Cuba's negotiated trade and FDI deals with its two biggest partners in these types of negotiations, Venezuela and China. However, an important difference from the neoliberal trade and investment transactions dominant in the world today, which are known for their generally overly short-term time horizons, is that the economic rationality of politically negotiated relations has the ability to be more medium and long term.
28. Note that such political negotiations with governments can be important even in cases where the final transactions are with private foreign capital, such as for example concerning the special economic zone of Mariel, for establishing procedures, regulations and guarantees that make the trade or investment attractive to foreign private capital.

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8

The Structural Causes of the Severity of the World Crisis in Mexico

Abelardo Mariña Flores and Sergio Cámara Izquierdo

8.1 Introduction

The 2008–2010 cyclical crisis of the Mexican economy was one of the most severe since the Great Depression. The contraction of the Mexican economy was the deepest in Latin America and among the worst in the world. Though the triggers of the crisis were to be found outside Mexico, specifically in the bursting of the mortgage bubble in the United States, the aim of this chapter is to show that the severity of the 2008–2010 crisis in Mexico, both historically and in comparison to other countries, as well as the mild subsequent recovery, has its structural roots in the precariousness of the neoliberal regime of accumulation in Mexico. We argue that this precariousness is related to the specific characteristics of the neoliberal restructuring in Mexico that have resulted in its ever-increasing dependency on the US economy, a concomitant structural weakness of the domestic market, resulting from its specific articulations to the world market and its anti-labor nature, and a systemic instability, associated with its financialized nature.

The rest of this chapter is structured as follows: Section 8.2 describes the impacts of the Great Recession on the Mexican economy during both the contraction and the recovery, and compares them to other Latin American economies. Section 8.3 presents a periodization of the process of capitalist accumulation in Mexico during the last 80 years, paying attention to the main features of the post-war,

expansive, long wave and the 1970s profitability crisis in order to provide a structural contextualization of the neoliberal restructuring. Section 8.4 analyses the particularities of the neoliberal restructuring in Mexico as a consequence of its subordinated articulation to the world market. Three main aspects are emphasized: the labor precarization, the indiscriminate external opening, and the subordinated financialization. Section 8.5 identifies the dynamics of profitability and the investment effort as explanations for the weakness of productive accumulation during the neoliberal contractive long wave. Section 8.6 highlights the external, productive demand and financial dependency of the Mexican economy as a consequence of the particularities of its neoliberal articulation to the world market. Section 8.7 analyses the structural limits of cyclical economic policy during the development of the global crisis in Mexico and relates its extreme depth and duration to the specific neoliberal configuration of the Mexican economy. Finally, conclusions are drawn.

8.2 A Severe Recession and a Mild Recovery

The 2008–2010 crisis was preceded by the weakening of economic activity from the beginning of 2008, coinciding with the start of the recession in the United States; the contraction started in Mexico in the third quarter of 2008 (figure 8.1). The global crisis was transmitted to Mexico through the reduction of manufactured goods and tourist services exports, originated by the contraction of US external demand, the big contraction of remittances from the United States, due to the big increase in unemployment in that country, and the decline of external oil revenues, caused by the decrease of both international prices and exported volumes. The Mexican cyclical crisis was, according to its combined depth and duration, one of the most severe since the Great Depression, next only to the 1982–1985 crisis in its duration and to the 1995–1997 crisis in its depth. Real GDP declined a total of –6.7% during 4 quarters until the second quarter of 2009. The recovery of the previous real GDP peak of the second quarter of 2008— took five quarters, that is, until the third quarter of 2010.

The expansion that started at the end of 2010 has been quite mild. The accumulated growth of real GDP in the following 14 quarters (three-and-a-half years) has been a meager 9.5% (a 2.6% yearly average). Moreover, the economy has showed a persistent slowdown since the end of 2012, reaching a state of stagnation until the first quarter

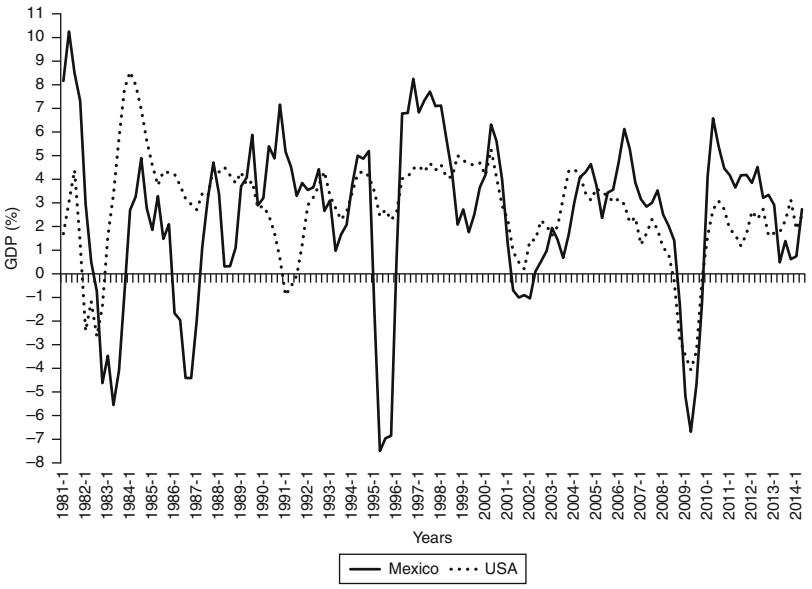

Figure 8.1 Real gross domestic product Mexico and United States, 1981q1–2014q2, seasonally adjusted, percent compared with the same quarter of the previous year.

Source: Inegi, Banco de Información Económica and Bureau of Economic Analysis, National Income and Product Accounts.

of 2014. The recovery and subsequent expansion was triggered by the positive effect of the United States economic recovery on manufactured exports; however, the value of oil exports and, especially, remittances from abroad, haven't showed a similar restoration, while tourist services exports have shown an upward trend only since 2012. The domestic demand recovery has been stalled by the increasing precariousness of employment (quality of jobs and wage levels) and the persistent weakness of remittances.

The performance of the Mexican economy since 2008 has been the worst in Latin America (with the exception of El Salvador), due to both the depth of the 2009 recession and the mild recovery since 2010 (table 8.1). On the one hand, the contraction of the Mexican economy in 2009 was the greatest in the region. On the other hand, the recovery has been sluggish and below average, despite the strong rebound effect. The rest of this chapter shows that the severity of the 2008–2010 crisis and the weakness of the recovery are related to the

Table 8.1 Latin America: GDP change (%)

	Mexico	*Argentina*	*Bolivia*	*Brazil*	*Chile*	*Colombia*	*Ecuador*	*Paraguay*	*Peru*	*Uruguay*
2009	(4.70)	0.85	3.36	#####	#####	1.65	0.57	#####	0.86	2.25
2010–2013	3.50	6.00	5.31	3.37	5.27	4.77	5.16	7.13	6.72	5.88
2008–2013	1.49	4.48	4.38	2.60	3.30	3.45	3.91	4.33	5.31	4.68

	Venezuela	*Costa Rica*	*El Salvador*	*Guatemala*	*Honduras*	*Nicaragua*	*Panama*	*Dominican Republic*	*Haiti*
2009	#####	#####	#####	0.53	#####	#####	3.86	3.45	3.08
2010–2013	2.29	4.52	1.78	3.39	3.50	4.62	9.27	5.04	1.71
2008–2013	1.58	2.80	0.74	2.47	2.23	2.86	7.23	4.11	1.53

Source: IMF, World Economic Outlook.

precariousness of the neoliberal accumulation regime as a consequence of the particularities of the neoliberal restructuring in Mexico.

8.3 A Periodization of Capital Accumulation in Post-war Mexico

The Mexican economy has gone through two long waves of capital accumulation during the last 80 years. An expansive long wave of capitalist accumulation initiated in the second half of the 1930s, consolidated at the end of the Second World War and endured until the beginning of the 1980s. This period was characterized by a high rate of growth, low inflation rates, and stability in the exchange rate, under a fixed regime from 1956 to 1975. In contrast, the Mexican economy has experienced a contractive long wave of capitalist accumulation since 1982, characterized by a significantly lower rate of growth, and, during the 1980s and 1990s, elevated inflation rates and a continuous devaluation of the Mexican peso under a managed floating regime. The underlying cause of this economic development is to be found in the structural conditions of profitability, along with the complementary institutional and normative frameworks (table 8. 2).

The deep structural transformations of the world and Mexican economies during the interwar period and the Second World War resulted in a high level of the general rate of profit that set the stage for the expansive long wave (figure 8.2). The favorable structural

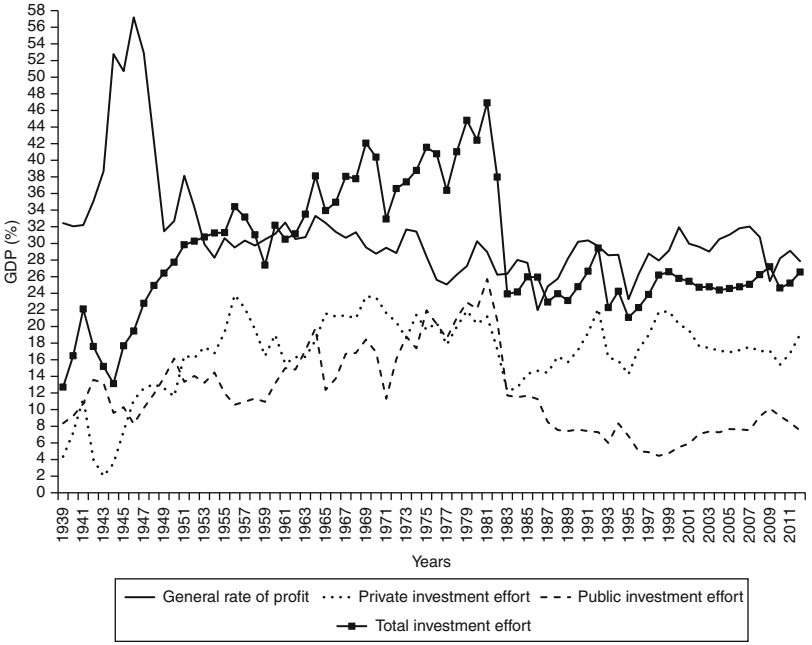

Figure 8.2 The general rate of profit (surplus value/net fixed capital stock) and productive investment effort (gross fixed capital formation/(surplus value + fixed capital consumption)) México, 1939–2012.

Source: Own calculations based on various sources and the methodologies developed in Mariña and Moseley (2001), Mariña (2001b), and Cámara (2003).

conditions of profitability were complemented by the active role played by the state in the promotion of capitalist accumulation and economic development in accordance with the social and political correlation of forces generated by the Mexican Revolution and reflected in the Constitution of 1917. As a matter of fact, the process of industrialization by substitution of imports (ISI) that marked the beginning of the expansive long wave, while induced by the downfall of world trade and international flows of capital during the Great Depression and the Second World War, was initially boosted by a vigorous public investment effort that allowed the initial expansion of the industrial productive plant. It was only during the consolidation phase (1946–1968) of the long wave and the expansion and deepening of the ISI that private investment—intensive in machinery and equipment—soared to align with the high profitability,

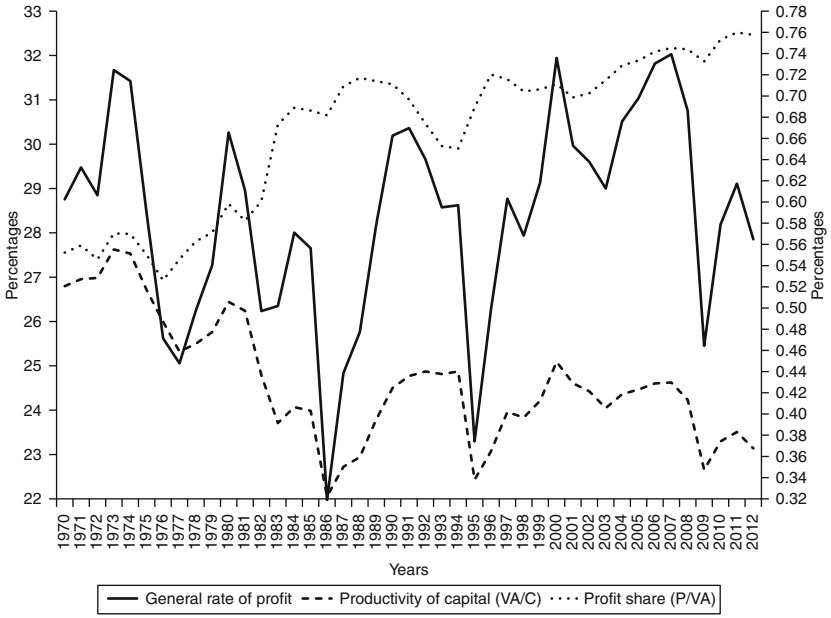

Figure 8.3 The general rate of profit (surplus value/net fixed capital stock) and its components México, 1970–2012.

Source: Own calculations based on various sources and the methodologies developed in Mariña and Moseley (2001), Mariña (2001b), and Cámara (2003).

while public investment kept its high level. The state maintained its involvement in the economy, deploying a Keynesian-inspired economic policy[1] (table 8.2).

The tendency of the rate of profit to fall manifested in Mexico at the end of the 1960s and the beginning of the 1970s, along with the international trends, but with the particularity that it depended relatively less on the technological component (productivity of capital) and more on the distributive component (profit share), and it prolonged longer, in comparison to the international trends (figure 8.3) (Cámara Izquierdo, 2008: 55–61).[2] The consequent structural crisis of profitability (1969–1981), being the main cause of the deceleration of the private productive investment, revealed itself in a rising economic instability and inflationary pressures since 1969, evidencing the limits and contradictions of the ISI. While the implementation of anti-cyclical expansive policies prolonged the expansive long wave by means of incrementing

Table 8.2 Elements for a periodization of capital accumulation in Mexico, 1933–2013

			Expansive long wave (1933–1981)					*Recessive long wave (1982–2013): Neoliberal restructuring*		
			Takeoff	*Simple ISI*	*Complex ISI (stabilizing development)*	*Instability*	*Oil boom*	*Imposition*	*Consolidation*	*Crisis*
	1933–1981	*1982–2013*	*1933–1945*	*1946–1955*	*1956–1968*	*1969–1977*	*1978–1981*	*1982–1987*	*1988–2000*	*2001–2013*
Macroeconomic indicators										
Real GDP Average annual growth rate (%)	6.2	2.3	5.8	6.0	6.6	5.4	9.2	–0.1	3.5	2.1
GDP deflator Average annual growth rate (%)	9.6	24.4	9.1	9.4	4.2	13.2	22.8	78.0	24.4	5.4
Nominal exchange rate (pesos per dollar) Average annual growth rate (%)	4.3	21.6	3.3	9.9	0.0	6.8	2.1	95.6	16.0	2.3
Productive Investment Effort										
Nonresidential GFCF/NET PROFITS+CFC Period average (%)	(1) 31.3	(5) 25.3	(6) 16.4	27.5	33.6	38.5	43.8	26.8	24.6	(11) 25.3

Continued

Table 8.2 Continued

			Expansive long wave (1933–1981)					*Recessive long wave (1982–2013): Neoliberal restructuring*		
			Takeoff	*Simple ISI*	*Complex ISI (stabilizing development)*	*Instability*	*Oil boom*	*Imposition*	*Consolidation*	*Crisis*
	1933–1981	*1982–2013*	*1933–1945*	*1946–1955*	*1956–1968*	*1969–1977*	*1978–1981*	*1982–1987*	*1988–2000*	*2001–2013*
PUBLIC NONRESIDENTIAL GFCF/TOTAL (current prices)										
Period average (%)	48.5	32.0	57.2	46.4	41.9	45.9	52.3	46.1	26.1	31.2
Equipment/Nonresidential GFCF (constant prices)										
Period average (%)	52.8 (1)	47.3	41.5 (6)	63.4	55.6	53.2	52.6	48.8	48.4	45.5
IMPORTED EQUIPMENT/TOTAL EQUIPMENT (constant prices)										
Period average (%)	48.2	55.0	54.7	60.7	43.2	39.0	42.4	32.4	52.8	67.6
Productive Capacity										
Nonresidential gross fixed capital stock (constant prices)										
Average annual growth rate (%)	5.8	3.7	2.5	7.0	6.0	7.7	8.8	3.4	3.1	4.4

Structures (constant prices) Average annual growth rate (%)	5.5	4.4	3.5	4.2	6.3	7.3	8.5	4.9	4.1	4.4
Equipment (constant prices) Average annual growth rate (%)	6.3	2.2	−0.6	14.2	5.4	8.3	9.2	0.9	0.7	4.2
Foreign Current Transfers										
Current account balance/ GDP (current dollars)	(1)		(6)							
Period average (%)	−1.6	−1.6	1.3	−1.4	−1.9	−2.4	−4.1	0.9	−3.0	−1.3
Trade balance/GDP (current dollars)	(2)		(2)							
Period average (%)	0.2	−0.1	3.9	−1.0	−1.2	−1.1	−1.3	5.5	−1.3	−1.6
Exports/GDP (current dollars)	(2)		(2)							
Period average (%)	12.2	23.4	13.6	14.2	11.2	9.7	11.8	19.3	20.8	27.8
Imports/GDP (current dollars)	(2)		(2)							
Period average (%)	12.0	23.5	9.7	15.2	12.4	10.7	13.1	13.8	22.1	29.4
Factorial service balance/ GDP (current dollars)				(9)						
Period average (%)	nd	−3.0	nd	−1.4	−1.4	−2.0	−3.3	−5.6	−2.8	−1.8
Interest payments/GDP (current dollars)				(9)						
Period average (%)	nd	−3.0	nd	−0.4	−0.6	−1.4	−3.0	−6.3	−3.0	−1.6
Current transfers balance/ GDP (current dollars)				(9)						
Period average (%)	nd	1.5	nd	0.8	0.7	0.6	0.5	1.0	1.1	2.1
Remittances received/GDP (current dollars)					(10)					

Continued

Table 8.2 Continued

			Expansive long wave (1933–1981)					*Recessive long wave (1982–2013): Neoliberal restructuring*		
			Takeoff	*Simple ISI*	*Complex ISI (stabilizing development)*	*Instability*	*Oil boom*	*Imposition*	*Consolidation*	*Crisis*
	1933–1981	*1982–2013*	*1933–1945*	*1946–1955*	*1956–1968*	*1969–1977*	*1978–1981*	*1982–1987*	*1988–2000*	*2001–2013*
Period average (%)	nd	1.4	nd	nd	0.6	0.5	0.4	0.7	0.9	2.1
Purchasing Power of Wages										
Monthly real minimum wage	(3)		(7)							
Average annual growth rate (%)	1.9	–4.0	–5.2	3.6	6.8	3.5	–2.8	–8.3	–5.4	–0.6
Average real manufacturing wage	(4)		(8)							
Average annual growth rate (%)	1.5	–1.0	–4.6	2.5	3.5	3.1	–1.2	–7.4	0.1	1.1

(1) 1939–1981
(2) 1933–1938: Goods
(3) 1935–1981
(4) 1940–1981
(5) 1982–2012
(6) 1939–1945
(7) 1935–1945
(8) 1940–1945
(9) 1950–1955
(10) 1960–1968
(11) 1981–2011

Fuentes: Own calculations based on Inegi, Banco de Información Económica; Banxico, Estadísticas; and CONASAMI.

public investment and expenditure, they also deepened the existing contradictions through the increase of the budget and trade deficits, leading to the balance of payment and devaluation crises in 1976–1977 and, after the oil boom (1977–1981), in 1982, which was triggered by the increase in the international rates of interest and the collapse in oil prices, and which put an end to the expansive long wave (table 8.2). The ensuing contractive long wave was characterized by the neoliberal restructuring of the general conditions of capital valorization, aimed at counteracting the fall in the general rate of profit and recovering its level, which we analyze in detail in the next three sections.

