

# LATIN AMERICA

## RETHINKING FINANCIAL DEPENDENCY\*

*Pierre Salama*<sup>\*\*</sup>

**ABSTRACT** The main characteristic of the financial crises of the nineties was that they resulted in severe external financial constraints. Today, the “balancing” of the inflows and outflows of the balance of payments is done by adjusting interest rates, the key variable of economic policies. The hike in interest rates raises the cost of borrowing considerably — weakening the position of the states vis-à-vis the federal State —, and adds to the budget deficit, which cannot be contained merely by reducing public expenditure. It also leads to a reduction in the investment projects of firms. The financial logic underlying the functioning of a “casino economy” produces great instability in the economic activity, an acute social vulnerability, and the impossibility under this growth regime to obtain any significant reduction in the widespread poverty.

**Key words:** financial dependence; financial crises; interest rates; stagnation; volatility; vulnerability

**JEL Code:** F36

### AMÉRICA LATINA: REPENSANDO A DEPENDÊNCIA FINANCEIRA

**RESUMO** A característica principal das crises financeiras dos anos noventa foi a conseqüente severidade das restrições nas finanças exteriores. Hoje, o equilíbrio entre a entrada de fundos e a saída de fundos do balanço de pagamentos é feito por meio do ajuste das taxas de juros, a variável-chave da política econômica. O incremento das taxas de juros aumenta consideravelmente o custo dos empréstimos — enfraquecendo, assim, a posição dos estados em face do governo federal —, além de aumentar o déficit no orçamento, o qual não pode ser controlado apenas pela contenção das despesas públicas. Essa medida também leva a uma redução nos projetos de investimentos das empresas. A lógica financeira por trás do funcionamento de uma “economia de cassino” produz grande instabilidade na atividade econômica e uma vulnerabilidade social marcante, tornando ainda impossível, sob esse modelo de crescimento, conseguir qualquer redução substancial na pobreza generalizada.

**Palavras-chave:** dependência financeira; crises financeiras; taxas de juros; estagnação; volatilidade; vulnerabilidade

---

\* Artigo recebido em 31 de março de 2004 e aprovado em 23 de março de 2005. O autor gostaria de agradecer principalmente ao seu amigo Mamadou Camara por suas observações sobre este estudo.

\*\* Professor of Economics, scientific director of the journal *Tiers Monde*, e-mails: psalama@wanadoo.fr e salama@seg.univ-paris 13.fr.

## INTRODUCTION

The financial crises of the eighties differed greatly from those of the nineties. The main characteristics of the former were the magnitude of the external debt and the obligation to service it with the country's own resources. The main characteristics of the latter were the outcome of severe external financial constraints. In both cases, financial development was essentially a government concern. It characterized the differences in growth regimes in the eighties and in the nineties.

To be more specific, in many respects, the finance-State relationship differed from those which, giving preference to firms, analyze the impact of finance and financializing on their investment function. Mynski's approach, setting the supply price of capital goods — involving the profit rate (the "mark up" in the Kaleckian interpretation) — against the demand price — involving the interest rate — is not very significant, however rich and original the analysis. This is not only because credit financing is not common practice in Latin America, in comparison with developed countries<sup>1</sup> — which does not mean that it is negligible — but, above all, it is because the low rate of gross capital formation is explained primarily by the rent-seeking tendencies of entrepreneurs — this behaviour being linked to a particularly unequal income structure —, and also because of the opportunities at hand to choose portfolio investments, in view of the particularly attractive interest rates offered by government treasury bonds. Both factors have a similar impact considerably hindering investment, especially in comparison to Asian economies.

The rise in interest rates should be accompanied by a decline in the value of assets, a consecutive reduction in the demand for investment goods effecting a decline in profits, and an increase in interest expenditure. In such an instance, a Ponzi<sup>2</sup>-type financial crisis is likely to occur. However, this is not the most important mechanism. It does not explain why financial crises occur more frequently in Latin America than in Asian countries.<sup>3</sup>

It is thus not the gap between the supply and demand price that determines the level of investment, but the particular context in which entrepreneurs act (greater inequalities, high interest rates) which encourages their rent-seeking behaviour. In other words, the hike in interest rates has an indirect effect on investment (credit of course costs more, but, most of all,

there are more opportunities for a trade-off in favour of financial activities). Banks buy, or invest in, public debt securities, and their activity is oriented more towards this function and less towards loans to firms. A financial crisis should be studied in relation to the growth regime and the government's economic policy. This is what we will endeavour to do.

The financial crisis did not have the same significance in the eighties as in the nineties. In both cases, it resembled a Ponzi-type crisis as applied to the State: domestic resources were not sufficient to service the debt in its entirety. In the eighties, countries had to sign letters of intent in order to obtain “involuntary” credits to supplement their own resources. In the nineties, access to international financial markets was renewed, but this did not exclude recourse to “involuntary” credits. In the earlier period, debt servicing generated hyperinflation and a large internal debt. The drop in purchasing power was a consequence of both inflation and the economic crisis. For a large part of the population, the most impoverished, pauperization was absolute. In the nineties, the debt was serviced during a period of economic recovery, with a significant increase in labour productivity. Financial dependence led to the relative pauperization of a significant portion of the population, except in times of financial crisis or when income levels declined. This is what we will try to show.