8.4 The Particularities of the Neoliberal Restructuring in Mexico

At a global level, the characteristics of the neoliberal restructuring relate to the weakness of the working class in its confrontation with capital, the renewed hegemony of nonproductive forms of valorization—especially of capital as property (interest-bearing and shareholder capital) as opposed to capital as a function (industrial and commercial capital)— the empowering of transnational companies, and the preservation of the United States declining economic hegemony. The mechanisms of implementation were tight economic policies, in spite of the liberal discourse, applied by progressively stronger and more authoritarian national states, along with international economic organizations such as the International Monetary Fund (IMF), the World Bank (WB), and the World Trade Organization (WTO) (Cámara Izquierdo and Mariña Flores, 2010: 22–24; Cámara Izquierdo, 2012: 196).[3] In Mexico, beyond this general context, the specific characteristics of the neoliberal restructuring were closely related to the subjugation to the agenda of the international organizations as a consequence of the recurrent crises and its radical articulation to the United States—the northern neighbor and the hegemonic capitalist power—, and took definitive shape after the electoral happenings of 1988 (Mariña Flores, 2005).

The global patterns of the neoliberal restructuring can be classified into three categories according to the spaces of valorization of capital involved: the recovery of the general rate of profit in the traditional productive spaces of valorization through the continuous devalorization of labor force via a varied set of mechanisms, the opening of

new spaces of valorization through the economic and geographical expansion of the capitalist form of production (privatization of public companies, repression of non-capitalist forms of ownership, collapse of the Soviet bloc and market reforms in China, deregulation of the international mobility of capital, etc.), and the reactivation of the financial spaces of valorization that were restricted during the Keynesian period along with the abrupt increase in interest rates (Cámara Izquierdo, 2010: 45–48, 2012: 196–199; Cámara Izquierdo and Mariña Flores, 2010: 25; Duménil and Lévy, 2007: 72–80; Mariña Flores, 2008: 9–11; Mariña Flores and Torres Ramírez, 2010). In Mexico, the previous mechanisms took the specific form of a pervasive labor precarization, an indiscriminate opening to foreign trade and investment, and a subordinated financialization.

The policy of nominal wage restraint was implemented in Mexico since 1977 in the context of the IMF adjustment programs and was spurred by the inflationary pressures and the successive economic crises. The anti-labor policies, complemented by the destruction of collective bargaining, were institutionalized since 1988 by means of the stability pacts (Ortega and Solís de Alba, 1999). The new neoliberal wage regime resulted in a quantitative precarization of labor, manifested in the steep decline in real wages (table 8.2),[4] as well as in a qualitative precarization, as the wage became a mere cost of production, linked to the productivity of labor, rather than a means of subsistence. It was also complemented by a deep labor market deregulation that made more flexible the conditions of sale, productive consumption and reproduction of the labor force. As a consequence, the neoliberal labor regime is characterized by employment instability, total or partial unemployment, intensification of labor, flexible working days, decrease in the coverage of social benefits, etc.

The devalorization of labor power and the increase in labor flexibility contributed to reinforce the low-wage, low-skill, labor-intensive industries—especially the maquila sector—, already robust as a consequence both of the incompleteness of the ISI, which boosted decidedly the final goods industry, but to a lesser extent, the intermediate goods and fixed capital industries, and of the early opening of Mexico to foreign investment and trade in this sector since the 1960s. This specialization in low-technology industries determined the position of Mexico in the neoliberal pattern of international division of labor and is simultaneously a cause and a consequence of the subsequent indiscriminate foreign opening that was implemented in Mexico since 1983 in the context of the IMF and World Bank intervention,

supported by the local and international financial capital groups, during the chronic external debt crisis (1982–1987) (Flores Oléa and Mariña Flores, 1999: ch. VII).

The neoliberal process of foreign trade opening started in 1983 with the gradual reduction of import license requirements and reference prices, continued with the accession to the General Agreement on Tariffs and Trade (GATT) in 1986, and had its highest point with the entry into force of the North American Free Trade Agreement (NAFTA) in January 1, 1994 (Mariña Flores, 2001a; Clavijo and Valdivieso, 2000: 15–19). Foreign investment was also gradually liberalized. In 1984, foreign capital companies in the hi-tech export sectors and transnational affiliates in Mexico were allowed, and the maquila program was extended to cover all the national territory; between 1986 and 1989, foreign investment was open to a growing number of sectors, and in December 1993, the legislation was adapted to the NAFTA (Clavijo and Valdivieso, 2000: 24–26). As a consequence, the developmentalist industrial and trade policies that imposed quantitative restrictions to foreign trade and investment flows were abruptly substituted by their profound liberalization, along with overall processes of deregulation of economic activity.

The rapid transformation of Mexico from a highly closed economy to one of the most open in the world (table 8.2) evidences the indiscriminate nature of the external opening.[5] Furthermore, this opening was subordinated to the global strategies of geographic relocation of the national and foreign transnational corporations. Actually, the increase in Mexican exports as a consequence of the GATT (9.8% of real annual growth between 1986 and 1993) and the NAFTA (16% in 1994–2000) (Cámara Izquierdo, 2009: 193–194) is mostly explained by these strategies rather than the strengthening of the Mexican productive capacity (Vidal Bonifaz, 2001; Correa López, 2001). Indeed, most of the exports come from the manufacturing and maquila sectors and are largely destined to the United States; also, there is a very high elasticity of imports to exports that resulted in a progressive disarticulation of the domestic productive chains.[6] The rapid increase of foreign direct investment, especially with the entry into force of the NAFTA, (Cámara Izquierdo, 2009: 192–193) also reflects the relocation of production plants of the transnational industrial corporations from the central countries—mostly, from the United States—to Mexico in order to export the final and intermediate (mostly auto parts) goods back to them.

The indiscriminate and subordinated foreign opening needed to be complemented with the restructuring of the Mexican financial system, though this process was first urged by the dire economic situation (high inflation and rapid growth of the public debt). The neoliberal patterns based on the financial flexibilization, deregulation and liberalization in order to expand the financial instruments and markets as concrete spaces of capital valorization were followed (Mariña Flores and Torres Ramírez, 2010; Cámara Izquierdo and Mariña Flores, 2010: 23–25). The first stage of the financial liberalization, initiated in the mid-1970s, was oriented to deal with the macroeconomic context. The reforms consisted in the partial flexibilization of the interest rate fixation, the liberalization of national financial markets and of the commercial banking system, and the creation and subsequent liberalization of the public debt markets (Clavijo and Valdivieso, 2000: 19–20). In addition, the banking sector was nationalized in 1982, eliminating the organic link between the financial system and the industry, and incrementing the autonomy of the banking system. During this period, non-banking financial institutions were also strengthen to counteract the power of the commercial banks, thus empowering the stock market, which, along with the public debt market, boosted the overall development of private and public financial instruments (H. Guillén, 2005: 232–240).

The second stage of the process took place since 1988 and completed the financial liberalization. The major reforms were the progressive opening to foreign portfolio investment, the privatization of commercial banks and the creation of new financial intermediaries, the restructuring of the aim and operation of development banks, and the creation of a new regulatory framework. Notwithstanding, the most relevant neoliberal transformation was the autonomy of the Bank of Mexico and the legally binding inflation target for monetary policy (Clavijo Fernando and Valdivieso, 2000: 20–22 and 26). This latter reform implied the abandonment of the traditional targets of employment and activity level and the orientation of monetary policy to controlling the inflation rate and maintaining the purchasing power of the Mexican peso (Ampudia Márquez, 2007; Huerta, 2007). In other words, it implied the subordination of the financialization process to the interests of the national and international financial capitals through the creation of the necessary conditions to guarantee their profitability within the Mexican boundaries (see section 6).

8.5 A Weak Neoliberal Process of Capitalist Accumulation

The neoliberal restructuring process was relatively successful in the recovery of the general rate of profit; the tendency of the rate of profit to fall was interrupted, and an upward trend started in 1987 and prolonged until the mid-2000s. Nonetheless, the maximum levels of the general rate of profit during the expansive long wave were not restored, and neither was its relative stability, given the effects of the sharp devaluations of the exchange rate (1995 and 2009) (figure 8.2). The partial recovery of the general rate of profit is at the root of the reactivation of the private investment effort during the 1990s, along with the stabilization of the inflation and the exchange rates, and the fall in interest rates during the way out of the 1995–1997 crisis. However, despite the relatively favorable conditions, the private process of capital accumulation remained weak, especially in the 2000s, when the cyclical recovery of the general rate of profit did not translate into a rise in the private investment effort (table 8.2, figure 8.2). This is a consequence of the two foremost structural features of the neoliberal restructuring that characterized this period as a contractive long wave.

First, the recovery of the general rate of profit is mainly explained by the increase in the profit share (especially, during the 1980s and the 2000s), while the productivity of capital contributed to a lesser extent (except during the second half of the 1980s and the beginning of the 1990s) (figure 8.3). These dynamics express the anti-labor bias of the Mexican neoliberalism,[7] in accordance with the maquila model of articulation with the world market implemented in Mexico that has enhanced the absolute mechanisms of surplus value production to the detriment of the relative ones. Certainly, the comprehensive technological restructuring of the productive apparatus is restrained under a competitive scheme based on lax labor and environmental legislations, and low labor costs. This scheme constitutes a major hindrance to the expansion of the domestic market that, along with its negative impacts on the profitability dynamics, has inhibited the recovery of private productive accumulation. Notoriously, the massive inflows of foreign direct investment as a consequence of the entry into force of the NAFTA, and the privatization of vast sectors of the economy could not offset these pernicious dynamics.

Second, the weakness of the productive accumulation process is also explained by the financial liberalization of the Mexican economy,

particularly during the intensification of the financialization process during the 2000s. On the one hand, the opening of financial spaces of capital valorization has diverted the accumulation funds and credit flows away from the productive spaces, hindering a greater recovery of the general rate of profit. On the other hand, the high interest rates required by the subordinated financialization (see section 6) imply an additional disincentive to productive investment, especially for the small and medium enterprises that suffer from the lack of access to the international credit markets. Lastly, the systemic instability that is characteristic of financialization has also intensified the cyclical crises and its negative impact on investment (Mariña Flores, 2010).

In addition to the dynamics of the private investment effort, the slow growth of the productive plant during the neoliberal contractive long wave can also be accounted for by the collapse in public productive investment during the 1982–1983 crisis and the perpetuation of its low level during the 1990s. Consequently, the overall productive accumulation rate remained at low levels in spite of the mild recovery of its private component (table 8.2, figure 8.2). Only during the 2000s did public productive investment rise moderately, but its impact on the global accumulation rate was offset by the simultaneous weakening of private investment.

8.6 The Neoliberal External Dependency

The neoliberal articulation of Mexico to the world market based on an export-oriented maquila sector resulting from the anti-labor bias and the indiscriminate opening of trade, and on the freedom of financial flows resulting from the financialization tendencies, has led to productive, demand, and financial structures highly dependent on the rest of the world, especially on the United States; this is the main reason behind the lack of autonomy in the definition of economic policies in Mexico (see also section 7).

First, the neoliberal productive structure rests on a competitiveness pattern based on static competitive advantages related to the flexibilization of the working day, the intensification of work, and the decline in real wages, which favors labor-intensive production processes to the detriment of processes based on investment in new technologies, which are the basis of dynamic competitive advantages. Therefore, the implementation of wage restraint policies, and anti-labor policies in general, becomes a permanent necessity, rather than a choice of policy, in order to maintain the international competitive advantage

and promote the allocation of the big transnational corporations in Mexico.[8] Furthermore, the maquila export industry is characterized by its limited domestic productive linkages and its high dependency on the imports of machinery and intermediate goods, corresponding most of the latter to intra-firm trade. This feature has contributed to a continuous disarticulation of the domestic production plant and to a severe process of deindustrialization of the Mexican economy, especially of the manufacturing sectors developed during the ISI process, owing to the indiscriminate opening up of the country to international trade.

The labor-intensive competitiveness pattern and the trade opening process have failed to reverse the structural deficit of the trade balance. The growth of exports to the United States, which generated an increasing trade surplus with this country that was reflected in positive oil and maquila industry balances, was insufficient to offset the negative balance of agricultural products and non-maquila manufacturing goods (table 8.2). Actually, the balance of trade only showed positive figures in a transitory manner after the devaluation crises of 1982 and 1994–1995, but the more rapid growth of imports than exports quickly restored the trade deficit, which soared during the cyclical expansions (Cámara Izquierdo, 2009: 195–196).

Second, the aforementioned stagnation and decline of real wages and wage income has restricted the expansion of the domestic market, which has lost its importance as an engine of the accumulation process. Consequently, the economic activity of Mexico has become highly dependent on the external demand—especially from the United States, the main destination of the exports(figure 8.4).

Third, the Mexican economy suffers from a persistent current account deficit as a consequence of the structural trade deficit that needs to be financed by capital inflows: direct and portfolio investment and bank loans (table 8.2).[9] This dependency implies a structural subordination of the monetary, exchange rate, and fiscal policies to the interests of foreign capitals. Thus, in order to garner enough inflows and avoid pressures on the exchange rate, the country must offer attractive domestic conditions of profitability to the large volume of international financial and speculative capitals seeking profitable opportunities, given the global context of financial deregulation. Furthermore, the priorities of the Mexican government and monetary authority are, on the one hand, to safeguard the short-term profitability of foreign financial investments in foreign currency terms and, on the other hand, complementary to the former, to guarantee the

Figure 8.4 Domestic market as an engine of the accumulation Mexico, 1970–2013.
Sources: Own calculations based on Inegi, Banco de Información Económica.

medium- and long-term convertibility of the foreign investment in equity shares and public debt securities.

The attractive short-term profitability conditions are achieved and sustained by simultaneously maintaining relatively high real interest rates and exchange rate stability, even at the cost of its overvaluation. Besides inhibiting the processes of productive investment, this policy generates a vicious circle, as it worsens both the trade balance, because of the exchange rate overvaluation, and the factorial service balance, because it increases both the external debt and the cost of its service. Also, it confers a structurally pro-cyclical nature to the monetary and exchange rate policies in the contractive phases of business cycles, especially during global contexts of financial instability, in order to preclude the risk of a massive capital outflow. In a similar vein, the neoliberal fiscal policy in Mexico is constrained to a balanced budget, especially during the periods of economic crisis and instability, conferring it also with an inevitable pro-cyclical nature (Marois, 2012).

The assurance of long-term profitable convertibility of the foreign investment relies on a long-term over-accumulation of international reserves – as it exceeds the needs to face short-term speculative attacks against the Mexican peso – that requires an overall external indebtedness (to banks and international organisms, and direct and portfolio investment) beyond the requirements to balance the current account deficit (A. Guillén, 2001: 64; Flores Oléa and Mariña Flores, 2004: 532–533; Mariña Flores, 2012; Huerta, 2007; Rozo and Maldonado, 2012). Actually, the factual objective of the overaccumulation of reserves has been to preserve a constant proportion of them, 25% on average, in relation to the adjusted external debt that includes, besides the gross overall external debt, the amount of public debt and equity shares held by non-residents (figure 8.5). This reserve accumulation involves a very high cost in terms of both overindebtedness and the differential between the domestic and foreign interest rates.[10]

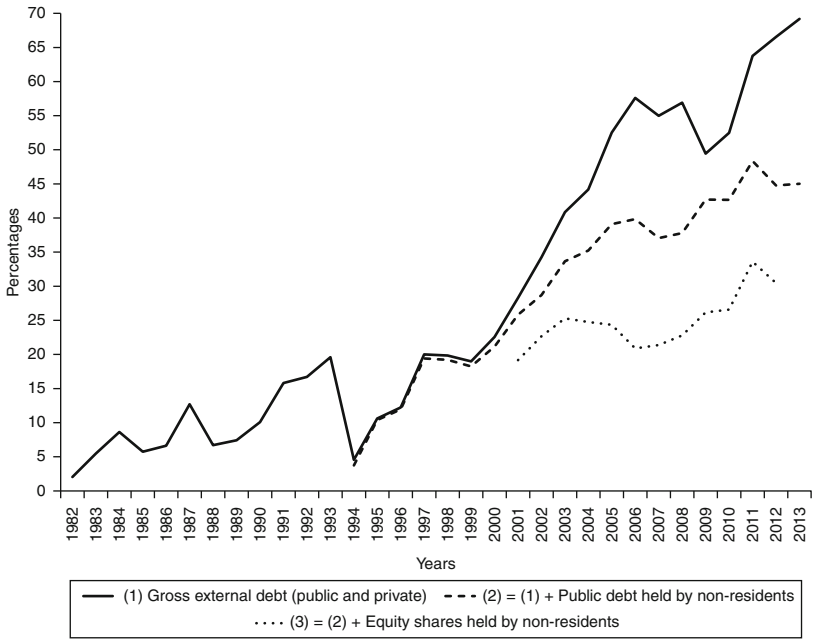

Figure 8.5 International reserves as a share of the gross external debt and the foreign portfolio investment (end of the year: %), Mexico, 1982–2013.

Sources: Own calculations based on Inegi, Banco de Información Económica; and Banxico, Estadísticas.

8.7 The Limits of Cyclical Economic Policy

In 2007–2009, the global crisis made evident the limits of the neoliberal restructuring process on a global basis (Cámara Izquierdo and Mariña Flores, 2010). Actually, the world economy showed the first signs of such limits, particularly in the capitalist centers, during the dot.com crisis in 2000–2001 which ended the expansion that had unfolded since 1994 (including the strong and lengthy "Clinton boom" in the United States). This crisis halted two basic tendencies that gave support to the United States-led neoliberal restructuring: the relative dynamism of productive investment and the subsequent recovery of capital productivity, and the maintenance of high real interest rates (Cámara Izquierdo, 2010: 56–58). The exit of the crisis required sharp reductions of interest rates, not seen since the beginning of the 1980s, that instead of stimulating productive investment, promoted a global process of financial and speculative overaccumulation in the 2000s. In the United States and other central countries it implied the creation of speculative bubbles in the housing sector and associated derivative markets which, when they burst, detonated the global banking and financial crisis of 2007–2008 and, through their geographical and sectoral propagation, gave way to the world recession of 2009.

Along with the world economy, the 2000–2001 recession in Mexico also showed the first signs of the limits of the neoliberal restructuring, as it ended the feeble recovery of private productive investment in the 1990s and boosted the subordinated financialization process through the quantitative and qualitative expansion of financial and speculative instruments and markets during the subsequent recovery. The deep involvement of big Mexican corporations in national and international financial and speculative markets resulted in big financial losses during the 2008–2010 crisis. Moreover, the overall financial external dependence of the Mexican economy generated strong pressures on the current account balance and the exchange rate due to the high risk of massive capital outflows. In this context, in contrast to most of the rest of the world, during the crisis, the Mexican government could not implement a comprehensive set of anti-cyclical policies aimed at reducing the negative effects of the plunge of external revenues on productive activity, employment and domestic demand. On the contrary, the structural subordination of its economic policy forced the implementation of pro-cyclical policies.

Monetary policy was very restrictive during most of the crisis, offering high interest rates to attract foreign capital, accumulate foreign

reserves and sustain the exchange rate. Despite the negative tendency of GDP since the second quarter of 2008, the Bank of Mexico increased the target interest rate three times in the second half of the year in order to offset the massive outflow of capital and the negative fluctuations of international reserves that, nevertheless, resulted in a – 45% depreciation of the exchange rate between September 2008 and March 2009 (figure 8.6). This tight monetary policy increased the positive spread between the nominal interest rates in Mexico and the United States, and until the beginning of the depreciation of the Mexican peso, the real interest rate in Mexico (deflated with the dollar/peso exchange rate). At last, and at the cost of reinforcing the recessive tendencies, the Mexican peso not only stopped depreciating, but also started a partial and consistent revaluation beginning in April 2009 that lasted until mid-2011. As a result of the reduction of interest rates which was finally instrumented at the beginning of 2009, the spread between the nominal interest rates in Mexico and the United

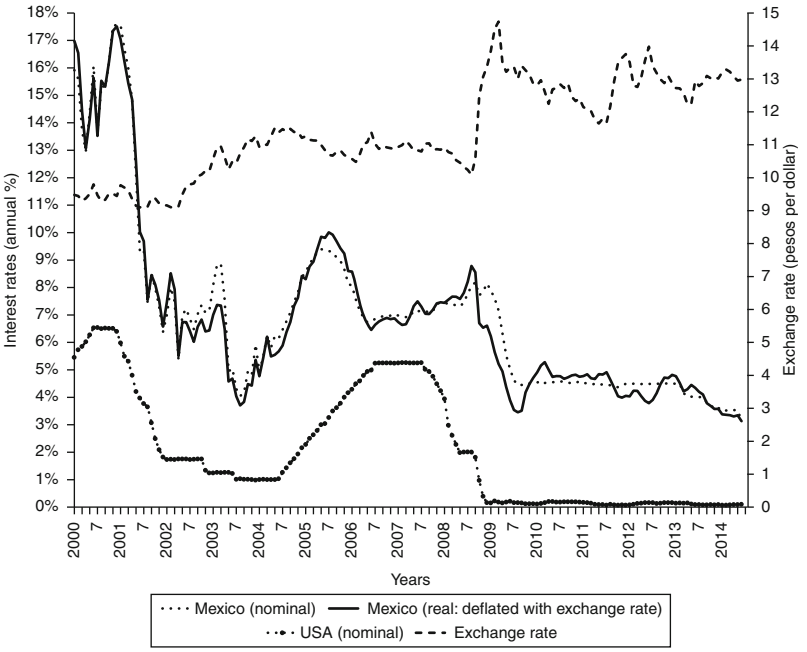

Figure 8.6 Annual interest rates of federal funds and exchange rate of the Mexican peso.

Mexico and the United States, 2000–2013, monthly.

States started to diminish at the beginning of 2009, stabilizing at a level a little above 4%. The real interest rate in Mexico, pushed by the renewed revaluation of the Mexican peso, partially recovered its high levels at the end of 2009 and the beginning of 2010. The stabilization of the exchange rate was attained by the fast recovery of international reserves (and its implicit cost) since the second half of 2009, due to the sharp increase in foreign investment in public debt titles, which was driven by the rise in real interest rates in Mexico. The ratio of international reserves to foreign debt (public and private), which had fallen to 50% in 2009, showed a sharp increase during and after 2010, reaching a level of 69% in 2013.

Fiscal policy also had a strong prociclycal nature, which was aimed at avoiding negative inflationary pressures on the exchange rate by sustaining fiscal equilibrium in a recessive context characterized by the accelerated decrease of fiscal incomes (tax revenues) through the reduction of public expenses—even in real terms during 2010—and an increase in tax rates, and prices and fees for public goods and services.

The revitalization of the Mexican economy since the third quarter of 2009 has rested on the reactivation of the United States economy and on the continuing precarization of labor, especially reinforced by the bad quality of the restored jobs. The recovery has been mild because it has feeble foundations. Its continuity and strength is uncertain inasmuch as it structurally depends on the evolution of the US economy: firstly, because the labor precarization has impeded the reactivation of the domestic market; secondly, because the pro-financial features of economic policy remain an obstacle to economic growth; and finally, because the cyclical recovery of the rate of profit – based, similarly to the United States, on its distributive component – has been limited, still remaining below its previous high peak, in contrast to the United States (Cámara, 2014: 11).

8.8 Conclusions

The Mexican neoliberal regime of accumulation, besides assimilating the general contradictory characteristics of global neoliberalism that arise from its anti-labor, globalized and financialized nature, developed an extreme precariousness and instability compared to most of the peripheral economies, including those in Latin America, and especially in relation to the medium-developed economies that emerged as new dynamic poles of accumulation in the world market (BRIC).

These contradictory features of neoliberalism in Mexico are linked to its subordinated articulation to the world market, especially to the United States economy, that emerged from the specific characteristics of the neoliberal restructuring in Mexico. Three major mechanisms were implemented to restore the general conditions of valorization of capital: the labor precarization, the indiscriminate external opening, and the subordinated financialization.

The neoliberal process of labor precarization was remarkably severe in Mexico, leading to a vast reduction in real wages and a flexibilization of the conditions of sale, productive consumption and reproduction of the labor force. This process was complemented with the rapid and indiscriminate external opening to foreign investment and trade. Both structural transformations boosted the labor-intensive manufacturing and maquila sectors, which rely on low labor costs and poor working conditions to compete, and endowed the Mexican economy with a specialization in low-technology industries within the neoliberal pattern of international division of labor. They also changed the regime of capital accumulation to an export-led model that eroded the domestic market as the engine of the accumulation process.

The previous economic transformations failed to provide the basis for a renewed process of capital accumulation and, to a major extent, for a model of economic and social development. First, the private process of productive capital accumulation has been inhibited along with the processes of comprehensive technological change; instead, the absolute mechanisms of surplus value production, based in labor-intensive low technologies, are preferred as the means of recovering the rate of profit. Second, the trade deficit remains a crucial structural feature of the Mexican economy that reinforces its external dependence. Third, the transformations have implied a continuous deterioration of the living conditions of the population as a consequence of the reduction in job quality and real wages. Finally, the radical liberalization of the financial system in a context of structural trade deficit has generated the permanent requirement to lure external capital inflows. As a consequence, economic policy has been subordinated to guarantee the profitability of financial capitals. Subordinated financialization has developed into overvaluation of the exchange rate, maintenance of high real interest rates, and overaccumulation of international reserves; also, it has implied further inhibition of private investment in productive capital, the continuity of trade and current account deficits, high financial and opportunity costs of holding

reserves, the pro-cyclical nature of economic policy, and systematic instability in the Mexican economy.

The precariousness of neoliberalism in Mexico was confirmed by the severity of the 2008–2010 cyclical crisis and the subsequent mild recovery. The deep recession is explained by both the external dependence of the United States economy and the inability to implement anti-cyclical economic policy. The mild recovery evidences the structural weakness of the technical and social basis of the neoliberal regime of accumulation in Mexico.

Notes

1. The main features of the Keynesian compromise in Mexico were the continuous increases in real wages, the expansion of the domestic market, and the maintenance of low real interest rates. See Solís (1997: 41–46) for an analysis of the economic policies implemented during the expansive long wave.
2. The first specificity owes to the maintenance of a fixed exchange rate regime and the subsequent overvaluation of the Mexican peso that diminished the current cost of fixed capital given its high imported component (Mariña Flores and Moseley, 2001). The exchange rate policy also allowed for increases in real wages higher than the increases in productivity, situation that intensified since 1969 as a consequence of both the expansive wage policy in order to cope with the social discontent and to boost effective demand and the deceleration of productivity growth (Bortz and Velasco Arregui, 1987) The second specificity relates to the cyclical recovery of the general rate of profit associated to the oil boom as a result of both the contractive wage policy to fight inflation and the massive access to cheap foreign credit.
3. The neoliberal project was first imposed by the dictatorships in Uruguay and Chile in 1973, in Peru in 1975 and in Argentina in 1976; in the capitalist centers, it was first implemented by the governments of Reagan in the United States and Thatcher in the United Kingdom in the 1980s (Mariña Flores, 2015).
4. The minimum real wage accumulated a loss of purchasing power of –76% between 1976 and 2013, while the manufacturing real wage experienced a maximum decline of –48% between 1978 and 1996 that, though partially reversed, it still 30% lower in 2013 than in 1978.
5. A comparable situation cannot be found in any other major country in Latin America; moreover, this transformation cannot be explained exclusively by its proximity to the United States (Mariña Flores, 2009)
6. Mariña Flores (2001a) develops an input-output analysis of the disarticulation of the Mexican economy between 1980 and 1993.
7. This bias is reaffirmed in the 2010s by the perseverance of the contractive wage policy and the approval of the amendments to the Federal Labor Law.

8. This competitiveness pattern is also the fundamental cause of the deterioration of the living conditions of the population and the increase in the poverty levels in Mexico during neoliberalism.
9. The trade deficit is not offset by the positive balance of transfers, sustained by the migrants' remittances, and it is aggravated by the negative factorial service balance.
10. Rozo and Maldonado (2012) estimate that the cost of holding reserves in Mexico was a staggering 2.2% of the GDP in 2011, as the sum of the financial and opportunity costs and the fee of IMF's Flexible Credit Line.

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9

Venezuela and the International Crisis

Diego Mansilla

9.1 Introduction

This chapter attempts to explore the effects of the international crisis of 2008–2009 on the Venezuelan economy. Venezuela is the fourth biggest Latin-American economy, with 7% of the region's GDP. It follows the region's giants (Brazil, Mexico and Argentina) and accounts for 8% of regional exports due to sales of petroleum and its derivates, which are practically its only exports and the core of its economy.

Before the outbreak of the international crisis, Venezuela was expanding at annual growth rates above the average in Latin America and taking advantage of the improved exchange terms. In those years, the country was displaying an historical economic growth path, low indebtedness, increasing the international reserves, and achieving a generalized improvement on income distribution and social indicators. However, Venezuela was one of the countries in the region where the international crisis hit the hardest. Not only was the decrease of its GDP in 2009 higher than the Latin America average (with a 5.8% yearly decrease in the fourth trimester of 2009), but in 2010, it was the only country in the region that was not able to recover from it. Only in 2011 was the economy able to recuperate the growth path, ending with six consecutive quarters of recession. But it could never regain the lost momentum.

It's noteworthy that this economy, which was strengthened and benefited by the international evolution of prices, has suffered more significantly than the economies of the region that were affected by

the exchange terms. This is true especially if we consider that even during the recession years, Venezuela has continued to be among the countries with higher improvement in terms of trade.

Venezuela is well known as an oil-producing country, and a big part of its economic, fiscal, and commercial structure depends on hydrocarbon production. In 2013, the country had 20% of the world's petroleum reserves, the highest reserve since it surpassed Saudi Arabia in 2010 (OPEC, Anual Statistical Bulletin 2014). These growing stocks, reinforced with the *Faja Petrolífera del Orinoco*[1] (Orinoco heavy oil belt) in 2007, represent almost 300 years of extraction at current levels, and they show the power that Venezuela has in the global energy market. *Petróleos de Venezuela S.A.* (PDVSA), a 100% government-owned company, which was created after the nationalization of the petroleum during the 1970s, has monopoly control of Venezuelan petroleum.

The significance of its petroleum in the Venezuelan economy is so large that it gets officially calculated as the participation of the oil-sector in GDP (25.5% en 2012).[2] The international oil rent Venezuela earned in 2011 reached US$ 78,000 million, of which 66% has been contributed to the treasury.[3] In 2013, petroleum-related contributions represented 46% of the Venezuelan government income (12% of GDP). As a counterpoint, the agricultural sector is significantly underdeveloped, to the point of having to import much of the food consumed in the country; the manufacturing sector is also underdeveloped, except in the fields directly related to the petroleum industry.

In the second half of 2008, the American financial and banking crisis broke out and spread out to the rest of the world. Consequently, the world market shrank and significant financial flows were withdrawn from the peripheral countries, the access to credit in financial market was interrupted, and the price of the basic products collapsed. This is how in just six months, the international price of the petroleum drop almost 70%, reaching US$ 41 in December of 2008. The Venezuelan barrel reached an average of US$ 124 in July 2008 and just US$ 31.6 in December of that year, a 71% decline.

In addition, as a consequence of the downturn in activities due to the crisis, world demand was reduced for the first time since 1983 (mainly in the United States, the recipient of almost 70% of the exports of crude petroleum from Venezuela). To answer to lower demand and stop the tendency of prices to drop, OPEC made drastic cuts in the members' crude oil production allocations, in order to reduce the supply. This resulted in a negative effect on the foreign

trade of Venezuela, which had to reduce the quantities of petroleum exports in order to comply with the OPEC agreements. The result was the drastic collapse of Venezuelan exports by 40% in 2009, although, with the drop of the imports, it managed to maintain the current account surplus when most of the region got into large deficit.

The recovery of the crisis in the second half of 2009 reached values similar to those that existed in 2007. Despite similar prices to the ones registered during the previous expansion, the Venezuelan economy continued to deteriorate, showing the evolution of prices was not the only explanation for crisis. Notwithstanding, the Venezuelan economy has ever recovered the previous levels of growth. The increase in GDP achieved since 2011 was slightly less than before the crisis; the external situation worsened, with a deficit in the balance of payments, an outflow of reserves, and the increase of external debt. This new stage has also interrupted social and distribution improvements.

In order to understand the reasons why the international crisis has hit the Venezuelan economy, we should refer to its particular productive structure and its social and political features, with petroleum as its locus. After an overview of the situation of the Venezuelan economy when the crisis started, we will analyze the internal effects of the crisis in the third section, detailing the evolution of the main macroeconomic variables and the key sectors of the economy. Finally, we end the chapter by presenting our main conclusions.

9.2 Economy and History of Venezuela

The economy of Venezuela could be characterized as a rentier-State model,[4] in which the abundance of the hydrocarbon contributes to shape an unbalanced structure. As some authors put it, Venezuela suffers from "oil intoxication" (Ominami, 1984; Baptista, 2010). Even though the country is the most industrialized country in the Organization of Petroleum Exporters Countries (OPEC), hydrocarbons are almost its only export product, which shows a strong specialization within world commerce and the international job division.

The petroleum industry (and its derivatives) act as an export enclave, with only few relationships upstream and downstream, allocating most of its production outside the country. As happens with other major oil exporters, Venezuela has the capacity to grab most of the generated rent. However, the country does not have the sole decision-making power about its main product. Venezuela is a founding

member of OPEC, a cartel of petroleum exporters that agrees on exports fees for each of its members in order to manage prices. As a result, sometimes the country is doubly conditioned in its sectorial politics. In the face of a change in international prices, a stipulated reduction in production allocations means a downfall in the main economic activity of the country.

The rentier-State model in Venezuela has been deepened since the beginning of the twenty-first century because of two key facts. One was exponential price increases for petroleum since 2001 without considering the expansion before the crisis of 2008, something that is known as "the third petroleum shock" (the only one without a war conflict). Between December of 2001 and December of 2006, the WTI (West Texas Intermidiate) has doubled, and during 2007, the price increased by 47%. The second key fact is the arrival to power of Hugo Chávez in February of 1999. His government applied an economical model that increased dependency on hydrocarbons, but also created a series of mechanisms that reallocated the income from the petroleum sector.

Since 1958, Venezuela's modern democracy of the "*Pacto de Punto Fijo"(Fixed Point Pact)* came about in the governments of the "Acción Democrática" and COPEI parties. The income from petroleum funded industrialization and import substitution strategy without generating valuable social transformations, and instead contributed to growing economic and social inequality. Since 1973, the increase in oil prices has multiplied the government's income, and within a few years, foreign exchange and tax income tripled. These allowed broadening and deepening industrialization policies and some social improvements, but they vanished during the 1980s and 1990s with the arrival of the neoliberal programs of opening and privatization.

By the end of the 1990s, social indicators in Venezuela were showing this country as the most unequal in the region, with a poverty rate above 50% of the population, a per capita income 35% lower than in 1970, an economy in crisis, and an external debt of 25% of its GDP. Venezuelans strongly rejected politicians and felt indifference with the democratic process and the traditional parties. In this context, Hugo Chávez, launched the *Movimiento Quinta República* (Movement of the Fifth Republic). Previously, he had attempted an armed insurgency in 1992 in opposition to the government's neoliberal politics and lack of representation by the *Punto Fijo*, launched the *Movimiento Quinta República* (Movement of the Fifth Republic). His campaign was based on a national and popular government and a

strong rejection of neoliberalism. Although traditional parties joined forces to impede his triumph, Chávez won the general election with 56% of the votes and assumed the presidency of Venezuela in 1999.

The first phase of Hugo Chávez's government can be classified as state reorganization and institutional reforms, including of the constitution (approved by 72% of the electorate), but the government made no significant transformations to the social or productive structure. In November of 2001, the "*Ley Habilitante*" (Enabling Law) was approved, which granted extraordinary authority to the president to pass decrees with theforce of law. The most important of the 50 laws issued under this regime was the *Ley Orgánica de Hidrocarburos* (Organic Hydrocarbon Law), which was instituted in January 2002.

This law ruled that the state-owed PDVSA had operating control and majority shareholding in all primary activities of the petroleum sector, and it also transformed the tax structure of hydrocarbons.[5] In addition, a strong state intervention was applied to both PDVSA and its subsidiaries, in order to control their operations and generate a remittance of dividends. Until then, the state petroleum company, while maintaining a formal dependency with the executive power, had significant freedom of action.[6]

Given these changes, strong social and political confrontations emerged, leading in April of 2002 to a *coup d'etat* and a lockout that paralyzed PDVSA for more than 60 days. According to the company, the oil strike had a cost of about 8 billion dollars, with a decline in GDP of 24% in the first quarter of 2003 (the oil sector GDP fell 40%), increasing poverty and unemployment. This process was finally over in 2004 when Chávez won outright in the recall referendum and regained final control of the petroleum policy.

Since 2003, government reforms were deepened and radicalized, starting a new stage in Venezuelan economic history, "twenty-first-century socialism." It began with an aggressive nationalization campaign in strategic sectors (electricity, telecommunications, steel, cement, banks, etc.), putting back in the hands of the state companies that had been privatized before 1999. Partnerships with foreign companies and oil fields in the *Faja del Orinoco* were nationalized, as well as those with most oil suppliers, in order to vertically control the petroleum production industry.[7] During those years, social policies were reformulated by the universality principle, and public spending significantly increased, especially in social spending, which reached a high record in 2007.[8] The main goal was the redistribution of rising petroleum revenues. The social plan was articulated through the

Misiones (missions), special units created to respond directly to different social problems without money passing through the national treasury. In addition, various funds were created, such as the *Fondo para el Desarrollo Económico y Social del País* (Fund for Economic and Social Development—FONDEN). Between 2004 and 2013, PDVSA contributed US$ 123.200 million to the *Misiones* and US$ 78.416 million to the investment funds. These funds and *Misiones* have been criticized as mechanisms to generate significant public expenditures without the control of the national budget, providing little information and transparency.

One major structural problem of the Venezuelan economy that the Chavez administration did not resolve was inflation, partly due to the rentier-State model and the "oil intoxication." Beginning in 1999, in just three years, prices increased less than 15%, and had reached 32% in 2008, due to the increase in the international prices of raw materials and food.