### **THE LOST DECADE AND “VICIOUS FINANCING”**

The development of financial activities is not parasitical by nature. Generally, firms operate in a macroeconomic environment over which they do not ordinarily have much control, and they do so based on very limited information. The current complexity of the production process increases uncertainty with regards to project profitability. Covering new risks also leads to the development of equally complex financial products. On this account, the financial market — on the condition that it be sufficiently large and diversified, which is not the case in Latin America — can generate new technologies and consequently ensure the conversion of the production apparatus towards the fabrication of increasingly sophisticated industrial products, by creating financial instruments adapted to risk. The export of complex products requires not only the intervention of banks and the setting up of a complex and original financial “package”, but also the use of

financial derivatives to cover a series of risks, including the exchange rate risk. Thus, the ever more complex organization of the financial market with regard to its products and their interplay is, to some extent, the result of the increasing complexity of production. This financial complexity is intensified with financial liberalization (de-compartmentalization, dis-intermediation and deregulation). Of course, there is an additional cost, but the profits are higher than the costs.<sup>4</sup> The development of finance and the increase in sophisticated financial products thus allow for an increase in capital *in abstracto*, for the capital cycle occurs only if financial activities favour the valorization of productive capital. The growth of the industrial sector requires a more than proportional development of the financial sector. There is a shift towards “financialization” when these activities are developed because financial products are attractive *per se*, and not as a result of a will to lower the risks in financing production. Financialization is the threshold from which financial operations, which are more lucrative than productive activities, are given a fillip, to the detriment of the latter.

From then on, the financial sector appears to be gaining independence from the productive sector. Like Janus, finance has two faces: a virtuous side, when it facilitates capital accumulation, and a parasitic side, when it does so to its detriment. Both aspects coexist: sometimes, one side prevails, and sometimes, the other, depending on the period and the macroeconomic environment (income distribution, modes of insertion in the global economy, relationship with the developed economies and international financial markets). When the virtuous side prevails over the parasitic side, financial activities can be understood as the trade activities analysed by Marx: they are “indirectly productive”. Financial development is therefore all the more virtuous when it helps to increase fictitious assets at a time when the growth of the stock market capitalization is significant: the increase of these fictitious assets enhances the propensity for consumption by households, and, as a result, offers additional scope for productive capital valorization. The rate of investment increases and, with it, the size of the debt, prompted by the rise in the value of shares held by firms and the increase in their market capitalization. This debt, no doubt, is used to finance new investments, but it is essentially the consequence of the acquisition of assets at high prices during the fusion (acquisition process). Under these circumstances, finan-

cial development gives a boost to the growth rate. We are therefore far from a unilateral interpretation, in which the finance-industry relationship is conceived solely from the point of view of levying the industrial profits realized through financial operations.

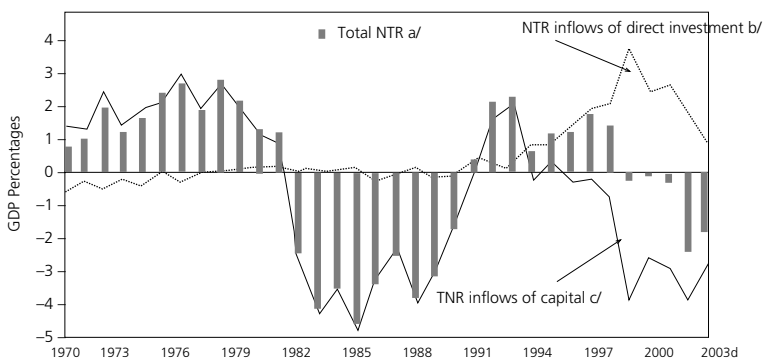
This is not the scenario that characterized the eighties in Latin America. Far from presenting its “virtuous” side, finance became “vicious”, “perverse”. It fostered returns, accentuated the disparities between income from capital and income from work, undermined accumulation, restricted job creation and helped create marginalized societies. This is what we are going to see.

Let us take a brief look at the earlier financial crises: in the early eighties, Mexico was no longer in a position to service its debt. International financial markets reacted in an extremely brutal fashion. As a result, Latin American countries, as well as several Asian countries, no longer had access to international credit facilities, unless they signed a “letter of intent” with the International Monetary Fund (IMF). Henceforth, they must service a substantial part of their debt from their own domestic sources, while negotiating with the IMF the rescheduling of another part: the amortization of the principal. In order to do this, they must now increase exports in order to achieve a positive net trade balance, and therefore implement policies of austerity (drastic reduction in public expenditure, substantial devaluation). At the end of it, exports were expected to exceed imports by about 30%, and debt servicing would represent between 2% and 5% of the total wealth produced (GDP), depending on the country and the years, i.e. more than the war reparations forced on Germany after the First World War by the Treaty of Versailles. The net flows of capital were reversed: Latin America would export more capital than it would receive (see figure 1).