Moreover, structural capital flight deepened with the arrival of Chavez, political events, and the increased availability of dollars in the country. To fight this, and to limit the outflow of currency that pushed the price of the Bolivar after the political crisis of 2002, implementing a system of exchange control and limiting imports and transfers abroad. The *Comisión de Administración de Divisas* (Currency Administration Commission—CADIVI) took control of currency purchase activities. However, this did not stop capital outflows and resulted in a development of a "parallel dollar" system, in which the price of the dollar was several times higher than the official currency. In 2015, this system was amended with the creation of the *Sistema Marginal de Divisas* (marginal currencies system), with an official value 27 times higher than the regulated value (but still less than the informal trading).

9.3 The Economy of Venezuela during the Chavez Period and the Impact of the International Crisis

By studying the main economic variables of the Venezuelan economy, we can observe clearly the effect of different political stages (figure 9.1). The 1990s ended with a decreasing tendency on GDP, which was not modified by the arrival of Chavez government. On the contrary, the crisis deepened, and the GDP fell 16% from 2001 to 2003 as a consequence of internal political events. After reforms were implemented, Venezuela maintained a surprising annual average

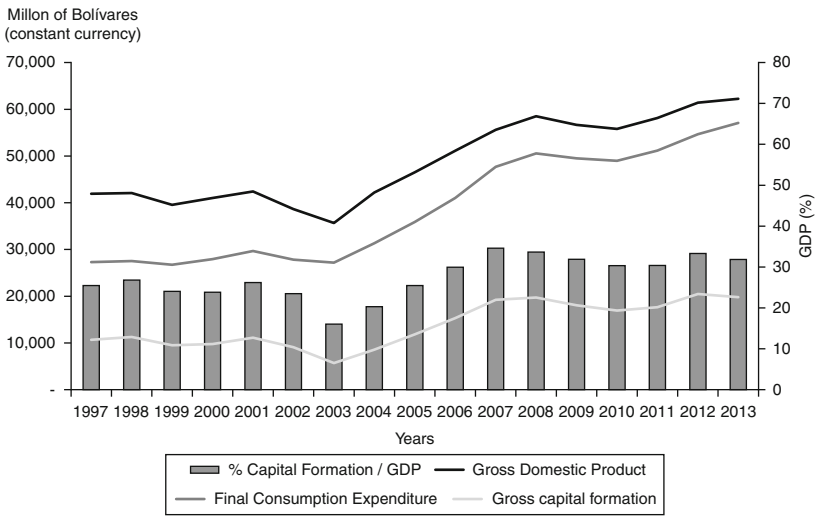

Figure 9.1 Venezuela's real trend GDP and GDP components.
Source: BCV / Author.

growth of 10.4%, the fastest period of growth since 1948. These transformations and the expansion of public and private consumption during those years were mainly a result of the distribution of the national income from oil, which allowed a sustained growth period that was only interrupted in 2008 by the international crisis.

After the commodities bubble popped, the Venezuelan economy experienced a new crisis with deep contraction in exports. The recession of 2009–2010 produced a decrease of 4.6% of GDP. However, by 2011, the cycle of economic decline had ended, and Venezuela started growing again, but at a slower rate (3.7%).

Total consumption rates (both public and private sectors included) stayed almost constant into the 2003 crisis. Since then, this rate has increased constantly until 2008 (13.2% annual average growth with a higher rate than current GDP levels in those years). This process was led by private consumption, which exhibited higher average growth rate than public consumption (13.9% against 10.6%). The 2008 crisis did not reduce total consumption, due to an increased in public spending (4% between 2008 and 2010), whereas private consumption was reduced by 5%. Both public and private consumption levels showed strong recovery signs after economic growth bounced back, but at a slower pace than in previous years.

Gross fixed capital formation (GFCF) shows a different dynamic than the one registered by consumption. First, it was severely affected by the events that took place in 2003, when it reached minimum levels (decreasing 50% in two years, only 16% of that year's GDP). From the recovery period, investment levels increased at significantly high rates, ending at 35% of GDP in 2007. Since the international crisis of 2008, despite the deep recession that affected the Venezuelan economy until 2010, the level of GFCF remained at higher levels than during the 1990s. In 2013, due to the recovery of economic growth, GFCF explains 32% of GDP.

The important recovery experienced after 2003 was, in fact, a change of the structural tendency that maintained the Venezuelan economy. Analyzing the evolution of the real per capita GDP, we can observe that Venezuela was in a deep stagnation cycle from 1984 to 2002 (figure 9.2). During those almost 20 years, per capita GDP was in a tight range, with a clear bearish trend since 1992. Between the maximum and minimum level, there was only a 7% range relative to the average value, and in 2001, GDP per capita was at the same level as in 1972. Finally, recession associated with the 2002–2003 crisis marked an historic low. After that, the variable exhibits a rising trend until the end of the period under analysis (figure 9.2).

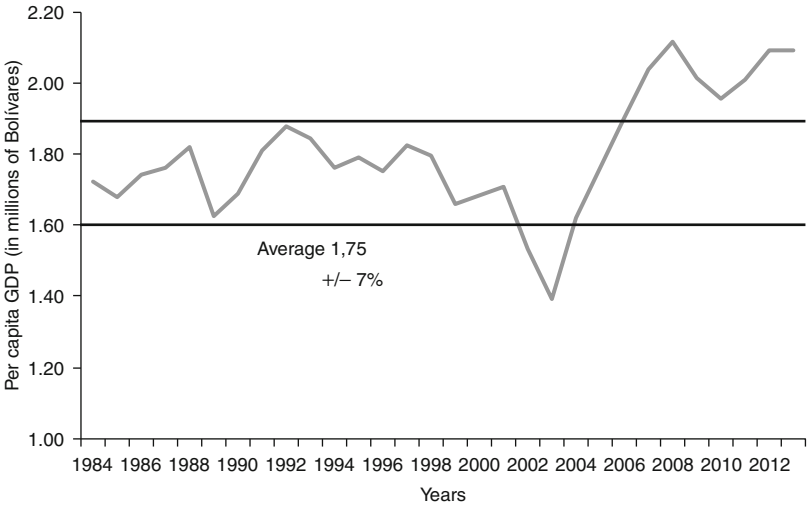

Figure 9.2 Venezuela's real per capita GDP (in millions of Bolívares).
Source: BCV/Author.

A study by Bello and Ayala (2004) shows that the structural stagnation the Venezuelan economy underwent until the beginning of the twentieth century reached maximum values between 1974 and 1981.[9] However, after 2003, the current stagnation tendency was broken. Since then, the Venezuelan economy registered a radical change in its growing dynamic, reaching a historical maximum in 2008, only surpassed during the 1970s, when the oil price boom took place. But this latest change, unless the previous ones, was accompanied by significant improvements in income distribution indicators. In this period, the per capita GDP grew at a surprising annual rate of 9%.[10] The effects of the international crisis reduced product per capita; in 2010, reaching a new minimum that was still higher than the maximum value registered in the previous period (and 39% higher than the 2003 value). While it is certain that most of the growth registered between 2003 and 2008 is explained by the increased rent of the oil sector, the

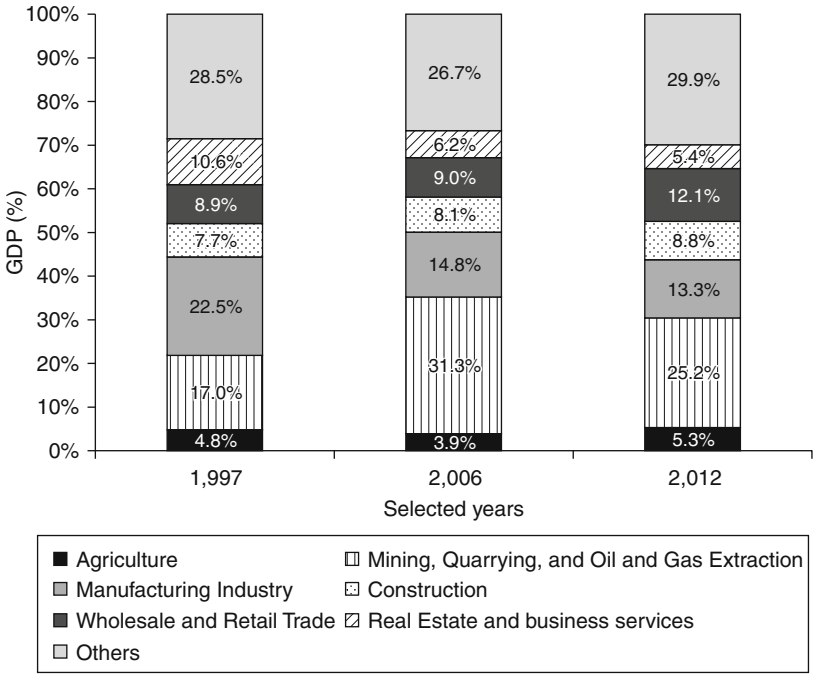

Figure 9.3 Venezuela's GDP—distribution by sector.

Source: BCV/Author.

estimation of the nonoil per capita GDP also shows a surprising rise (62% between 2008 and 2003).

Venezuela's productive structure is a reflection of the factors mentioned in the previous sections. Dominated by the primary sector (30.4% of the GDP to 2012[11]), it responds fundamentally to the evolution of oil-related activities. The manufacturing industry represents only 13.3%, of which the petroleum refinement represents 0.9% points.[12] Within the services sector, wholesale and retail trade and construction are the most relevant activities (figure 9.3).

Comparing the GDP structure between 1997 and 2012, a significant change is visible in the GDP participation of mining and quarry activity (mostly oil). This is exclusively related to higher relative prices (the implicit growth of the price index for the oil industry doubled the industry price index, even when the growth was less than international prices). The oil extraction level, however, decreased during the same period. In 2006, before the international crisis, it reached 31.3% of GDP. Industry participation, on the other hand, decreased almost 10% on GDP since 1997 which indicates that economic reforms did not achieve great success in Venezuela's industrialization process.

9.3.1 Macroeconomic Effects of the Crisis

The most important contagion factor of the international crisis of 2008 for Venezuela was in international trade. More precisely, the crisis affected the oil market because of the changes in international prices as a consequence of speculative movements in commodities markets, as well as the significant impact on international oil demand brought by the economic recession.

An analysis of quarterly Venezuelan GDP evolution notes that 2008 barely shows a decrease in the growth rate, which had been stable since 2004. In 2009, on the contrary, a sharp fall took place, reaching a 5.8% year-to-year contraction in the last quarter. By 2010, GDP contraction was stopped in the second semester, but only in 2011 was growth finally visible again. A preliminary conclusion shows that recession lasted 6 consecutive quarters, making Venezuela the country that suffered the most adverse consequences of the international crisis within the region (figure 9.4).

To understand the reason for the negative GDP trend that Venezuela showed after 2008, it is necessary to differentiate between oil-related GDP and the rest of the economy. Oil activity entered a crisis phase by the fourth quarter of 2008, followed by a 10% annual fall in the third quarter of 2009 due to the total collapse of oil prices. After that, even

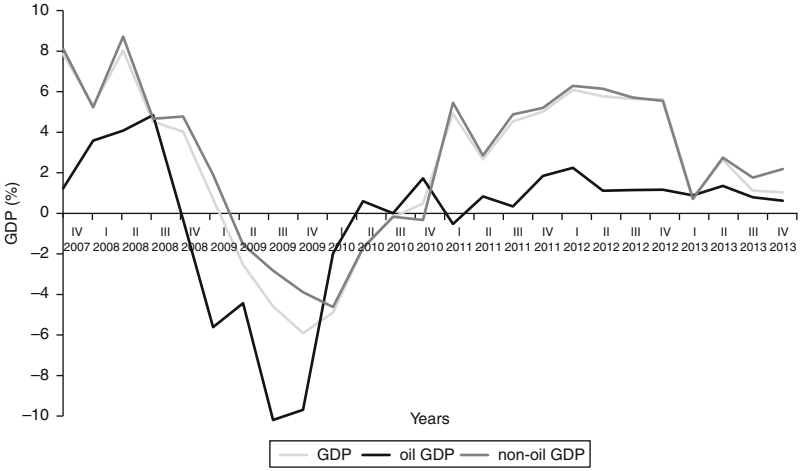

Figure 9.4 Venezuela's year-to-year GDP growth.
Source: BCV.

once Venezuela had overcome the recession at the beginning of 2010, annual growth never reached over 2% again. As will be explained in following chapters, this low growth rate does not come from pricing problems (which are higher than before the crisis), but it has its origins in the lower export volumes because of coordinated limitations of oil output by OPEC agreements, responding to lower demand and a very stable trend of oil output since 2009.

This sharp decline in the oil industry had a significant impact on the rest of the economy in two ways. On the one hand, lower petroleum economic activity reduced domestic demand directly. On the other hand, lower fiscal income also pushed local economic activity and general demand lower. Since the second half of 2008, non-oil related GDP started a massive crash in its growth rate and experienced a contraction phase in 2009. The fall in oil-related GDP was followed by the energy crisis of 2009, caused by a severe drought, limitations of imported inputs and products due to a shortage in international reserves, and a drop in public spending. All these factors pushed aggregate demand levels down. In the fourth quarter of 2009, the economy reached its worst moments during the crisis with a 5.8% year-to-year decline. In 2011, growth finally recovered at a 5% annual rate, but at a declining annual growth rate to 2% in 2013.

A study of non-oil related GDP shows that the impact of the crisis was not homogeneous in all the sectors of the Venezuelan economy. Wholesale and retail trade were the activities with the highest contraction, reaching –13% between 2008 and 2009. Both sectors suffered a strong contraction in the oil-industry demand, followed by a decline in consumption levels, import limitations, and an energy crisis. Even though the growth rate in the public sector lowered to the point of stagnation, it never reached a contraction phase. Construction growth lagged behind the rest of the economy growth rate, decreasing from 2009, but exiting recession in the second half of 2011.

The fall in oil prices after the second half of 2008, and the decrease in the volume of exports damaged fiscal health considerably. In Venezuela, fiscal income is mostly based in oil activity (57% in 2007) plus indirect income. Thus, a drop in exports strongly reduced the main source of income for the government. In March 2009, a budget reform was approved, lowering the expected price of oil from US$ 60 to US$ 40 with a lower estimated output. Public spending was cut to only an increase of 7.5% in 2009, when in 2008, it was 38%. But in real terms, the public spending cut reached 16%. At the same time, value- added tax was lifted from 9% to 12% in order to compensate for lower oil income. Also, increasing debt emissions and cutting unnecessary expenses were some of the actions taken by the government. Minimum wage was increased as well in two phases of 10% each (this meant, however, a lower real purchasing power, since this increases did not compensate the impact of 2008 inflation level). Nevertheless, the decrease in spending was lower than that in revenue levels, so the central government deficit increased, reaching 5% of GDP (with a primary deficit of 3.7% of GDP).

These spending cuts and tax increase measures ended up by deepening the recession that had been brought on by the global crisis, rather than helping the economy to overcome its effects. Despite the different tools available to act countercyclically, and in opposition of the rest of the countries of the region, these few measures deepened the fiscal and domestic demand crisis. The comparison carried out by ECLAC (2010) brought striking results, showing that while countries of the region deployed a package of heterogeneous and fiscally expansive measures, Venezuela only took minor pro-cyclical actions. Some studies hold that these recessionary policies were the main cause of the strong impact that the international crisis had in Venezuela.[13]

After the decline in exports, the Venezuelan government decided to implement restrictions on imports to maintain the trade surplus,

both through trade measures and by means of further rationing foreign currency by CADIVI. Since the majority of Venezuelan imports are intermediate goods, these measures contributed to lower domestic production and deepened the crisis.

Also as a response to the effects of the crisis, Chavez deepened reforms through the nationalization of several strategic companies, particularly banks and industrial companies highly related to the value chain of the oil industry. Politically, a referendum for the amendment of the 1999 constitution was launched successfully. This allowed indefinite re-election of all who were elected to public office, which was approved by 54 % of the votes.

9.3.2 Primary Sector

As mentioned before, Venezuela's economic structure is dominated by the primary sector, specifically petroleum extraction, since both agricultural activities and mining operations have a relatively low participation in total GDP (both account for only 5.9% of the GDP). Agriculture's participation is reduced to the point that in the official statistics of GDP by sector published by the Central Bank of Venezuela, it appears as "others" along with "restaurants and private hotels" and "public diverse activities."[14] This low participation reflects the poor development of food production, taking into consideration the potential of natural resources in Venezuela, which results in an output level that is not enough to cover the demand of the population, forcing significant imports of food. 2013 saw the country's highest historical participation in imports: 22.5% of which were food or products for the food industry (about $10.159 million dollars' worth), mainly beef, milk, wheat, corn and rice.

To reduce the cost of food, especially for the most humble sectors, Venezuela's government implemented the *Misiones,* programs used to provide the nutritional bill with oil income. In 2004, the Misión Alimentación, which finances the Mercal (*Mercado de Alimentos*, meaning food market) was implemented; one of the most important missions, its main objective has been to sell essential food products (like oil, rice, or powdered milk) at subsidized prices. Also, in the early 2008, two subsidiaries of PDVSA were created to increase State intervention and petroleum financing in the food sector (Agricultural PDVSA and the Venezuelan food producer and distributor—PDVAL is its acronym in Spanish). Such programs were rapidly extended to large segments of the population

The impact of the international crisis in the agricultural sector was mainly recorded in the significant increase in the cost of food imports following the expansion in commodities prices, which led to a reduction in the access to food. After the commodity prices rally started, food imports in Venezuela increased by 98% in 2008 (about 4,760 million dollars), which explained the entire rise of that year's imports. The country's dependence on imported food provoked domestic prices to follow international price trends, and a huge rise in internal food prices took place after August 2007. According to the Consumer Price Index, the annual growth rate of food and beverage prices began to be systematically above the general index. The peak in inflation rates was in September 2008, with an annual price increase of 36%, while foods and beverages showed a growth of 53%.

In addition to the effects of the international crisis, during 2009 the agricultural sector suffered an important drought as a result of an "El Niño" stream that severely affected the region that year[15]. In cereals, for example, the year 2009 showed a sharp decline in quantities harvested (–12% on rice, –34% on corn compared to 2008). The lowest local production combined with the increase of international prices raises domestic prices and imports even more, causing a decrease in food intake levels. Even for an economy accustomed to high inflation rates, the increases registered after the international crisis modified the internal structure of relative prices, punishing the poorest sectors. In response to this, some plans to increase agricultural production and regulate imports were carried out (such as the case of the bailout of Argentina's dairy company, SanCor, which paid their credit of the Bank of Economic and Social Development of Venezuela with exports of powdered milk).

Given the importance of the hydrocarbon sector in the Venezuelan economy, we need to observe the evolution of its characteristics and importance on the world market to assess the impact of the international crisis. We mentioned that Venezuela has the world's largest oil reserves and the eighth largest natural gas reserve worldwide, despite not having significant development in natural gas production. However, most Venezuelan oil is of low quality because of its high sulfur content and high density, so it must receive special treatment in order to provide products (especially the lightest and more profitable, such as naphtha). Because of this, the price of Venezuela's oil is inferior to referential international prices (WTI, Brent or the OPEC basket itself). Besides, it has few opportunities to operate in short-term markets, as it has to work with specific refineries through long-

range contracts. This tendency was increased in recent years due to the beginning of mass production of the Orinoco Heavy Oil Belt, in which extra-heavy oils predominate[16]. While in 2002, the Venezuelan oil extraction had 25° API[17] of gravity in average, by 2011, 20.6° API average oil was obtained and has decreased even more in the following years, since the heavy and extra-heavy oil extracted increased from 48% to 58% in 2013.

As mentioned before, despite the central role of petroleum in the Venezuelan economy, its domestic evolution is far from relying solely on internal variables. The importance of Venezuela in the OPEC and in the worldwide petroleum market makes production levels to be subject to the cartel regulations regarding supply volumes set for each member country, especially in times of great variations in international prices.

These restrictions became more relevant after the arrival of Chavez's government. By that time, the international oil price was close to its historically lowest level as a consequence of the crisis in Southeast Asia that had begun in 1998, in addition to a rise in extraction quotas that OPEC decided on that same year. Although Venezuela was one of the founding members of OPEC, under previous governments, it had systematically violated the stipulated extraction volume, weakening the pressure power of the cartel. The Chavez government instead opted to strengthen the organization, respecting the extraction reduction agreements and including other relevant producer countries outside of OPEC, like Mexico and Norway. The oil extraction cuts and the international political events made international oil prices increase constantly from that minimum level.

Thus, the fulfillment of the established production allocations, combined with the decline of the older fields that were not replaced by new investments, made Venezuela go from extracting 3.7 billion barrels per day to a level that has not surpassed 3 billion barrels over the last decade. Nevertheless, the lack of recovery in the extraction levels prior to the crisis shows that Venezuela's oil extraction decline was not caused just by OPEC production allocations (since the organization increased extraction levels in 2012), but it is also rooted in the lack of productive investment from PDVSA.[18] This is true especially if we consider that Venezuela needs heavy investment in order to be able to dispose of its reserves.[19]

As shown in figure 9.5, while the Venezuelan barrel price in 2009 experienced a sharp drop from the previous year, the average annual value was similar to the price in 2006–2007, before the international

crisis started. After 2011, Venezuelan export prices greatly exceeded the peak of 2008, a record high up to then. However, the extraction and export volumes never reached previous levels.

To understand the evolution of oil extraction and exporting in Venezuela during the last decade, we should take into account the measures taken by OPEC following the collapse of international prices in late 2008, and the decrease in international oil demand. In 2008, OPEC had to make three successive cuts in production quotas that were established for each member country in order to reduce supply. With these maneuvers, about 5 million barrels per day were withdrawn from the market (16% of the production allocations established in 2007).

In spite of that, during 2009, prices returned to pre-crisis levels. The fulfillment of production restrictions caused the near-paralysis of the Venezuelan oil industry, sunk to levels of extraction only experienced during the petroleum strike in 2002. As shown in figure 9.5, since 2008, the crude extraction in Venezuela dropped by 10% (from 3.2 to 2.9 million barrels per day), which caused a 13% drop in exports (from 2.2 to 1.9 million barrels per day), even though the average price of the basket of Venezuelan exports remains close to US$ 100 per barrel.

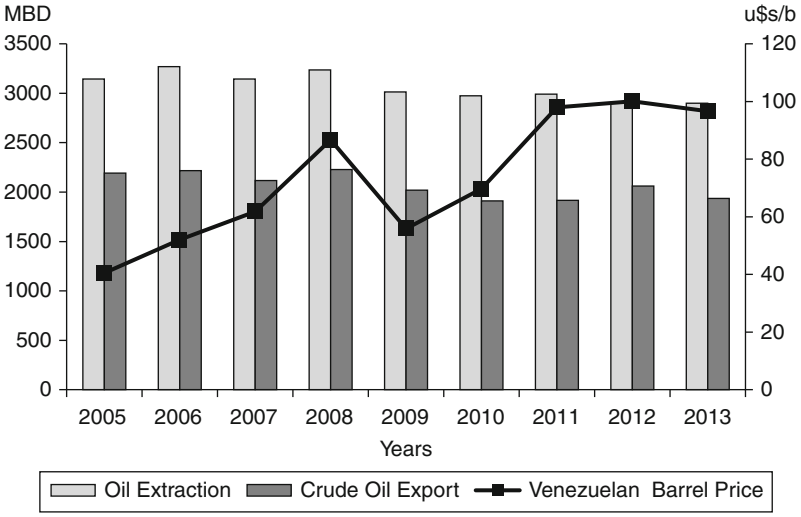

Figure 9.5 Evolution of extraction and export of petroleum in venezuela, value of export barrel.

Source: BCV, PDVSA, PODE.

The need to restrict oil supply after OPEC resolutions, and the lower level of foreign currency income—resulting from lower export volumes—had a negative effect on oil investments, especially riskier ones, such as drilling exploration wells. From 25 exploratory wells drilled in 2008 to search for new oil and gas reserves, they dropped sharply to 8 in 2009 and only 6 in 2010. These figures are even lower than the 13 recorded in 2003 during the oil strike. As an indicator of the restriction to the expansion of oil extraction, PDVSA currently has only 4% of its oil reserves developed (meaning in condition to be extracted with existing facilities and infrastructure). This again indicates that Venezuela could increase its extraction without violating OPEC regulations, but it suffers from the maturity of its main fields and the lack of investment in development, even in times of prosperity.

9.3.3 Industrial Sector

As we mentioned before, the industrial sector explains a reduced portion of the Venezuelan GDP, and it has been shrinking in the last few years. In previous periods of oil bonanza, there were attempts to increase the value of industrial activities on GDP. In the 1970s, for example, the oil rent was channeled to develop a heavy industry system, and PDVSA was created, with the state as a single shareholder, to operate the established oil monopoly. The investments were focused on the production of basic supplies, such as steel, aluminum, chemist and petro-chemist. In this way, the State generated an industrial structure both "upstream" and "downstream" of the central oil production.

Nowadays, the significant increase of foreign currency, earned by growing oil income, is not channeled into deeper industrialization. In 2012, the participation of the manufacturing industry on GDP was only 13.3%, 41% less than its participation on 1997 (22.5%).[20] This is a consequence of a virtual impasse in the manufacturing sector: between 1997 and 2012, the average growth of industrial GDP in real terms was only 0.5%. Moreover, when analyzing the internal structure of the Venezuelan industry, the latest available data shows that by 2006,[21] the most important industrial activity was petroleum refining (8.8%), followed by the iron and steel industry, (7.4%), milling products (5.4%), then precious metals products and non-ferrous (5.2%), and production and processing of meat (5.1%). This shows that the Venezuelan industry was concentrated in activities directly related to primary resources, linked to agricultural products (34.9%

of sectorial value-added is mainly milling, production, and processing of meat and bakery products) and mining products (24.2%, led by petroleum refining, industry iron and steel, precious metal products and non-ferrous). Of the remaining 40.9%, the most important activities are the manufacture of chemicals, printing and publishing activities, and furniture. it's important to point out that this description of the industrial structure is highly dependent on the variable relative prices of the Venezuelan economy, and they are not good instruments by which to obtain a realistic picture of the real industrial structure. As mentioned above, measurements at current prices end up deeply underestimating the participation of the Venezuelan refining industry and the national product.

Another relevant feature of Venezuelan industry is that manufacturing activities show a weak complementarity and coordination, with a large portion of imported intermediate supplies.[22] The most dynamic and innovative industries (such as those involving chemical and pharmaceutical, the manufacture of machinery and automobiles, etc.) represent barely 16.8% of industrial GDP. Also, these activities make no real efforts in R&D in the country, which explains why they have a low proportion of value-added relative to GDP, while this indicator is led by activities such as development of soft drinks or textiles and rubber.

Both petroleum refining, which is included within the oil GDP in statistics, and supply-producers for the oil industry sectors (as steel industry, steel mills, etc.) strongly depend on the decisions and evolution of the hydrocarbon sector. This means that with decreases in mining, or investments such as those seen during the crisis of 2009–2010, these sectors present a drop in production (for lack of supplies or demand). Nevertheless, these being large scale and expensive stops processes, production modifications are usually milder than in the rest of the industry.

Refining activity is a state monopoly, and the six existing complexes in Venezuela are owned by PDVSA. It should be observed that, given the characteristics of Venezuelan oil and the international expansion policy developed to evade government controls by the "meritocracy" who ran the state oil company up to 2003, PDVSA has most of its refining capacity overseas (1,519 million barrels per day versus 1,303 inside the country). Most of the refining capacity abroad comes from CITGO, its US subsidiary, while also counting on minority stakes in refineries in the Caribbean (part of the Petrocaribe agreement) and Europe.

Except in times of great crisis like 2003 and 2009, the activity of Venezuelan refineries usually remains close to 80% of installed capacity utilization. In 2009, the processed crude fell off 5% because of the severe sector crisis, keeping only 74% utilization. Also, the lower fuel production was reflected in a drop in export volumes (the external sale of gasoline and vehicular naphtha declined 33%), since the domestic consumption remained relatively constant.

Analyzing the annual change in GDP value in constant currency, we can see that manufactures began to suffer the effects of the international crisis by year 2009, entering 2010 with a 9% decline in two years (figure 9.6). In 2011, manufacturing returned to moderate growth, but without recovering pre-crisis levels. Analyzing the main activities, we discovered that food and beverage continued to expand in 2009, with a drop of 8% in 2010. However, the main capital-intensive activities, such as the refining and metal-bearing industries, have much deeper drops (reaching an annual 30% decline) as a result of both the international crisis effects and the energy crisis caused by the drought.

A similar evolution is observed in the use of the industrial installed capacity (table 9.1). In 2006–2008, the average use within the industrial sector was 60.4%, with a slight decrease in 2008. Since 2009, a clear downward trend is observed in the use of installed capacity,

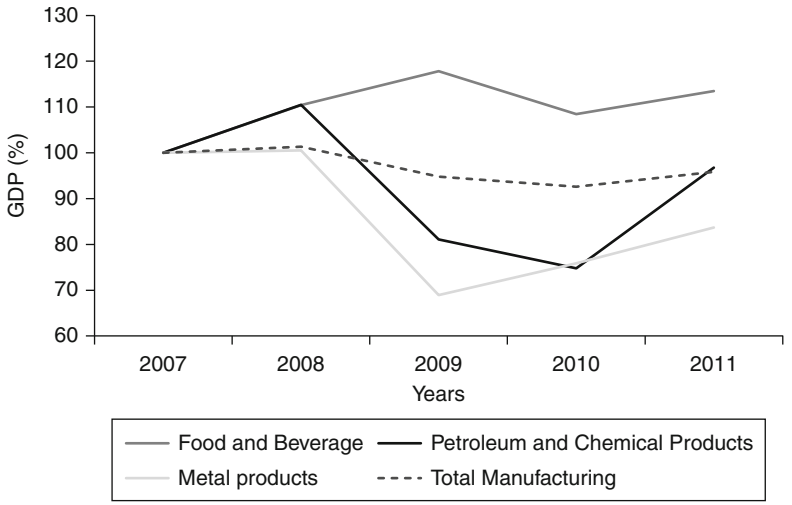

Figure 9.6 Evolution of gross value of production at constant prices in Venezuela.
Source: INE 2012 and 2013. 2007 = 100.

Table 9.1 Use of installed capacity—industrial sector in Venezuela (in %)

2004	*2005*	*2006*	*2007*	*2008*	*2009*	*2010*	*2011*	*2012*	*2013*
55.7	58.5	60.6	61.1	59.5	54.7	52.9	55.6	57.6	54.7

Source: Survey of Economic Situation, Conindustria.

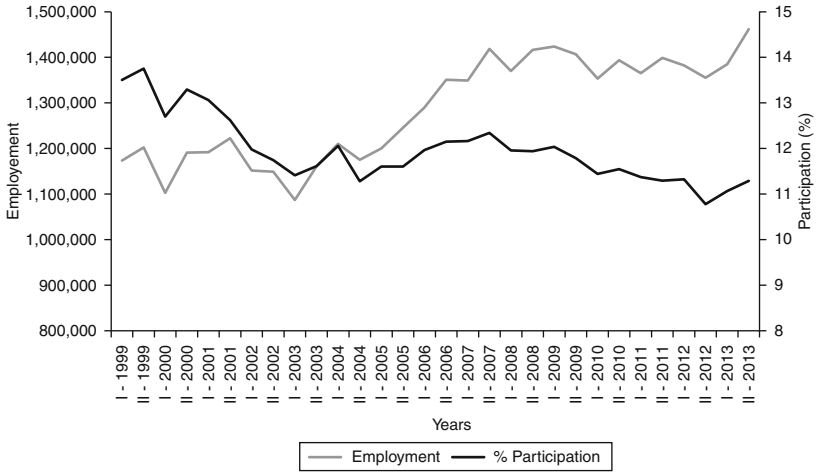

Figure 9.7 Manufacturing industry jobs in Venezuela.

reaching its minimum level in 2010 with a drop of 13% in just 2 years,a similar level to the one recorded during the oil strike of 2003. After 2 years of recovery, in 2013, use of installed capacity returned to the levels seen during the 2009 crisis.

Another way to analyze the role of industry in the Venezuelan economy and the impact of the international crisis is to look at its importance as an employer. In this sense, we can also observe a loss of relevance in the manufacturing sector (figure 9.7). While in 1989, the industry employed 16.8% of workers (both registered and informal), by 1999, its share had fallen to 13.5% and to barely 11.3% in the second half of 2013 (reaching a minimum of 10.8% in the second quarter of 2012). Industrial participation increases in total employment were recorded only between 2004 and 2007 and in 2013. Since 2007, the number of workers employed in the industry remains almost constant at around 1.4 million jobs.

As shown in figure 9.7, the international crisis and the lack of electricity caused by drought had repercussions in the industrial employment since the second half of 2009, although a loss of jobs had already been registered in 2008. Between the first semester of 2009 and the first of 2011 (the lowest point of the crisis), more than 58,000 industrial jobs were lost, even when total employment increased by 175,000 jobs in the same period. Only by 2013 was it possible to recover the level of jobs in the industrial sector that were missed by the international crisis. In terms of participation, however, industrial employment remains at very low levels.

9.3.4 External Sector

The external sector is heavily influenced by the oil-dependent, rentier-State arrangement of the Venezuelan economy. As mentioned, almost all merchandise exports are petroleum products, both crude oil and fuel (96% of total exports in 2013, reaching a peak of 93.6 billion dollars in 2012). The main export market is the United States, on which Venezuela concentrated 40% of its crude exports in 2013. During the last few years, however, Venezuela has made significant progress in diversifying export markets by reaching commercial agreements with India and China. Their two economies received 36% of total oil exports in 2013, while in 2008, they had represented barely 4%. The opening of new markets for oil exports was very important in order to compensate for lower exports to the United States, which has reduced its purchases from Venezuela by 50% in the last six years.

By contrast, the agreements and alliance proposals with Mercosur members and the Caribbean countries failed to achieve large sale volumes. Since the arrival of Chavez to power, Venezuela adopted an active policy to deepen the economic and political relations with other peripheral countries, and especially those in Latin America. In many cases, PDVSA was used as a mechanism to provide economic benefits to strengthen political and diplomatic relations, while helping the aim to diversify oil exports.[23] Venezuela runs only 11% of its oil exports to Latin America and the Caribbean (which is similar to the 1999 figure) although it concentrates 73% in Cuba, Nicaragua, Jamaica, Dominican Republic and Uruguay, as a result of political agreements and the PETROCARIBE initiative.

Risings international oil prices since 2001 allowed a sustained increase in exports, despite the impasse and even a slight setback on exported quantities. From 1999 to 2013, oil exports increased more

than 5 times, accompanying the rise in prices (the OPEC basket index was multipled by six in that period).[24] This led to an even deeper concentration of exports, and the necessity to become increasingly dependent on oil sales. As a result, from 1999 to 2013, non-oil exports declined from 20% to just 4%.

A peculiarity of the Venezuelan economy (it is a feature shared with others countries with an oil-rentier model) is that the majority of the exports are conducted through state-owned enterprises. Since the 2008 oil reform, the public sector directly controls all the oil exports. In addition, with the nationalization of enterprises considered strategic, the state ownership of the chain of supplies in the oil industry was completed, increasing the state's involvement in non-oil exports. Thus, by 2012, the public sector handled 98.4% of total exports.

The aforementioned increase in international oil prices that allowed a steady increase of exports[25] permitted Venezuela to maintain the current account surplus (The last year with a deficit was 1998, when oil prices were at a historically low level). Figure 9.8 shows that since 2003, the export growth accelerated, reaching about 95,000 million in 2008 (an increase of nearly 2.5 times in five years). Nevertheless, the current account balance barely increased 1.7 times in the same period, since imports were quadrupled, reaching 51.500 million dollars in 2008. Most of the new imports were intermediate goods,

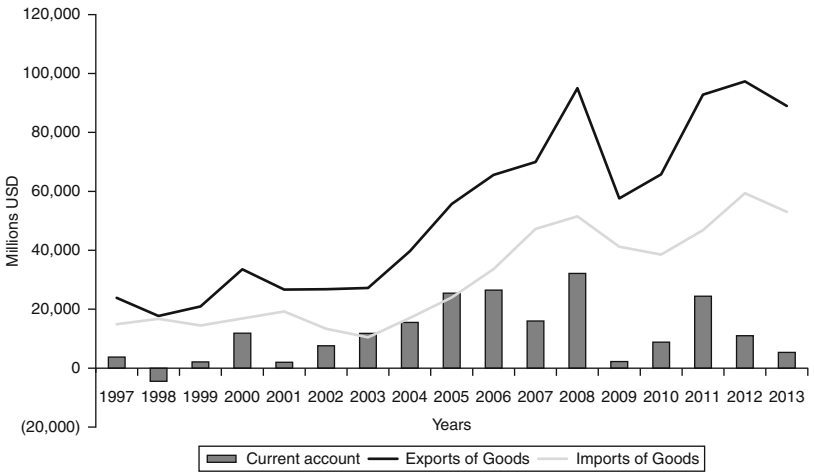

Figure 9.8 Current account evolution in Venezuela (in US million $).
Source: BCV.

followed by final consumption articles, mechanical appliances, machinery and electrical equipment, and motor vehicles, followed by meat and milk.

With the drop in international oil prices in 2009, after the speculative bubble in commodities and the cuts in oil production decided upon by OPEC, Venezuelan exports declined significantly from the record 2008 level. Nevertheless, the amount exported that year ($57.600 million dollars) was only exceeded in three times (from 2006 to 2008), following the rise of international prices.[26] In response to minor exports, the government implemented a plan for regulation and protection of national production that strongly limited imports. This limitation came from CADIVI's higher restrictions on the delivery of currency, and the implementation of trade taxes. This program lowered imports 20% on inter-annual and was deepened in 2010. The main accounts to reduce imports were the same that increased the most during the oil bonanza. The significant decline in imports in a context of poor export performance contributed to a current account surplus of about $2.250 million dollars in 2009. Although this surplus is the lowest recorded since 2001, by 2009, almost all of Latin America experienced current account deficit, being surpassed only by Argentina. The effect of the decline in foreign trade was so great that it affected the opening degree of the Venezuelan economy, declining from 51.8% of GDP in 2008 to barely 38.5% in 2009.[27]

As for the capital account, 2009 saw a reduction in the deficit recorded in previous years. This deficit was not even lowered because of the strong impact of the nationalization of companies in strategic sectors that was executed that year. The drop in foreign direct investment explains the 26% capital deficit. However, unlike other years trade surplus was not enough to compensate for capital account deficit, so the balance of payments became negative (3% of GDP) after several years of sustained increases in reserves (figure 9.9). Over the last decade, only 2007 has registered a negative balance of payments result (2.5% of GDP).