The price that is exacted is extremely high: ten years of slump, mainly as a result of the reduction in public expenditure,<sup>5</sup> which translated as fewer incentives to invest, hyperinflation in several countries as a result of the massive devaluations, increased poverty and inequality. In such an environment, the poor are hit even harder by inflation because of their poverty. External debt servicing is an expenditure that has to be budgeted for two reasons: an important part of the total debt is public, and the foreign exchange risk component of the private debt is often assumed by the State. Therefore,

the problem that must be resolved is this: how to appropriate foreign exchange generated by devaluations to service the external debt, in view of the fact that it is not possible to increase the aggregate [global] saving rate. The massive devaluations, combined with a protectionist policy, aim to release the surplus of the trade balance and to produce the necessary foreign currencies to service the external debt. Moreover, they are also responsible for bringing prices to new heights, thereby *de facto* increasing forced savings. They constitute what the neo-structural Latin American economists have called a “supply shock”. The State issues treasury bonds with rates pegged first to past inflation, and then to anticipated inflation (that is to say, in fact, to the exchange rate quoted on parallel markets, the latter being the best indicator of future inflation). It is therefore the hyperinflationary context that has been created which paradoxically makes government treasury bonds an attractive proposition. The absolute impoverishment of some makes possible the absolute affluence of others just as if this was a zero sum game. A portion of domestic savings can now be transferred, but it has been achieved only because a process of forced savings took place, and at the cost of a more widespread dollarization. It appears as though it is the forced savings (*in local currency*) that are servicing the external debt (in dollars), as long as the rate of voluntary savings does not increase.

Figure 1: Net transfer of resources (as percentage of GDP at current prices)



Source: Cepal based on official figures. (a) The net transfer of resources (NTR), is calculated by subtracting interest payments on debt and dividends from the net inflows. Net capital inflow represents the balance of the capital and financial account minus errors and omissions, loans and utilization of IMF credit, and financing of an exceptional nature. The negative figures indicate the transfer of resources abroad; (b) is equivalent to net inflows of direct foreign investment (DFI) less net payments of dividends; (c) is equivalent to net inflows of capital distinct from DFI, less net interest payments; (d) preliminary estimation.

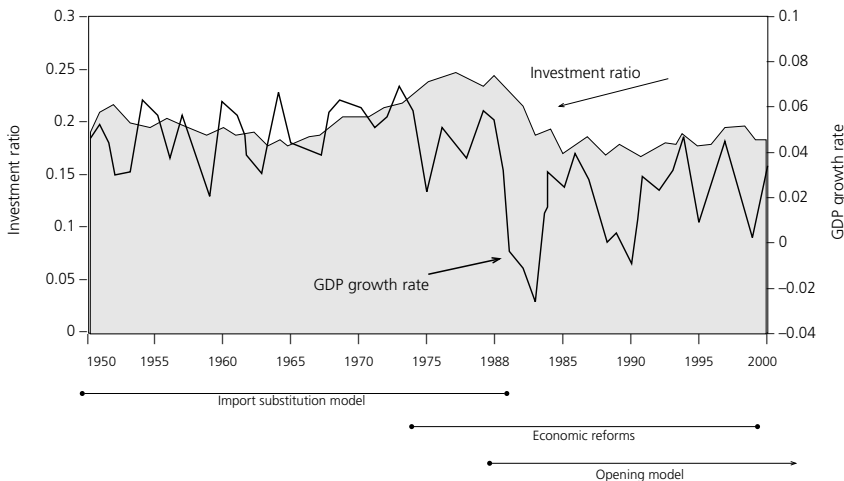
External debt generates an internal debt, which is not easy to control, and which is more and more lucrative for banks and for a small section of the population. Debt servicing also has disastrous consequences for the majority of the population and especially for the poorer categories, but it is beneficial to a small minority, as we have just seen.

Being more lucrative, treasury bonds are increasingly preferred to productive investment. The apportionment between productive and financial investment, with the latter becoming increasingly speculative and involving a relatively limited number of financial products, is inclined to be more and more in favour of the latter, more profitable in the short term, and more attractive because of the considerable risk involved in long term financial commitments when hyperinflation remains at high levels, and even intensifies. With the deterioration of the economic situation and the transition to higher inflationary levels, the purchase of treasury bonds by firms and the increasing weight of these purchases in their balance sheet become for some a means of protecting themselves from the negative fallout of inflation, and for others, fewer in number, a way of making money themselves through speculation.<sup>6</sup> The investment rate falls, especially in times of open crisis (see figure 2). This financialization of firms has two consequences. The first involves the rapid obsolescence of production techniques and the difficulty in facing international competition when borders open and subsidies are reduced<sup>7</sup> as a result of a fall in investments. The second consequence: the crisis, as well as the transition from high inflation to hyperinflation mentioned above, encourage speculative investments in treasury bonds, more lucrative than productive investments. The decline in the rate of investment is, however, not induced solely by the increasing share of finance. In fact, the relationship is more complex. Macroeconomic policies adopted by governments in order to meet as fast as possible the conditions imposed by the International Monetary Fund (IMF), and so obtain payment “facilities” for their external debt, restrict public expenditure and drastically reduce operating costs, especially investment.<sup>8</sup> When the degree of openness of economies is relatively limited, as was the case with the Latin American economies in the eighties, the reduction in public expenditure has a recessional effect on activity levels. In this context and because of it, private investments decline. The crisis, as well as the transition from high inflation to hyperinflation mentioned above, encourage speculative investments in treasury

bonds, more lucrative than productive investments. Therefore, the switch from productive investment to financial investment is not directly responsible either for the economic slowdown or for the inflationary crisis, but it's the hyperinflationary recession induced by the restrictive public expenditure policy, with the consecutive net transfer of capital overseas, that encourage this switch. This emphasizes the recessional effect of this high inflation and the economic depression phase of the economy.