The comparison of this point with the rest of Latin America shows how strongly the impact of the international crisis was on the Venezuelan economy. According to ECLAC, only three other Latin American countries showed negative results on their balance of payments, and for an amount that, all three deficits added, barely represent one-third of the Venezuelan deficit. Although the trade surplus recovered in a few years, reaching 24,000 million in 2011, capital account deficit (and "errors and omissions," which is usually used as

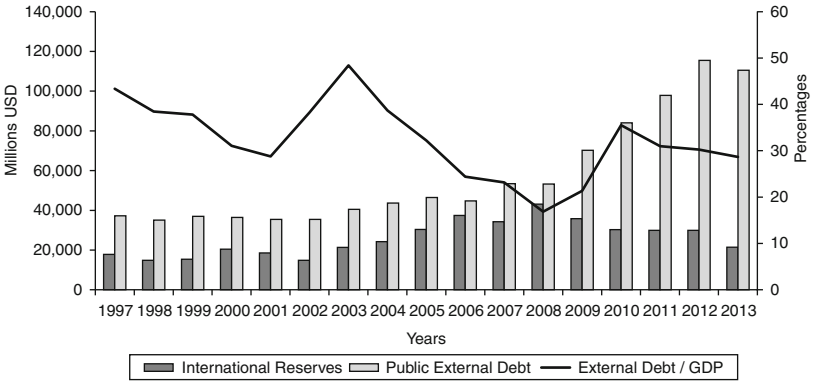

Figure 9.9 Evolution of international reserves and external debt in Venezuela.
Source: BCV. In millions dollars and %.

an indicator of capital flight) had the balance of payments still showing a significant deficit.

With the outbreak of the crisis, the capitals flight grew more serious. According to various estimates, in 1999, Venezuelans had more than US$ 70,000 million in capital abroad. Thus, residents outside their country accumulated two dollars per one dollar of external debt (Medina Smith, 2005). According to official data from the Central Bank of Venezuela, from 1999 to 2013, the private sector deposits abroad increased by 138 billion dollars at an average annual rate of 14.7%. This should be seen as a minimum value of capital flight.

The deterioration in external accounts since 2008—as a result of weak exports and capital account deficit—brought along a drop in international reserves and an increase in public debt. However, in the case of Venezuela, these variables have not such significant effects as in other peripheral economies, due to the state's extraordinary ability to generate and arrogate foreign currency incomes. In the case of international reserves of the Central Bank of Venezuela (BCV), while it fell by 30% between 2008 and 2010, it barely declined in relative terms, both regarding the GDP (from 13% to 12%) and imports (from 82% to 76%). In addition, $30.332 million in reserves in 2010 equal the level recorded in 2005 and double the reserves from 1999. This includes the Venezuela Investment Fund (FIV) and the Macroeconomic Stabilization Fund (FIEM), but leaves out the FONDEN (legally, a corporation), which accumulated contributions to 2011 for US$ 81.400 million from equal parts PDVSA[28] and the BCV. Since then,

the international reserves level tended to remain relatively stable up to 2013, when it dropped significantly, just above $20 million.

In this context, total external debt increased by 58% between 2008 and 2010, reaching US$ 84 million. This was pushed by the public debt, which grew by 91%, while the private debt decreased. In relation to the product, this means the end of the debt reduction process that had been recorded since 2003, rising from 17% in 2008 to a maximum of 35% in 2010, and decreasing below 30% by 2013. While this is a significant increase, it does not become a significant burden, due to previous low levels of debt. Debt service, however, barely reaches 15% of exports and 44% of the trade balance.

9.3.5 Employment and Income Distribution

Despite being rich in natural resources, Venezuela has historically shown extreme levels of inequality and poverty. During the 1990s, these levels deepened as a result of the policies of structural adjustment, liberalization, privatization and labor reforms promoted by international organizations. While in 1990, 34% of households lived in poverty, 7 years later, the number had increased to 55.6% of households in poverty (and 60.9% of people), with indigence levels reaching 25%.

While poverty levels have declined since then, the 2002 crisis made poverty rise again, reaching 54% of households in 2003, this time accompanied by a significant increase in unemployment (which reached 19% of workers). Since then, the process of economic growth has had a positive impact on these variables, and poverty and unemployment decreased steadily throughout Chavez's administration. In 2013, poverty rates remained at 29.4% of households (and 34% of the population), which is similar to the levels at the beginning of the 1990s. Unemployment that year stood at 8.1%, maintaining the level of workers living in poverty.[29]

Regarding the Human Development Index, or HDI, major improvements have been seen. According to the United Nations Development Program (UNDP), the HDI improved from 0.662 in 2000 to 0.748 in 2012, placing Venezuela in 71st place as a High Development country. According to INE, the values are slightly higher, with the country reaching an HDI of 0.771 in 2012. This ranking was due to a significant improvement in most social indicators; to name a few: between 1990 and 2011, illiteracy fell from 9.3% to 4.9%, infant mortality fell between 2003 and 2011 from 18.5 to 15.3 per thousand, life

expectancy at birth increased between 2004 and 2013 from 73 to 74.7 years, and the population over 60 years old with pension coverage rose from 16% in 1998 to 43% in 2009.[30]

Another important social improvement of the Chavez process is observed in income distribution indicators. The Gini indicator was 0.47 in 1999 and reduced to 0.40 in 2012, with an improvement of 14% (figure 9.10). As a result, Venezuela's economy ranked second behind Uruguay for equitable distribution in Latin America in 2012.[31]

As can be seen in the evolution of major social indicators series on figure 9.10, the international crisis did not have strong effects on these variables. Although a slight increase in the unemployment rate is recorded (which rose from 7.5% in 2009 to 8.8% in 2010), the greatest impact can be found in how the crisis meant a stop to the constant decline in poverty recorded since 2004. After 2007, households below the poverty line remained at 27% (with a slightly higher 29% in 2013). This contrasts with the effect of the 2002 crisis, and the oil strike was much more important, with a general increase in poverty and unemployment indicators.

Delving into the social effects of the 2008 crisis, we must consider that the strong state intervention helped to avoid a rise in unemployment levels. While within the private sector more than 30,000 jobs were lost in 2009, the public sector provided a 100,000 jobs increase in that year. Although these numbers are influenced by the

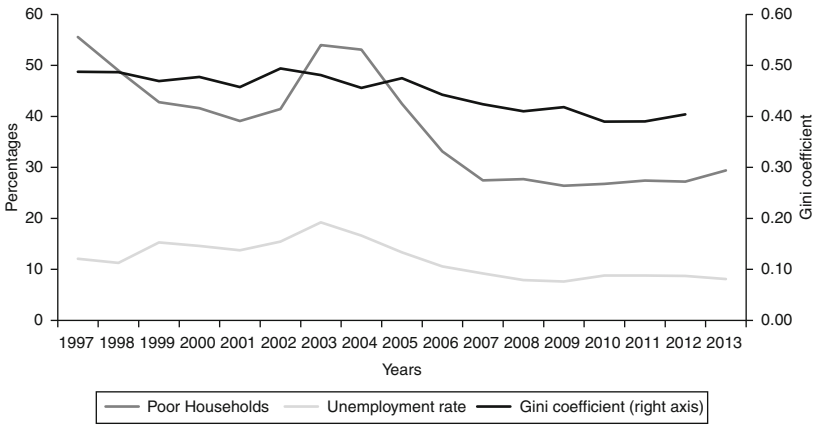

Figure 9.10 Social indicators of poverty, unemployment and the Gini coefficient in Venezuela.

Source: INE and ECLAC.

nationalizations carried out that year, the net increase in employment was exclusively a result of the state's effort. Since then, the participation of the public sector has increased year after year, until it reached 20% of employees (vs. 14% in 2002).

The decrease in tax revenues experienced in the crisis and the subsequent reduction of public spending led to a drop in investment in social expenses. In 2007–2008, public social spending represented 20.6% of GDP; it was reduced to 17% in 2009–2010. Despite economic recovery in 2011–2012, social spending represented only 15.4% of GDP by 2012. Notice that in spite of this value remaining low for the *chavista* period, it is still 40% higher than the average recorded in the 1990s.

As for remuneration, the average real wage shows a downward trend, mainly due to inflation. Between 2007 and 2013, the price index increased by 5 times the initial level, causing a drop in real wages of 17% (figure 9.11). In contrast, the minimum wage established by decree maintains a more favorable outcome with a real decrease of 3% (when until 2012 it showed an increase of 4%). Taking a wider range of time for the analysis period, the trend remains. From 2000 to 2011, while wages lost purchasing power against rising prices, the minimum wage showed a significant increase in real terms.[32] This

Figure 9.11 Real wage and price index in Venezuela.
Source: INE and BCV 2007 = 100.

increase, established in 2009, stopped the drop in real minimum wage, unlike the average salary, which continued to fall until 2010.

9.4 Conclusions

In this chapter, we have done a brief review of the specific characteristics of the Venezuelan economy, its production structure, and the effects on it of the international crisis of 2008–2009. Despite being situated in a strong position, in the middle of a process of economic and social expansion, the 2008 crisis hit Venezuela hard, making it one of the most affected countries in Latin America. The drop in GDP (–5%) was greater than in other countries in the region. This declining trend continued in 2010, even when other economies had recovered their growth path.

To understand this reaction to the external sector, we had to take into account the rentier aspects of the Venezuelan accumulation regime, and the burden of having the main global oil reserves and being a major exporter of oil and fuels. Petroleum in Venezuela is considered low- quality oil because of its high sulfur content and high density, features that have increased since the development of the Orinoco Oil Belt. This is why PDVSA can't operate in the short-term market but depends on reaching agreements with refineries specifically prepared for its oil and receiving a lower value than the international price.

The hydrocarbons work for Venezuela as an export enclave dependent on the ups and downs of the international market, having weak linkages with the internal production complex (except for a network of industrial inputs suppliers supported by its own oil revenues). Not only the oil industry, but also Venezuelan exports and imports, the domestic availability of foreign exchange and state financing, and the economy as a whole depend heavily on the mood of the market.

The hydrocarbons market (and commodities in general) were among those most affected by the great volatility of the 2008–2009 crisis. 2008 began with a marked increase in global fuel prices, a result of the massive inflow of speculative capital from the use of financial derivatives. Fuel prices reached historic highs, beating even previous crisis levels that had been fueled by armed conflicts and blockades.[33] However, in the second half of 2008, the bubble burst, unleashing the financial and banking crisis in the United States, affecting both the financial market and international commerce, and causing prices of basic inputs to plunge.

Given this scenario, OPEC made several adjustments, cutting production to protect international prices in a context of flagging demand. For a country as dependent on the oil industry as Venezuela is, this triggered an inevitable crisis. In addition to lower prices, the regulation of extraction quotas prompted a decline in exports, and therefore a productive adjustment both commercially and financially. While prices have recovered since 2010—reaching an even higher annual average from 2011 to 2013 than in 2008, the historic record-holder—extraction activity continued to decline. Thus, in a country with a highly dependent non-oil sector, no dynamism, and enthusiasm for foreign currency income for oil, an oil crisis in times of favorable terms of trade appeared senseless.

It has been argued that Venezuela's oil boom was wasted, but this argument usually does not take into account the scope of social, political and economic developments since Chavez assumed power. After a few years of "administrative reorganization," which included a constitutional reform, Chavez's government began to change the oil structure from 2001. A radical change was carried out in the concession system in force, by which PDVSA gained operational control and a participation majority in oil industry. These measures led to strong social and political conflicts that culminated in a *coup d'etat* in April 2002 and an oil strike in PDVSA later that year, which caused the national GDP to plummet 24%.

Strengthened by overcoming these conflicts, in 2003, Chavez's administration began to carry out major reforms in the economic and social structure of Venezuela, with oil income redistribution as the axis. Since then, not only has economic growth recovered, but also the structural tendency to stagnation that once held the Venezuelan economy changed, with high growth rates and expansion of GDP per capita. But unlike other processes of growth thanks to the tailwind of the international market, Venezuela made great strides in reducing poverty and the historic inequality that had characterized it. Measured by the Human Development Index or any social indicator (literacy, malnutrition, infant mortality, etc.) this was an undeniable social development process, attached to a major reduction in levels of inequality, thanks to high social spending and the *Misiones,* tools used for the distribution of oil revenues.

However, we must recognize that this growth model intensified the dependence of the Venezuelan economy on the international hydrocarbons market. While on previous occasions the abundance of foreign exchange was used to create certain industrial structures,

currently the burden of the petroleum sector has increased to over 28% of GDP. On the other hand, the manufacturing industry lost half of its stake in the GDP, representing only 13%, while decreasing its importance in total employment. Venezuela's main industry is oil refining, followed by the iron and steel industries. These means that the GDP is totally dependent on oil production activities, which were created by the state in earlier industrializing processes, and depend on having oil revenues.

The increasing dependence on hydrocarbons is most evident in the external sector. Oil exports multiplied with the growth of international prices experienced since 1999, gaining share in exports exceeding 80% at the beginning of the Chavez government to 96% of foreign sales in 2013. Simultaneously, because of nationalization and changes in oil regulations, the Venezuelan state had total control over the petroleum and complementary industrial activities; the public sector came to control 98% of exports. Therefore, the Venezuelan state is practically the only agent that has access to genuine currency through the export of hydrocarbons.

Briefly, these were the main characteristics of the expansion process prevailing in Venezuela at the outbreak of the international financial crisis. The main contagion factor was, as mentioned before, commercial, and more specifically, through the hydrocarbons market. While a record of exports was reached in the sector in 2008, in 2009, exports fell considerably (almost 40% in one year). Despite this significant drop, foreign sales had very high values in historical terms. Like other countries in the region, the result was a fall in international reserves and debt growth. However, the outer strength that Venezuela had before the crisis allowed it to rapidly overcome its problems. As a consequence of the restrictions on exports, the decline in international demand, and the sharp drop in prices, the oil industry was seriously affected, reaching an annual drop of –10% in 2009. For its part, the public sector, with most of its revenue depending on the oil industry, reformulated expansionary plans of government spending and higher taxes without being able to avoid falling into fiscal deficit.

Venezuela's process of economic and social growth since 2003 was based on the recovery and redistribution of international oil rents. Although great advances were made in the social sector, breaking the structural trap that prevented per capita growth for decades, it is important to point out that it took place at a time of high and rising international oil prices, and the structural changes made in economic and social matters failed (if they ever tried) to decrease the

participation of hydrocarbons in the Venezuelan economy. During the last years, oil dependency in terms of GDP, exports, state funding, and social policy was increased, resulting in deindustrialization and greater participation for the primary sector of the economy. As was shown, the sharp fall in production that Venezuela's economy suffered in 2009 and 2010 was mainly due to the effects of the international crisis on the oil industry.

Notes

1. Currently known as "*Faja Petrolífera del Orinoco Hugo Chávez Frias*."
2. This includes the extraction of hydrocarbon and refining services. Unless stated to the contrary, for the calculation of the GDP, it has been included the net taxes on the products and services of financial intermediary measured indirectly.
3. MPPPyM. *Petróleo y Otros Datos Estadísticos* (2013). The *Ministerio del Poder Popular de Petróleo y Minería* (Ministry of Popular Power of Petroleum and Mining) considers appropriate International oil rent as the operating surplus of the oil industry that exceeds the "normal."
4. As important indicator of international rent obtained by Venezuela, note that in 2013 the Export Reference Basket was US$ 98 per barrel, when the extraction cost from PDVSA was US$ 11.
5. Mommer (2002) and Rodríguez Araque (2002).
6. Boué (2002, 2004).
7. Nonetheless, the weight of the public sector in the economy did not change significantly. From 2003 to 2013, the share of public sector in non-petroleum product declined from 18.6% to 17.8%.
8. Aponte Blank (2012).
9. See Bello and Ayala (2004).
10. This means that growth rate would duplicate GDP per capita in only 10 years.
11. 2013 GDP in constant currency data not available.
12. It is remarkable that refinery activity participation both in GDP and industrial index is very low (about 7% of industry GDP). These factors undermine the preconception of centrality of refining in the Venezuelan industrial complex. This can be explained by the relative price structure of fuel in Venezuela which under a strong policy of subsidized prices, refinery activity participation tends to get under-calculated. Fuel in Venezuela has artificially low prices both in terms of currencies as well as compared to other products. A clear indicator is that PDVSA lost US$ 16 per barrel used for local consumption in 2011.As a comparison, in Argentina for the year 2004, oil refinery GDP participation was very similar (1.3% vs. 1.4% Venezuela). However, measured in volumes Venezuela refineries produced twice Argentina output but according to national statistics of both countries, its Venezuelan Gross Production Value was only 10% higher while Argentina Added Value was

39% higher. If Venezuela would keep the same refined oil—added value ratio, refineries-related GDP would also increase 143% reaching a 3.4% of national GDP and 18% of the industrial sector. As a consequence of the increase in international fuel prices (not reflected in Venezuelan economy), the weight of Venezuelan refineries would be even more underestimated in the following years. Additionally it must be take in consideration that Argentina also had a policy of subsidized oil prices, lower to international levels but with solid profitability. On the contrary, PDVSA was losing 10 US$ per barrel at the comparison year.

13. Vera (2011).
14. Oddly, "Minery" and "Electricity and Water" do seem to be discriminated although counting with an evenlower GDP participation (under 1%).
15. Although the mentioned decrease in food production, due to the low relevance of agriculture in the Venezuelan economy, the greatest effect of the drought of 2009–2010 was on the electric power generation. Most of Venezuela's electrical structure depends on hydroelectric generation so the descent of the Caroni River to historical minimum produced an energy crisis that brought along blackouts and the need for implementing saving plans that reduced industrial and business consumption.
16. The increased extraction in the Orinoco Belt made the use of large quantities of "light" petroleum necessary for its mixing. This demand is greater than the light petroleum output available in Venezuela so in 2014 light oil had to be imported, despite being a leading oil exporter.
17. The API gravity is an international scale for measuring the density of the crude oil made by the American Petroleum Institute. The lower the indicator, the denser and heavier the crude. MPPPyM, PODE (2011).
18. This diagnosis is seen even following the Venezuelan statistics since international data (both BP Petroleum Company and OPEC) show an even bigger decrease in Venezuelan extraction.
19. In addition to the mentioned increasing weight in the extraction of heavy and extra heavy oil, with higher cost and requests for investment, productivity of each Venezuelan well is far from that obtained by other OPEC countries. While in Saudi Arabia each oil well has an average of 2,800 barrels per day and in Angola is 1,100 barrels per day, in Venezuela barely reaches 190 barrels.
20. It should be noticed that, as mentioned before, the relative Venezuelan prices underestimate the product and added value of the refining industry and therefore the industry after the rising of international price.
21. The last data available is from 2007 (BCV MIP 2007). However it was not used in this analysis as we found significant differences attributable to changes in relative prices. This is how in 2007 the Petroleum Refining represents only 2.8% of GDP industry and it is placed fifteenth of the industrial activities, which is not a correct description of the Venezuelan structure, because of the fall of 62% in sectorial Added Value. This drop was caused by the maintenance of domestic sale prices (in nominal terms, meaning a drop in relative prices) despite the growth of international price which led to increased intermediate sector demand. Since 2008, the surplus decreases

in such a way that by 2011 more than half of the Added Value come from Salaries, which is not consistent with the condition Intensive Capital Activity (INE 2013 includes the Manufacturing of Chemical Products).

22. Velásquez et al. (2012).
23. For more details see Mansilla (2008).
24. It's not possible to compare the price of Venezuelan oil included in the OPEC basket since in 2005 "Tía Juana Light" was replaced by "BCF-17" and in 2009 the "Merey" oil was chosen. By having different qualities and API degrees, the differential relative to other prices, as OPEC basket itself, or spot price as WTI is variable, preventing an accurate analysis of price increase.
25. It should be clarified that the estimates of oil extraction and exports change significantly according to the source, which leads to a complexity that must be taken into account in the analysis. For example, there are important differences between the official data from PDVSA and the statistics of OPEC, with the registered discrepancies reaching 20% of Venezuelan exports. Since 2007 (the last year in which both statistics matched), OPEC indicates lower Venezuelan exports by 0.4 million barrels of crude oil per day. Valuing these minor exports by the price of a representative barrel of Venezuela, it represents about 57 billion dollars in last five years, an amount equivalent to one year's total imports.
26. The average earned $ 57 of crude and sub-products per barrel exported in 2009 were 46% higher than the average 2003–2006 (PODE, 2009–2010).
27. ECLAC, Statistical Yearbook for Latin America and the Caribbean.
28. Besides the usual contributions, PDVSA contributed in 2008 and 2011 to the Special Contribution on Extraordinary Prices in the International Hydrocarbon Market and the Special Contribution on Extraordinary Prices and Exorbitant Prices in the International Hydrocarbon Market, respectively; tools used to fund the social investment with the extraordinary international income.
29. It should be clarified that there are proposes on methodological problems in measuring unemployment, such as the effect of the missions in unemployment and the activity or the shortest period of job search revealed by the survey.
30. Aponte Blank, 2012 and Integrated System of Social Indicators of Venezuela (SISOV).
31. ECLAC, Statistical Yearbook for Latin America and the Caribbean 2013.
32. Boada and Mayorca (2011).
33. To understand the weight of this fictitious demand, even in 2012 with the regulations that were imposed after the crisis, the speculative purchases increased five times the real oil sales.

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10

The Aftermath of the Global Crisis in Latin America: General Remarks and Future Perspectives

Paul Cooney, Orlando Justo, and Juan E. Santarcángelo

10.1 General Summary of the Crisis

The global economic crisis that began in 2007–2008 was one of the four worst crises that capitalism has experienced.[1] A distinctive characteristic in this case is that the adverse impact in the first world was harsher than in the periphery, in contrast to crises in recent decades. In fact, the growth rate of GNP for the G7 was –3.7% in 2009, and fast-growing China suffered a deceleration, with growth rates dropping from 10% to 7.5% for two quarters.

The debates about the nature of this crisis have been the most extensive and serious among heterodox economists since the neoclassical interpretation proved to be inadequate in explaining the core reasons behind the collapse. Among heterodox theories, post-Keynesian, Minskyan, and especially Marxist economists have elaborated different explanations regarding the current crisis. At the same time, the jury is still out as to whether or not this crisis has come to an end, or if, as many conclude, it is in an intermediate phase with an even more devastating crisis on the horizon. The majority of analyses recognize the problem of over-financialization of the global economy; in other words, the financial sector was out of control, and instead of providing important credit for productive activities, it was becoming a drain on the normal functioning and accumulation of the capitalist

system, as presented in the argument of the growth of fictitious capital, reflected in the surge of speculation.

Unfortunately, we still see mainstream financiers dominating politics in the United States and Europe. In the case of the latter, the continued domination of monetarists defending austerity has kept Europe in the economic doldrums and has led to serious political confrontations within the European Union. Consider the negative impacts such policies have had on Greece and Spain and the subsequent political fallout. Nevertheless, monetarists and neoliberals still rule the day, even though the writing on the wall says that those days are numbered.

10.2 Summary for Latin America

Overall, the negative effects of the global crisis in Latin America were less severe than other recent crises of the neoliberal period, In fact, First World countries suffered it more and some countries are still paying a high toll, especially in Europe. In Ocampo's view "Although the eye of the storm has been the financial sector of the industrialized countries, in strict financial terms, this crisis was much less severe than that of the debt crisis and also less grave than the crisis of emerging economies at the end of the 20th century" (2009: 54). For the region as a whole, there was a drop in GDP of roughly 2–2.5% in 2009. In Latin America, the worst of the crisis was the last quarter of 2008, after the major global credit crunch, and it extended through part of 2009, when world trade fell by 22%. Several countries in the region were able to recover by the middle of 2009, and for others, it was not until 2010 or later. We have observed a range of trajectories in the different countries analyzed in this book, and some of those had been experiencing worse situations prior to 2007–2008. Thus, certain phenomena and policies were independent of the global crisis triggered by the US mortgage crisis. Below, we present an overall assessment of the countries of Latin America discussed in the book, seeking to highlight the specifics of each country but also to present the common aspects experienced as well as exceptions.

In order to provide a basis of comparison for the different economies of Latin America, in table 10.1, we present the rates of growth of GDP for recent years. As we can see in the table, the Mexican economy had the worst drop in GDP during 2009, and since 2008 has experienced the weakest growth among the countries we analyzed.

Table 10.1 Real gross domestic product, Latin America, 2008–2013, % annual change

Country	*2008*	*2009*	*2010*	*2011*	*2012*	*2013*	*Prom 2008–2013*	*Prom 2010–2013*
Argentina	3.08	0.05	9.45	8.39	0.80	2.89	**4.11**	**5.38**
Bolivia	6.15	3.36	4.13	5.17	5.18	6.78	**5.13**	**5.31**
Brazil	5.02	–0.24	7.57	3.92	1.76	2.74	**3.46**	**4.00**
Chile	3.23	–1.03	5.74	5.75	5.53	4.32	**3.92**	**5.33**
Colombia	3.55	1.65	3.97	6.59	4.04	4.93	**4.12**	**4.88**
Ecuador	6.36	0.57	3.53	7.86	5.22	4.64	**4.69**	**5.31**
México	1.40	–4.70	5.11	4.04	4.00	1.39	**1.87**	**3.64**
Paraguay	6.36	–3.96	13.09	4.34	–1.23	14.26	**5.48**	**7.61**
Peru	9.14	1.04	8.45	6.45	5.95	5.77	**6.13**	**6.66**
Uruguay	7.17	2.35	8.40	7.34	3.67	4.39	**5.55**	**5.95**
Venezuela	5.27	–3.20	–1.48	4.17	5.62	1.34	**1.95**	**2.41**

Source: Own elaboration using IMF Data.

This is due to the depth of Mexico's recession in 2009 and the mild recovery since 2010.

After Mexico, the weakest performance was that of Venezuela. For the year 2009, the fall of GDP was –3.2%, and the decline continued into 2010, when most other economies of the region had already shown signs of GDP growth recovery.

Argentina enjoyed quite high average growth rates of 8% during the period of 2003–2008. However, as a result of the crisis, the country virtually stagnated in 2009, having the only non-positive growth rate from 2003 to the present. Fortunately, this was followed by a rebound to 9.4% and 8.4% for 2010 and 2011. Although the growth of GDP has been weak since then, averaging just above 2.2% during 2012–2014, the latter decline is not directly linked to the crisis of 2007–2009, but rather, as we saw in Chapter 3, is due to internal limits in its economic structure and development path.

Considering the trajectory of Brazil's GDP, it was not particularly strong during the period of Lula's government, since from 2003 to 2010, this percentage was 4.0%, and during the government of Dilma, from 2011–2014, it has been slightly more than 2%. On the one hand, there were only two years of negative growth, 2003 and 2009, both at –0.2%, but there were a total of 9 years in which the growth rate remained below 3%. In the case of 2009, it is evident that the crisis

came to impact the Brazilian economy negatively, though growth only declined –0.2%. In spite of the rebound in 2010, reaching 7.5% growth, the subsequent years have been troubling, especially in 2012, when the growth of the Brazilian economy was an anemic 0.9%. It is worth noting that Brazil´s GDP growth has been both below the world average and below the average for Latin American economies over the last 10 years.

In spite of its weakening economy during 2009, Colombia still maintained positive growth rates of GDP. As Maya observes, this was not the case for all sectors, since industrial production contracted –5.6% in 2009 and had a very low growth of 0.8% in 2008. A serious drop in the growth rate of GDP characterizes the recession of 2008–2009 after growing 8.2% in 2007, it grew 3.5% in 2008 and 1.6% in 2009. There was economic recovery in 2010, as the GDP growth rate jumped to 3.9%, and it has managed to stay above 4% since then.

As Campbell observed, Cuba presented a distinct case within the region. The Cuban economy slowed significantly in the post-2007 period, and many would wrongly assume this is primarily a result of the global crisis; but in fact, Campbell argues, it had more to do with internal developments than with transmission mechanisms of the global crisis. Cuba's GDP had been declining since 2006, and it continued downward until 2009, rebounding slightly from roughly 2–3% by 2011. Thus, Campbell claims, this dynamic is the result of an adjustment process associated with Cuba's shifts to a new development model.

In referring to the transmission mechanisms of the crisis, the two broad categories that dominate analyses are finance and trade. Within finance, the categories include foreign direct investment, international credit, stock markets, exchange rate and interest rates, royalties and profit repatriation, capital flight, and the flow of remittances. In the context of trade, the primary transmission mechanism is the impact upon both exports and imports—though much more the former—and also the impact upon terms of trade.

Some of the authors of this book claim that the principal effects of the crisis were not financial, but commercial. The main reason is because of the contraction of exports, due to reduced demand by the center, often accompanied by strong declines in the prices of primary goods or commodities. Nevertheless, as this study shows, the impact of certain aspects of finance played more significant roles for certain countries, such as Brazil, at least for some of the recent years.

As a result of the outbreak of the crisis in September of 2008, there was a huge global credit crunch, as nobody was willing to confide in even the "too big to fail" (TBTF) financial and investment powerhouses. There was a subsequent credit crisis, with each country trying to weather the storm through 2008. By 2009, most countries put into place some type of government policy or a range of programs attempting to promote recovery, though with mixed results, and in some cases, such as Mexico, recovery remained elusive. We will turn to a full discussion of countercyclical policies below and only concentrate on the most notable aspects of investment for the countries analyzed.

Investments in Brazil experienced a decline of roughly 12% between the last two quarters of 2008 and the last two quarters of 2009, with a significant rebound between the end of 2009 and the beginning of 2012. Overall, in GDP percentage terms, there was a minor drop from 21% down to 17–18% in 2009, and then a recovery to around 20% from 2010 through 2013. At the beginning of the crisis, the local stock market, the *Bovespa*, registered a drop of 60% between May and October of 2008, and there had not been such a decline since 1994. For the year as a whole, stocks showed a decline of 41.7%. For the subsequent year, 2009, there was an encouraging recovery, with an overall increase in stock values of 82.7%.

In the case of Argentina, Santarcángelo and Perrone show that investment declined roughly 15% in 2009, with a significant rebound during 2010, which was not enough to reach pre-crisis levels. Overall, in GDP percentage terms, there was a drop from 23.1% down to 20.6% in 2009, and then a recovery to around 22.7% in 2010. As the authors state, "In spite of an increase in net FDI flows to Latin America, Argentina continued to have difficulty to confront the image of a country, which was unfriendly or riskier for foreign investment." This is still an issue at present, with the current negotiations and demands presented by holdouts in US courts, in spite of major efforts made by the current government.

In the case of Chile, Lara argues that due to the "financial shock, investment was strongly impacted with a decline of 15.9% in 2009, after having grown at 19.5% in 2008. Nevertheless, there was a reasonable recovery in 2010 and 2011 with increases of 12.2 and 14.4% growth, respectively. However, this was followed by declines of 0.4 and –6.1% in 2013 and 2014."

The situation for Cuba is once again rather particular. Cuba's rules and regulations for any FDI project are quite distinct from other

peripheral capitalist economies, as they tend to be more selective and seek only those projects which will be useful for the essential task for national economic development, namely of the domestic economy.

As in any major crisis, there tends to be a serious growth of capital flight as investors seek to shift their capital or investment to the safest place possible. In the case of a global crisis, this can be more difficult, but the phenomenon is equally relevant, and certain countries will be more affected, depending on the general investment environment and the stability of the currency.

In Argentina, there was a notable increase in capital flight, which reached a peak of $23 billion in 2008 and remaining high until 2011, when a foreign exchange restriction was put into place (see chapter 3). The flight of capital is clearly linked to a less stable exchange rate and the problem of double-digit inflation. The outflow of capital in the form of capital flight and remittance of profits increased sharply after the crisis, resulting in the implementation of increasing restrictions on the foreign exchange market by local authorities. Profit and royalty repatriation had a similar situation, doubling and continuing upward as they increased significantly at the beginning of the crisis, and thus after 2011, they were put in check as a result of the foreign exchange restrictions.

As Mariña and Cámara argue, "The deep involvement of big Mexican corporations in national and international financial and speculative markets resulted in major financial losses during the 2008–2010 crisis." Such external dependence generated strong pressures on Mexico's current account balance and also on their exchange rate, given the high risk of massive capital outflows.

Venezuela's international reserves fell, and its debt grew, as a result of both the crisis and the subsequent decline of the price of oil on world markets during the last year (2014–2015). On the positive side, the reduction of speculative investment and the associated problems of international financial market channels of contagion were less of an issue for the Venezuelan economy. However, the effect was more significant in the structural capital flight, which grew due to the political events of 2002 and intensified with the crisis.

According to Lara,

> Both the capital flows coming out of Chile as well as other 'emerging' countries', and the accumulation of international reserves, are largely a result of the significant trade surpluses experienced by these economies in the last decade; mainly due to the dramatic changes occurring in

> the international division of labor and ultimately, in the geography of global capitalist accumulation.

Commodities were the most impacted export products in Latin America, especially the soy, energy and mining sectors. However, the recovery of prices during 2009 implied that this crisis was not so long-lasting. In part, this is clearly due to the fact that the Chinese economy rebounded quickly, and given its increased role in Latin American economies, mainly trade, but also investment and infrastructural projects. In fact, China has become the primary destination for commodities exported from Latin America. Mexico's increasingly integration with the United States, especially since NAFTA went into effect in 1994, was reflected in weaknesses in tourism and slower rebounding for other exports. Therefore, two of the countries that had a slower rebound in trade had more dependence on either the United States or Europe. It also appears that Cuba, whose increased dependence on nickel exports to Europe, had a slower recovery of trade.

In the case of Chile, exports had a major drop of –6.4 % in 2009 and minor growth of 2.3% in 2010, remaining weak since then. Chilean imports experienced a greater decline as a result of the crisis of –14.6% in 2009; however, there was a strong rebound for 2010 and 2011. The upshot suggests a worsening trade balance, but this remains to be seen.

The Brazilian foreign sector had maintained solid growth of exports from 2000 to 2008, increasing by almost 300% (US$ 143 billion), and then followed by a clear drop of US $ 45 billion in 2009. After that, things seemed to return to normal with growth of 66% by 2011. However, from 2011 on, exports drop off and seem to stagnate. Not directly related to the crisis, yet a concern for Brazil, is 2014's trade deficit, the first the country's experienced since 2000. This will be further discussed below.

When observing Argentina, given the fact that Brazil is its main trade partner, there was a drop in exports in 2009, followed by a recovery in 2010, and slight growth afterwards. However, there are major concerns at present, given the very low growth in Brazil, which has a direct influence on Argentine exports.

In addressing the importance of the role of the State and the growing shift on the part of progressive governments, Ocampo argues,

> In Latin America this shift began before the crisis, reflected in the rise of several governments that are clearly identified as left, compared to

> the greater pragmatism with respect to the role of the State on the part of governments of the right and center. An important effect of the crisis is the renewed attention given to the role of the internal market and the development banks. Brazil has been the pioneer with respect to both these issues. (2009: 64)

In fiscal terms, there were many announcements of countercyclical policies in different Latin American countries, especially of increased public expenditure to confront the crisis. In accordance with ECLAC, the initial announcements of fiscal expansion were significant in Argentina and Brazil (between 6% and 9% of GDP), and more moderate, but also important (between 2% and 3% of GDP), in Chile, Colombia, Mexico and Peru. It is difficult to know however, how many of these announcements referred to additional measures and how many were simply a redefinition of existing programs (Ocampo, 2009: 61).

In fact, Chile is the only country that continued with the rule of fixing public expenditure in accordance with the goal of structural balance of public finances of 1% surplus of GNP. This figure was reduced to 0.5% during the boom and the surplus from the high price of copper was transferred to two financial funds, the Economic and Social Stabilization Fund and the Pension Reserve Fund, in accordance with the redesign of the previous Copper Stabilization Fund adopted in 2006.

Faced with rapidly deteriorating activity and increasing unemployment, the Banco Central de Chile reacted strongly during the first half of 2009, cutting the interest rate from 8.25% to 0.5%. The Chilean government also adopted other key measures related to credit: providing incentive for banks and other financial institutions to restore the issuance of loans. The government was quicker to enact fiscal "packages" aimed to tackle the crisis, with an increase of 20.6% between January and September of 2009. As Lara argues,

> The packages comprised temporary measures in favor of public investment, a cash allowance for low-income households, tax reductions and a temporary increase in subsidies for training programs. In addition, some permanent measures were introduced, including an extension of unemployment benefits to workers with fixed-term contracts and a wage subsidy for young, low-wage workers.

In spite of the historical increase in fiscal spending, and drastic cuts in the interest rate, the government could not prevent the economy from suffering a severe recession.

In the case of Brazil, the main set of countercyclical measures employed by the Lula government in order to confront the crisis or minimize its negative impacts were (1) a stimulus to increase bank credit; (2) restructuring the banking sector to guard against a serious increase of insolvencies and prevent weaker or smaller banks from going bankrupt; (3) stimulating demand through tax breaks, through income tax reduction and incentives for purchases; and (4) providing support to employees through the expansion of unemployment insurance. In reference to the third item in this list, given the decline in exports, the government made efforts to increase internal consumption through a number of tax breaks, the most significant effort being tax incentives for automobile purchases.

Brazil stands out with respect to the role that their national development banks play in their economy, and this was over many decades, but was quite significant in the case of this crisis. State banks' participation very clearly increased in response to the crisis: the main banks were BNDES, Banco do Brasil and the Caixa Econômica Federal. In fact, between 2008 and 2009, their participation grew from 36.3% to 41.5% of the total of loans made by the financial system in Brazil. During 2009, credit made available by BNDES increased by 50%. In terms of providing credit when many markets were dry or extremely cautious, BNDES played a key role for certain sectors of the Brazilian economy, not to mention the continued key role with respect to PAC (Program for the Acceleration of Growth), which has been key for infrastructural programs, mainly oriented toward the extraction and export of primary goods.

In Venezuela, the decrease in tax revenues experienced during the crisis and subsequent reduction of public spending, led to a drop of investment in terms of social expenditures. According to Mansilla, public social spending represented 20.6% of GDP for the period 2007–2008, but this decreased to 17% in 2009–2010. In spite of the economic recovery in 2011–2012, social spending represented only 15.4% of GDP. Mansilla correctly points out that "even this low value for the Chavista period is 40% higher than the average recorded in the 1990s."