We can therefore understand why the problem of the financial impact should be examined both at the macroeconomic level and at the firms' level. The external debt payments, financed through domestic sources in a closed economy, generate a profusion of financial products that are themselves responsible for the considerable growth of the internal debt, more often than not in the relatively short term. Unlike what happens in developed countries, the growing importance of finance does not stem so much from the increasing complexity of the economy, but from the external constraints which result from the external debt service. In this context, banks no longer play the role of intermediary vis-à-vis firms, but vis-à-vis the State, by sub-

**Figure 2: Rate of growth and rate of gross fixed asset formation**



Source: Diagram drawn from data supplied by Cepal and taken from G. Moguillansky (2003): "Inversion y volatilidad financiera en America latina", *Revista de la Cepal* n. 77. The interesting point of this presentation is that it compares two periods: first, a period when there is heavy import substitution characterized by a rate of growth and a rate of GFAF both relatively high; then, a second period with a low rate of growth and a low rate of GFAF. It would probably have been more appropriate to distinguish three periods by dividing the second into two parts: a period of hyperinflationary management of the debt, and a period of opening up.



scribing to the highly lucrative securities of its internal debt, and also by offering them to households and firms, rather than making credit available to firms, which is less lucrative, despite the high and volatile interest rates.

At the macroeconomic level, the swelling profits made by the financial sector, generated less and less by improvements in the productive base (decrease in the rate of investment, rapid obsolescence), are increasingly produced by a reduction in real wages. In the eighties, capital valorization reverted to old methods: it depended on archaic mechanisms of absolute added value (extended working hours, often by taking on multiple jobs in order to survive, as a result of the reduction in the purchasing power).<sup>9</sup> Value transfers were thus made in an archaic manner, just like in the old times, when the only way that entrepreneurs could think of extracting surplus gains was by extending working hours or overexploiting workers by lowering wages. If we assume that the rate of profit is lower than the indexed interest rates paid on treasury bonds issued by the government, we can be certain that some of the profits realized, instead of being ploughed back into the business, will be used to buy these bonds. The rate of investment will decline and future industrial efficiency will therefore be compromised. A vicious cycle is thus set off, which will then be very difficult to break free of. The decline in industrial efficiency will, however, prompt remedial reactions. In this context of financialization, financial profits are not restored by a more intensive use of new technologies requiring additional investment, short of transcending the context in question. They can only come therefore from a reduction in the wage bill through a decrease in real wages.<sup>10</sup> This decrease in income is responsible for extending working hours, generally in the informal sector. We are thus witnessing a return to, if not a reinforcement of, the archaic modalities of the exploitation of labour.

### **A GROWTH REGIME HEAVILY DEPENDENT ON FINANCE**

In the nineties, for reasons other than what we have just seen, finance developed parasitical aspects and was not able to acquire its “virtuous” aspects on a more permanent basis. These parasitical aspects, however, were not as bad as they were during the “lost decade” of the eighties. There was very little increase in the investment rate,<sup>11</sup> which was poor when compared to the

Asian economies. The macroeconomic constraints were “shifted”: other solutions were found for servicing the debt, which had yet other effects on economic growth, rise in prices and income distribution. Macroeconomic financial dependence, which is characteristic of growth regimes that are conceived once inflation ends, gives a boost to the rent-seeking behaviour of most entrepreneurs: investment rates increase only marginally, and the economy falls into a “casino logic”. This is what we will try to show.

Before the 1982 crisis (Mexico defaults and the “lost decade” starts in Latin America), loans came in the form of syndicated credits. The international financial system changed in the eighties and developed new financial products. International bonds, securities and notes got a boost, and credit lost in importance, with the exception, however, of capital flows headed towards Asian countries.

Except for “involuntary” credits, debt payments in the eighties were financed from domestic sources. With the liberalization of their markets, Latin American countries renewed access to international financial markets: debt payments were now mainly financed by capital inflows.<sup>12</sup> More specifically, these “voluntary” capital inflows were used initially to finance the negative trade balance and debt interest. The main part of the amortization of the debt principal was financed through “involuntary” bank loans and direct financing by international institutions. In the first phase, capital inflows were primarily made up of bond issues, and then, in the second phase, of direct foreign investment, while the net bond inflows decreased. In the third phase, the negative trade balance decreased, and then became positive as a result of devaluations and the adoption of flexible exchange rates, the initial outcome of the modernization of the production apparatus being undertaken with the revival of economic growth and the opening of foreign markets, the slowdown of economic activity, and favorable terms of trade (rise in the prices of some raw materials).<sup>13</sup>

	TB	BCA	A
1 <sup>st</sup> phase	Pln + DFI	Pln + DFI	Invol. credits + IMF
2 <sup>nd</sup> phase	DFI	DFI	Invol. credits + IMF
3 <sup>rd</sup> phase		TB	DFI+ Pln + IMF

NB: TB: trade balance ; BCA: balance on current account ; A: amortization of the principal ; DFI: direct foreign investment ; Pln: net portfolio investments ; IMF: International Monetary Fund ; Cb : “involuntary” credits.

This millennium began with two significant evolutions: the negative balance on current account decreased and showed a reverse drift in several countries — especially in Brazil (and Argentina, with the fall in GDP), which achieved a highly positive trade balance (except in Mexico, among the major countries) —, but direct investment, on the other hand, was cut drastically. With the conclusion of the stock market crisis in 2002, portfolio investments also dropped and just about compensated for the repayment of loans, which represented an additional burden when higher risk premiums had to be paid. On the whole, the situation was a paradoxical one, with total financial requirements decreasing in many countries, while the financial capacity was not always found to meet their needs. Net inflows of capital (treasury bonds, shares) were, however, not enough to finance the amortization of both the old external debt (bank credit) and the new one (loans from international institutions),<sup>14</sup> and the chances of toeing the IMF line were very great.