Once again, Mexico stands out as being the one country where pro-cyclical policies were pursued instead of countercyclical measures. Mariña and Cámara note, "The deep involvement of big Mexican corporations in national and international financial and speculative markets resulted in big financial losses during the 2008–2010 crisis." Such external dependence generated strong pressures on Mexico´s

current account balance and also on their exchange rate, given the high risk of massive capital outflows. Mariña and Cámara continue,

> In this context, in contrast to most of the rest of the world, the Mexican government *could not implement a comprehensive set of anti-cyclical policies* during the crisis aimed at reducing the negative effects of the plunge of external revenues on productive activity, employment and domestic demand. On the contrary, the structural subordination of its economic policy forced the implementation of pro-cyclical policies.

A major issue with regard to economic crises is the deterioration of social indicators, as tends to be the case with crises, and the most significant ones to consider are unemployment, wages and poverty, especially given recessionary trends. It is important to bear in mind that after several decades of neoliberalism in Latin America, it has been the working classes and poor who have suffered most from the consequences of failed policies. This is a result of the clear anti-worker impacts of labor flexibilization, and the growth of the informal economy and precarization.

In line with the analysis presented in the different chapters of the volume, the information from ECLAC and the ILO shows a deterioration in labor conditions. This is reflected in the drop in the rate of employment and the increase in unemployment (more acute in the second quarter of 2009 than the first in relation to the same periods of 2008), and a reduction in the growth of formal employment. In some cases it was even confirmed that there was an absolute contraction in employment (the case of Mexico), with the consequent deterioration in the quality of jobs. However, the impacts were still moderate. There were some important exceptions. The situation in Mexico is worrisome; in fact, they may be experiencing one of the most severe labor situations in their history, not only because of the strong recession that is affecting the economy, but also because of the radical change in the migratory conditions towards the United States. For 2009, ECLAC and the ILO project an increase of the rate of unemployment for the region of between 7.5% and 8.5%.

In terms of poverty, the UN predicted an increase of 3.6 million indigents in Latin America, an effect which is both moderate and susceptible to being confronted by focused policies. Despite the small impact in the unemployment level, one of the main concerns with crisis is that the effects on employment and poverty will accumulate through the crisis, especially if followed by a slow growth period. As

experience shows, the most worrisome will be the increase in informal labor to the extent that the generation of formal employment declines. In any case, consistent with the moderate effects so far, there have not been important political mobilizations associated with the crisis, at least not through the 3rd quarter of 2009 (Ocampo, 2009: 64). This is very different from what happened in the United States, where the unemployment rate increased strongly, more than doubling from 4.6 % in 2007 to 9.6 % in 2010.

Unemployment in Brazil increased more than 1% from 2008 to 2009, reaching roughly 9%, but moved down after that in metropolitan areas. As the standard measure of unemployment does not take rural areas – where unemployment tends to be higher – into account, the official measure is in general biased downwards, and thus hides the degree of unemployment in Brazil. Informal employment continued to decline, though at a slower rate between 2008 and 2009.

Mariña and Cámara argue that one of the key pillars of neoliberalism in Mexico was labor flexibilization, exemplified by the amazing growth of the *maquiladora* sector, which relied on low labor cost and dubious environmental and working conditions to be competitive. This endowed the Mexican economy with a specialization in low-tech industries within the international division of labor in a context of neoliberal globalization.

Lara refers to significant increases in unemployment in Chile from 7.8% to 9.6% between 2008 and 2009, and reaching 10.7% in the 2nd quarter of 2009. However, after the recovery, wages increased from 2010 to 2013, significantly exceeding productivity, being most evident in the copper mining sector.

In Colombia, although unemployment increased by a couple percentage points, reaching roughly 13% in 2009, it was much less than the 20% experienced during the 1999 crisis. After 2009, it declined slowly back to where it was before the crisis, and by 2012, it was around 11%.

According to Mansilla, the global crisis did not have a strong impact on most social indicators in Venezuela, which is counter to the usual assumption. Perhaps, similar to Cuba, there are social policies in place geared to prevent the standard market adjustments, which produce increases in layoffs, lower wages and subsequent increases in poverty. A similar case happened in Argentina, where the unemployment rate and people living under the poverty line only exhibited a small increase during the peak of the crisis. Thus, by 2010,

both variables were showing a tendency to decline, similar to the path registered before the financial crisis.

Maya argues that globalization, primarily through financialization, has resulted in both the deindustrialization and reprimarization of the Colombian economy, and that this has brought about a worsening of income inequality. He refers to the Gini coefficient, pointing out that it increased from 0.47 to 0.58 between 1990 and 2011. The Gini coefficient in the distribution of land also increased from 0.70 (1980) to 0.86 (2010), revealing the undeniable existence of large estates, which continue to expand relentlessly, and often through violence.

Overall, due to the robustness of China's economy, exports to it were the path to quicker recovery for many Latin American countries. Therefore, the tendency toward an increased role of primary goods, in particular minerals, oil, soy, cattle and other agricultural products, was strengthened, as they offered the best opportunities to return to more growth sooner. This supports Ocampo's claim that the primary transmission mechanism of the crisis was commercial rather than financial, at least in the medium term.[2] We shall now consider the impact of the crisis on different economic sectors.

In Argentina, although manufacturing grew at a rapid rate of 10.4% from 2003 to 2007, it then dropped down to 4.1% for the period 2008–2013. As Santarcángelo and Perrone pointed out, the continued expansion of soy, from the end of 2008 and 2009, helped to maintain the current account surplus. Thus, given the relative weakening of manufacturing growth in recent years, the advances of mining and agriculture, led by soy, facilitated the recovery. Therefore, one can conclude, as the authors did, that a sectoral impact of the international crisis was the reinforcement of the long-term shift toward reprimarization and the growing difficulty of making structural change.[3]

For Brazil, in spite of the increase in government spending of 3.7%, the overall GDP declined by 0.2% in 2009. Other notable declines for 2009 were industrial production by 5.5%; the agricultural and livestock sector by 5.2%; gross capital formation by almost 10% and exports by 10.3%. Manufacturing declined by 7% in 2009, as well as construction, which declined by 6.3%. The impact of the crisis varied significantly by sectors. The worst effects were in manufacturing, which was caused by reductions in investment and exports. Mining declined by 4.5% during the height of the crisis, but rebounded strongly by the second half of 2009, reaching 11.3% growth. There were other problems prior to the crisis that still remain relevant, especially given Brazil`s generally weak growth in recent years and the

continued shift away from industry toward the primary and extractive sectors, namely the process of reprimarization, which will be discussed in the next section.

In the case of Cuba, the two dominant sectors for exports are nickel and tourism. There had been noticeable growth of nickel exports in recent years, and this is most likely tied to the growth of China. However, Cuba's nickel exports has been negatively impacted since the crisis, which could be associated to the degree Cuba is dependent on exporting to Europe, not just to China. Campbell notes problems with nickel production related to internal issues, and not mainly due to the declining productivity of mines.

10.3 Insertion in the World Economy and Reprimarization

Several countries of Latin America experienced significant processes of industrialization beginning in the 1930s, such as Argentina, Brazil and Mexico. Other countries experienced more limited industrialization processes in subsequent decades. However, since the mid-1970s, several countries have experienced deindustrialization though this tendency was strengthened during the 1990s under the veil of the Washington Consensus and the establishment of the WTO. Of note is the case of Argentina, which began its first period of deindustrialization with the arrival of the dictatorship of 1976. In contrast, probably the most advanced industrialization in the region took place in Brazil, which continued to industrialize with the military government and only began its process of deindustrialization as of 1986.[4]

Besides the issue of deindustrialization, the process of reprimarization—or in some instances simply maintaining domination of the primary goods sector—has been taking place in Latin America, if not for the majority of those living on the periphery. This shift has been most evident during the past decades, or during the past two decades and intensified during the twenty-first century. In addition, there has been the increased role of TNCS and their global chains of production.

Several chapters of the book, highlight the issue of reprimarization in terms of recent developments. Most significant has been the growth of China, which has become the factory of the world, so to speak, and with an amazing increase in the demands for primary inputs or commodities—which are dominated by minerals, oil and other petroleum products—agricultural goods—especially soy—cattle, and other

livestock. Therefore, the growth of the Chinese economy at rates of 10% or more during recent decades is the primary factor in the surge of the prices of these primary products, and thus one of the main drives fomenting reprimarization.

We now consider the situation of the insertion in the world economy for individual countries, and the role of China, beginning with Chile. China has not only consolidated itself in the 2010–2013 period as the primary recipient of Chilean exports (mostly copper with 80% of the total), but also has become the second largest supplier of Chile's total imports. In the case of Chile, there is not a process of reprimarization but simply the continuity of primarization.

There has clearly been a shift in terms of Cuba's insertion in the world economy, given the previous domination of sugar cane in the country's economy. Nevertheless, the recent impact on the Cuban economy has been less due to the global crisis and more due to shifts in the economic model or policies that have been pursued since 2005. Cuba has been only minimally affected by the current lethargic world economy because it has been able to broadly continue, and sometimes even expand its level of necessary imports and its inward FDI. It is hypothesized that this is so because an important part (certainly not all) of both its trade and FDI relations are politically negotiated with governments, particularly Venezuela. This partially isolates Cuba from the short-term time horizons of private capital that cause the rapid transmission of world effects to individual economies.

Maya refers to the reprimarization of the Colombian economy and claims, "Crude oil (petroleum) is the leading sector in the mining and energy exports. In 2002, it participated with 21% of total exports. By 2009 this percentage increased to 25%." On the other hand, coal exports increased from US $991 million (2002) to US $5,416 million (2009). Consequently, FDI has increased considerably in the Colombian economy: "The mining sector increased its share in the total FDI by 22 percentage points, from 21% to 43% between 2000 and 2009." As a result, Maya has argued that there has been a process of deindustrialization, reflected in manufacturing, declining from 17% of GDP in 1990 to 12% in 2012. There has been a shift toward primary good production, on the one hand, and the growth of the financial sector to 20% of GDP on the other. As a result, Colombia has been experiencing a process of deindustrialization, evidenced by the fact that industry's share of GDP is now even below the average for Latin America, in contrast to its past, where there had been a successful ISI.

A key reason for Brazil not having been impacted so negatively is explained by the increasing role of trade and investment with China, which is tied to the issue of reprimarization and deindustrialization. As mentioned, Brazil's process of deindustrialization began in 1986, when manufacturing's value added percentage of GDP was 35%, and has now gone down to a mere 14.6% in 2011. Since 1995, the percentage of primary goods in Brazil's export portfolio has gone from roughly one-third to over 50%, and at the expense of manufacturing exports. Although these latter two tendencies are not encouraging in the medium- to long-run for the interest of returning to a serious and sustainable development path, at least they contributed to Brazil weathering the storm better than if they had been more dependent on the US economy. Nevertheless, the lower rates of growth in recent years, problems of corruption, and the never-ending greed of elites has contributed to the political crisis in Brazil in the early part of 2015 and the beginning of Dilma's second term.[5]

In the case of Venezuela, oil can be both a blessing and a curse. As the petroleum sector increased its share to over 28% of GDP, manufacturing industry had its share cut in half, and now only represents 13% of GDP and declining importance with respect to employment. The main industry for Venezuela is oil refining, followed by iron and steel industries. This implies that it is totally dependent on oil production activities and their associated demand; these industries were created and fomented by the State in earlier industrializing processes and are still dependent on oil revenues. Venezuela has had financial difficulties with the decline of the price of oil on world markets in the last year (2014–2015), which has affected their reserves and debt.

Finally, in the case of Argentina, as Santarcángelo and Perrone argue China has become its second largest trading partner and receives around 8% of total exports. Argentine exports to China exhibited a significant contraction of 42% in 2009 which was mainly explained by a reduced availability of products due to the poor climatic conditions experienced in the country in 2009, as is evidenced by the rapid recovery of the levels of exports from 2010. However, the volume of exports in the last couple of years exhibits a slightly downward trend.

10.4 Future Scenarios

The world economy appears to be at an inflection point, having experienced the crisis of 2007–2008, but not yet having broken from the

finance-dominated model of neoliberal globalization. In any attempt to resolve a crisis or economic downturn, it is necessary to truly understand the underlying causes of the crisis and seek to reverse or overcome them. Given the inadequate tools of Neo-Classical economics and the ideological blinders of neoliberal thinking, it should not be a surprise that the heterodox approaches have a clear comparative advantage in both understanding and analyzing this current neoliberal crisis. This is particularly relevant for Latin America, in seeking to break from the orthodox neoliberal policies of recent decades and reduce the dangerous over-dependency on finance and speculation.[6] Given the numerous neoliberal crises in Latin America in recent decades, neoliberalism seemed to be clearly in decline. However, the main beneficiaries of the excessive shift toward finance continue to be in power, as evidenced by the US and Europe, though not Asia (or much less so). Of concern for Latin America is that the elites that have clearly benefitted from neoliberalism do not wish to see it fade away, and thus a recharged conservative bloc is rearing its head and seeking to take power by any means necessary, be it through elections, impeachments, or coups. This is evident in several Latin American countries that experienced a swing to the left since the turn of the century. In this regard, the increased ties to China may provide a short-term solution for the problems of slow growth. However, the consequences in the medium and long terms would suggest an ongoing tendency toward reprimarization, with a range of problematic consequences.

The challenge is to identify which factors or shifts are permanent and which are a reflection of a period of change and instability. At present, we seek to identify the likely impact for Latin America, as well as to consider the potential trajectories for development. As mentioned above, besides the growth of China, another major factor has been the increased role of TNCS and their global chains of production, as well as the change in the rules of the game in terms of protection, subsidies and other development policies, due to the rules and sanctions of the WTO. Last, but not least, it can be argued that since the 1970s there has been an emergence of a transnational capitalist class,[7] present in both the center and periphery, which facilitates the new international division of labor with its apparent paradoxes and contradictions.

In this context, the concern for countries pursuing new development models is their reduced degree of autonomy as a result of the WTO rules and threats of sanctions. Many development policies of

the past would be proscribed today in order to remain in accordance with the WTO rules, and thus legitimate industrial policies become that more difficult to implement. In fact, as we consider future scenarios, it is the need in our view of a regional industrial policy for Latin America, one which promotes autonomous development and integration of the region, pursuing complementarity, not confrontation, in the areas of trade and investment. The examples of Mercosur or the Andean Pact would need to be strengthened, both economically and politically. Of particular importance, especially for confronting financial crises such as the one discussed in this book, is the fundamental need for an autonomous regional bank, such as el Banco del Sur (Bank of the South), a monetary fund and lending organization established on September 26, 2009 by Argentina, Brazil, Paraguay, Uruguay, Ecuador, Bolivia and Venezuela with an initial capital of US $20 billion. It represents a clear attempt to achieve regional independence and endogenous development, and this kind of policies should be further developed.

In spite of the relevance, this corresponds more to a broader and yet very necessary discussion on what serious development would look like for the populations of Latin America as a whole. There is a need for broader discussions in general on the issue of development, not that defined by neoclassical theory. Rather, a discussion pushing critical thinkers to examine what the general consequences and implications are for the current trajectories, and what may be the necessary changes to render a new, successful trajectory of development for Latin America in the near future.

One major concern is an eventual deceleration and recession for the Chinese economy. This could be triggered by different situations: another crisis or serious recession beginning with Europe, or it could also begin due to internal problems in China. According to some scholars with expertise on China's economy there have been some disconcerting signs in the last year.[8] Indicators of manufacturing indexes have tended to move downward as of late. Another concern is that of credit, since China has bailed out many public enterprises and has within the last year decided to increase the role of the free market in terms of credit within China. There is also a significant degree of uncertainty as to whether the government is hiding a number of the problems. In recent years, there have also been numerous labor protests, in spite of them being illegal in general, and this has contributed to an increase in real wages. This could be positive, in that it provides an alternative source of demand, if China has more difficulty exporting, but from industry's

view, the downside is higher costs, and many firms have already shifted production out of China to lower wage zones, such as Vietnam.

As a result of a Chinese downturn, there would be a very significant impact on the commodities markets, and thus on the main export portfolios for Latin America. As we saw, China represents the number one or two export and import trading partner for the vast majority of Latin American countries. Unfortunately, China may be a solid trading partner, but they are not interested in promoting industrial development in other peripheral countries. In fact, China is more interested in selling its manufactured goods to Latin America, not in importing manufactured or industrial products from the region.

Latin America should aim for the importance of industry for one, and a regional industrial policy is truly needed, not just one that accommodates the interests of the TNCs global commodity chains. This requires pursuit of technological developments, such that the outcome will be producing and possibly exporting more products with a higher value added, and with more technological content.

In this sense, it is essential to work not just to attain immediate results, but also to focus on the long run by enhancing and implementing educational policies aimed to develop these strategies, and to select a set of higher value-added sectors to seriously compete. These will contribute to increasing and diversifying the skills of the labor market, while helping countries to develop their own domestic industries.

In spite of what may seem audacious to some, the chances of Latin America to truly pursue a more serious development path will either require several countries as a bloc breaking with the WTO or forcing serious changes in the agreement. Latin America would then need to restore each country's autonomy in their industrial and trading policies rather than sanctioning strategies, such as protection and subsidies, that were essential for the advance of all industrialized nations, be it Germany, the United States or Japan. Without autonomy, economic development is simply a utopia.

In spite of the many positive achievements by progressive governments in the region in recent years, there are still many difficulties to overcome in order to improve the general standard of living while still being a peripheral capitalist country with all the traditional limitations. It is difficult to maintain a capitalist economy where the TNCS, the growing transnational capitalist class, workers and poor sectors have conflicting interests. These conflicts, which are one of the most essential characteristics of capitalism, can lead to major domestic problems and protests, if not, outright uprisings. This is particularly evident in

the cases of Argentina or Brazil in recent years, where the levels of disputes are constantly rising. Time will tell the direction that these disputes will take, or whether they can even be resolved under capitalism

It is highly likely that another global crisis is on the horizon. How Latin America prepares for and responds to it will be crucial for the near future. The global 2007–2009 crisis revealed the limits of neoliberal globalization, dominated by finance on a world scale. An important aspect globally is the extent to which so many capitalists and enterprises from across the globe speculated on international financial markets, thus spreading the wealth in the boom days and resulting in widespread crisis in 2008–2009. Much of the toxic assets are yet to be revealed, and this contributes to the holding back of investment on the world scale. Therefore, neoliberal globalization failed for the majority, in particular for the working classes of the globe.[9]

Notes

1. The three other major capitalist crises are: the Great Depression of 1873–1893, the second Great Depression from 1929 to 1941 (though also referred to as the Great Depression) and the Accumulation Crisis of the 1970s.
2. In the short term there had been a severe global credit crunch, impacting international reserves and other financial variables.
3. For a more detailed development of the challenges that Argentina is facing at the beginning of the twenty-first century, see Santarcángelo (2017).
4. For more on the discussion of deindustrialization and reprimarization in Brazil, see Trindade, J. R., Cooney, P. and Oliveira, W. (2016).
5. For further analysis of Brazil, see Gonçalves (2012, 2014), Cooney (2010), Trindade, J. R., Cooney, P. and Oliveira, W. (2016), and Trindade and Oliveira (2014).
6. It is a lesson that the EU may come to find out the hard way, depending on how the Greek crisis is resolved.
7. This concept has been substantially developed by both Sklair (2001) and Robinson (2008).
8. For a more detailed discussion on China see Cass, Williams, and Barker (2003) and Lo and Zhang (2011) among others.
9. Harvey points out the clear anti-working class bias of the neoliberal model and policies dating back to Reagan and Thatcher (Harvey, 2005).

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