### **AN ECONOMIC SLOWDOWN**

In the nineties, economic growth picked up again and inflation came down. At times, the rate of growth was high (Argentina), but mostly it was average, when compared to the growth between the fifties and seventies, or to that which took place in Asian countries. Not only was it not high overall, it was also volatile. This section attempts to show how the growth regime, designed specifically to pull the countries out of the crisis which hit the eighties, was partly responsible for the present drift towards stagnation and, above all, for its volatility. The latter retroacted negatively on the scale of growth.

A certain tendency towards stagnation was discernable, but it was not possible to affirm with any degree of certainty whether or not it would be of long duration<sup>15</sup> (figure 4). This is basically explained by the great disparities in income. The growth regime established in the eighties, in the wake of the crisis, reinforced those disparities.<sup>16</sup>

These staggering inequalities made an acceleration in the rate of gross capital formation difficult, with the latter “stagnating” at a lower level when compared with the Asian economies, where the disparities were not so marked. This acute disparity enabled approximately 30% of the population

**Table 1. Evolution of the rate of growth of GDP in the principal countries (in 1995 dollars)**

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
<b>Latin America and the Caribbean</b>	3.4	-0.6	2.1	3.4	0.6	-1.1	2.1	-1.1	-1.9	0.0
<b>Subtotal (20 countries)</b>	3.4	-0.6	2.1	3.4	0.6	-1.1	2.1	-1.1	-1.9	0.0
Argentina	4.4	-4.1	4.1	6.6	2.5	-4.6	-2.1	-5.6	-11.9	6.0
Bolivia	2.4	2.3	2.1	2.4	2.5	-2.1	-0.1	-0.7	0.4	0.2
Brazil	4.7	2.7	1.0	1.6	-1.2	-0.4	2.6	2.0	0.6	-1.2
Chile	3.3	7.2	5.3	5.2	1.9	-1.8	2.8	1.9	0.8	2.0
Colombia	3.9	2.9	0.0	1.4	-1.2	-5.6	0.5	-0.4	-0.1	1.6
Costa Rica	2.1	1.4	-1.6	2.8	5.6	5.3	-0.6	-1.0	0.7	3.5
Cuba	-0.1	2.0	8.6	2.9	-0.5	5.3	5.9	2.5	0.9	2.3
Ecuador	1.4	-0.1	0.9	3.1	0.1	-7.6	-1.0	3.5	1.9	0.2
El Salvador	3.7	4.0	-0.4	2.1	1.6	1.3	0.0	-0.2	0.2	0.1
Guatemala	1.4	2.2	0.3	1.7	2.4	1.1	0.7	0.0	-0.5	-0.2
Haiti	-19.1	7.5	3.7	1.3	1.0	1.0	0.2	-2.4	-2.3	-1.1
Honduras	-4.8	0.7	0.7	2.0	0.4	-4.1	2.8	0.0	-0.2	0.4
Mexico	2.5	-7.8	3.6	5.0	3.4	1.9	5.0	-1.8	-0.7	-0.3
Nicaragua	0.3	2.9	3.5	1.1	0.3	4.0	1.6	0.4	-1.9	-0.4
Panama	1.0	-0.1	0.6	2.6	2.6	1.5	0.6	-1.5	-1.1	1.1
Paraguay	0.3	1.7	-1.6	-0.3	-3.2	-2.6	-3.2	-0.2	-4.9	0.0
Peru	10.7	6.7	0.7	5.0	-2.3	-0.8	1.0	-1.4	3.2	2.4
Dominican Republic	2.9	2.5	5.3	6.3	5.6	6.2	5.5	1.3	2.6	-2.9
Uruguay	6.2	-3.0	4.2	4.6	3.6	-4.1	-2.6	-4.2	-11.4	0.3
Venezuela	-5.2	2.6	-2.1	4.6	-1.5	-7.4	1.7	1.5	-10.7	-11.2

Source: Cepal: "Balance preliminar de las economías de América Latina y Caribe", 2003.

to achieve income levels more or less equivalent to those reached by the corresponding sections of society in the developed countries. It induced rent-seeking behaviour. Indeed, the average income of the population was much lower than in the developed countries. The income level of 30-35% of the population was, however, comparable to that of the developed countries. The disparity between their average income compared to the remaining 65% of the population was thus mathematically much more marked than in the developed countries. This difference explains the difficulty experienced by many durable goods, such as cars, to "proletarianize", as their supply was not matched by a solvent demand from this segment of the population, in contrast to what is commonly observed in developed countries. It also explains why, when the market is limited both in absolute as well as in relative terms in relation to the dimensional constraints of supply, the growth expectancy for this type of product is limited, and also why we are likely to witness the paradox of a satisfactory capital valorization with little reinvest-

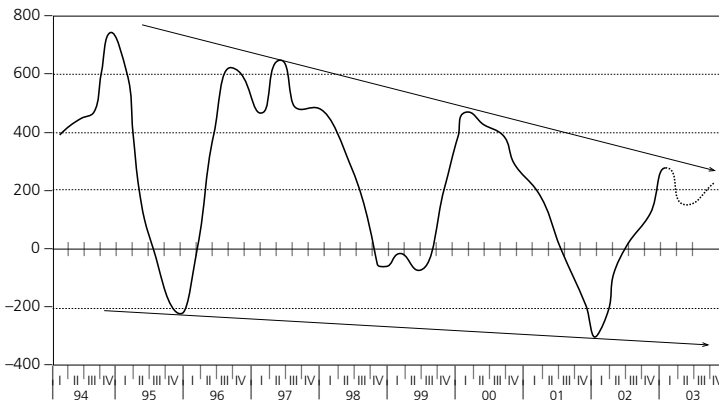
ment, as capital is more inclined to move out of the sector or out of the country, since the expansion prospects of this market segment are not very promising.<sup>17</sup>

The predominantly financial growth regime set up in the nineties brought about further modifications in the income structure. To be precise, the level of inequality remained more or less stable at the higher levels, but a bipolarity was discernable. The income of the top 5% to 10% in the well-off segment increased in relation to total income. The income of the next 30% was characterized by a decline: those in the upper income bracket evolved on the same lines as the top 10%, but at a slower pace, while the rest underwent a process of relative impoverishment. A mechanism similar to the one taking place in the U.S. thus occurred: the middle class became less important, and society as a whole began to resemble that of the early 20<sup>th</sup> century. Krugman reminds us that Gatsby, the hero of Fitzgerald's novel, moved in this society, where a whole host of domestic jobs could be found in the homes of 5% to 10% of the moneyed elite. This "come back" signaled a notable social regression.<sup>18</sup> It is therefore logical that the structure of spending was affected. In particular, the ostentatious spending by the upper classes, as well as the "redistribution" of income through growing domestic employment, were not of a nature to revitalise sectorial supply and hence a valorization of capital, except in the construction sector. It is true that the upper classes are likely to save more than the middle and lower classes, but a large part of their savings are secured in funds that are not used for investment. In fact, savings serve mainly to buy particularly lucrative treasury bonds issued by the government to service its internal debt, now a major budget item. When those savings are deposited in the banks, they do not provide capital to be used for investment, or produce very little: the interest rate are too high to encourage entrepreneurs and households to borrow, and the deposited savings go towards the State's liquidity requirements to finance its debt, with very little going towards investment.

As long as this inequality is not counterbalanced by decisive intervention in the economic sphere on the part of the State (active industrial policy), it is certain that the factors nurturing the tendency towards stagnation will continue to prevail. In line with this, the stagnation thesis of the sixties and seventies remains relevant for the most part, and can be used as the basis for developing a new theory of stagnation.

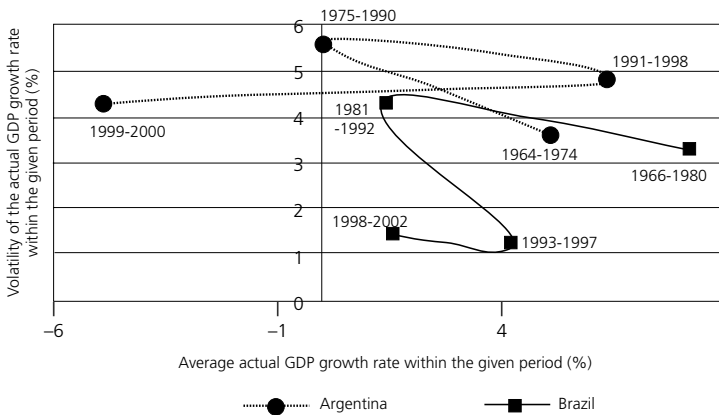
(b) This growth was volatile. Growth was punctuated by financial crises. Volatility was nevertheless less consequential than in the eighties.<sup>19</sup> It was however substantial enough, as we can see in figure 3. It was more important in some countries (Argentina) than in others (Brazil, for example), as figure 4 illustrates.

**Figure 3: Interannual variation ratio of quarterly GDP of Latin American economies, including the Caribbean, 1994-2003**



Source: Cepal Series n. 19, 2003

**Figure 4: Growth path differences between the two main Mercosur countries (1964-2002)**



Source: Indec, according to A. Saludjian, *op. cit.*

Not only are reversals of the economic situation frequent,<sup>20</sup> but in general they are particularly marked, so that changes in the GDP profile are more representative of the European 19<sup>th</sup> century cycles, with their absolute peaks and troughs, than of the 20<sup>th</sup> century cycles, with their accelerations and decelerations. This latter characteristic, more than the mediocre growth, explains the particularly great vulnerability of the poor.<sup>21</sup> In other words, for an equivalent average rate of growth in the long duration, the vulnerability is greater when volatility is high than when it is low. The deterioration in the standard of living is inversely proportional to the level of wealth (Hicks and Wodon, 2001) and, for the poorest, it remains out of sync with the cycle, when growth picks up again as a result of hysteresis (B. Lautier *et alli*, 2003, *op. cit.*, N. Lustig, 2000, *op. cit.*).

The impact of the sudden opening up of capital markets on the real economy is extremely violent when a financial crisis is brewing. To prevent the flight of capital, interest rates have to be raised to astronomical levels, which very quickly, unless capital outflows are slowed down, paralyzes production and triggers an economic crisis. Economists have found that the rapidity of reaction of the real economy is much slower than that of the financial economy.<sup>22</sup> An increase in the investment rate, for example, has a positive effect on growth only after a certain time. Even a consequential depreciation of the national currency, in the wake of speculative activity, boosts exports only after a certain length of time; even so, it must also be of a certain magnitude, when the economy is not a very open one and the goods exported are not primarily raw materials, if the goal is to achieve a positive trade balance. Reaction to these policies is thus not very swift. In contrast, the financial sector is very sensitive to speculation, resulting in the sudden flight of large sums of money from the country. This exacerbated sensitivity has considerable repercussions and leverage on the real sector. Let us look at some examples: a considerable increase in interest rates (they went up to 50% in Brazil at the height of the speculative offensives in 1998) — designed to check the ensuing capital outflows and reverse the process —, initially makes credit extremely expensive, inflates the State's internal debt, consequently making deficit reduction even more difficult, and lastly, *very quickly*, triggers a recession or deepens the crisis in the real sector. We are thus witnessing what is called the “overshooting” of the financial sector over the real sector.

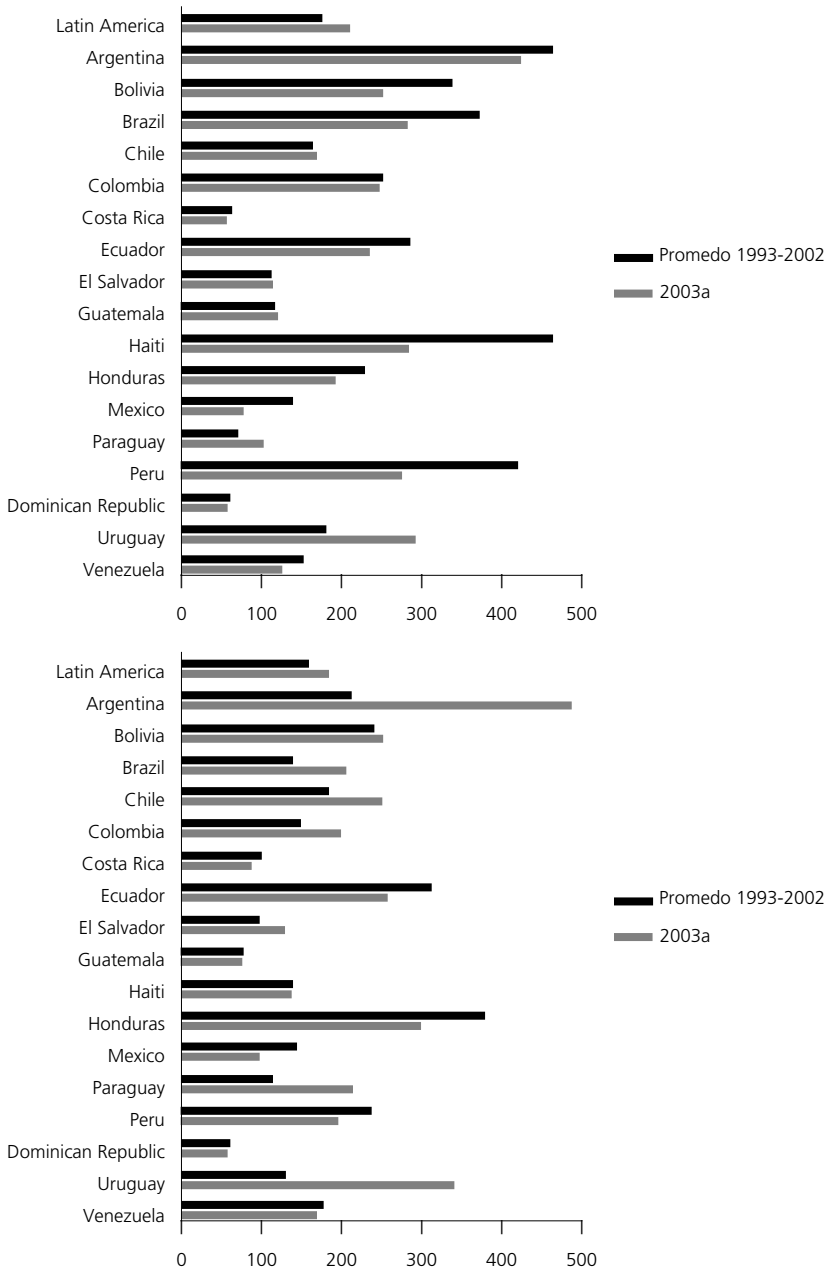
This difference in sensitivity is inversely proportional to the degree of openness of the economy. In Latin America, the economies remain relatively closed, despite a progressive opening up in the last ten years.<sup>23</sup> In consequence, one of the more important ratios to be considered is not the external debt/GDP ratio, but the debt/value of exports ratio. In Latin American countries, the latter ratio is very high (see figure 5).

The capacity of the growth regime set up in the nineties to produce financial crises was remarkable. Its financing requirements were considerable. The financial side (interests and dividends, amortization) was not easily controlled, except by a significant and sustainable increase in exports resulting in a significantly higher positive balance of trade. The financial capacity depended on several factors, some of which continued to generate pernicious effects (liberalization of the financial markets and high interest rates policies), while others proved difficult to control by the governments of those countries (financial possibilities of the developed countries depending on the circumstances). We can therefore understand that the question of the credibility of government policies is not situated at the absolute, but at the relative level. For example, an important reduction in the financial capacities, even though the financial requirements may be fewer, is enough for *the gap* between capacities and requirements to reach a critical size, thereby promoting speculation, driving up interest rates, triggering a financial crisis followed by a currency depreciation and a slowdown of growth. This drop in capacity can be greater than the reduction in financial requirements, and so precipitate a crisis, especially if the arrival of a new government to power raises doubts in the financial markets as to the current regime's continuation of the previous government's economic policy.<sup>24</sup>

These growth regimes are greatly dependent on finance. The key variable of adjustment is the interest rate,<sup>25</sup> and this to the detriment of growth when the net inflow of capital is inadequate. As Belluzo *et alli* (*op. cit.*) points out, the impact of financial speculation is rapidly reflected on the exchange rate. We can thus observe an uneven evolution of the exchange rate: when the governments' economic policies acquire a certain credibility, and when the financing power is not limited by a crisis in the developed countries, the real exchange rate is likely to rise against the dollar, even when the nominal exchange rate is relatively fixed (either totally fixed, or fluctuating



**Figure 5: Latin America and the Caribbean: Indicating the Total Gross External Debt (percentage)**



Source: Cepal, based on official figures.

a/ Preliminary estimates.

within a band). This appreciation is conducive to the repatriation of dividends and profits generated by the boom in direct foreign investment. When the financing requirements increase considerably, including when the balance of trade position improves — because of a considerable hike in the interest on the debt, in the reimbursement of the principal but also in the dividends (in keeping with the growth of the foreign investment stock), and in the inadequacy of some capital inflows (decline in direct foreign and portfolio investments) —, markets can lose confidence. The aim of the hike in interest rates is to check market apprehensions, or even to reverse the trend. But as we have seen, this rise must be all the more important, since the finance sector grows at a faster pace than the real sector, and also because the economy is not a very open one and has a high debt /exports ratio. The sudden rise in interest rates can trigger a crisis, rendering not only servicing the internal debt more onerous, but also making it more difficult to respond positively to the demands of the international financial markets, except by drastically cutting public expenditure, other than the expenditure on debt servicing. The failure of such a policy results in a massive devaluation — when the exchange rate is a fixed one —, and in a significant depreciation — in the case of a flexible exchange rate regime.<sup>26</sup> This also makes it easier to achieve a positive trade balance, helped moreover by the decline in imports due to the crisis. But, it is basically the accompanying measures that, in general, are useful<sup>27</sup> in regaining creditworthiness with international institutions and in shaking off the financial crisis.<sup>28</sup> The paradox is surprising: on the one hand, economic policies bring on the crisis instead of preventing it,<sup>29</sup> and on the other, they are often the “mandatory passage” for regaining the support of international organizations, and through them, that of international financial markets. We can thus understand why it is often countries whose efforts have been lauded by these organizations that are more likely to experience a crisis...

#### **THE EFFECTS OF THE FINANCIAL BOOM ON LABOUR MANAGEMENT**

Our thesis is that the autonomy of the financial markets is in fact only superficial. The source of the gains obtained by few is *partially* explained by the loss sustained by others. There can be winners or losers at an absolute or

at a relative level. In the former case, finance engenders pernicious effects and the growth regime is caught in a vicious cycle. This is our analysis for the eighties. In the latter case, the losers gain in absolute terms but lose in relative terms to the winners. Here, the growth regime enters into a virtuous cycle. This is what happened in the United States during Clinton's presidency. The Latin American economies are somewhere in the middle, but closer to the vicious cycle than to the virtuous one, with two special features that distinguish them from developed countries: financial products and currency. The financial products are mainly issued by the government in order to provide for the budget deficit and obtain funds for servicing the internal and external debts. Few financial products are issued by firms, whether bonds or shares. Their money is not a key currency, and the reimbursement of loans is linked to their capacity to obtain hard currencies. Consequently, we can draw a simple conclusion: financial dependence is, first of all, the concern of States, and secondly, of firms. Thus, we cannot take a Minsky-type argument,<sup>29</sup> generally used in the context of firms, and apply it to economic policies in order to explain the working of the "casino effect" which characterizes them. The fact that governments are induced to look for Ponzi-type finances does not have the same signification nor the same consequences as it would in the case of firms. To be more precise, firms are dependent on the environment within which they operate. This environment is marked by profound disparities in income (not very conducive to revitalizing growth), by limited openness, by less State intervention in the economy — as compared to what it was in the fifties through the seventies —, by integration in the world economy (based principally on the greater role of market forces), by considerable financial dependence and, lastly, by a growth regime that has taken several features from the "casino economy" (very severe external constraints due to the divorce between financing requirements and capacity). This external constraint has an immoderate influence on the government's interest rates policy and the search for a substantial primary budget surplus. High interest rates deter firms from resorting to the banking system for financing their investments, and motivate them to purchase government treasury bonds. The decision to go for financial investment in lieu of productive investment thus constitutes an additional factor of poor growth.

Productive investment has its limitations and, unless the entrepreneur accepts the idea of disappearing abruptly from the market, with all the irrecoverable costs that this would imply, he cannot put all his profits into financial products under the pretext that they are more profitable than investment in the principal activity. However, the profit differential leads firms to invest more than in the past in these products and to invest less in the principal activity and, in so doing, give greater importance to finance. Similarly, affluent households put their money into lucrative financial products. The specificity of the Latin American example is that these financial products are made of treasury bonds. Banks encourage this trend by subscribing to these bonds and placing them. They are less keen to grant credit to firms to finance their investments than to put their money into securities, unless they are compelled to do so (statutory reserves). High interest rates do not encourage firms to borrow in order to invest, and they do so mainly from their equity capital.<sup>31</sup> The larger firms, of course, have access to international financial markets, either directly or through the parent company.

The financialization of firms takes place to the detriment of investment, that is, indirectly to the detriment of employment and/or wages. In other words, the financial surpluses invested in financial products are really the result of an arbitrary decision detrimental to investment in comparison to financial products, rather than the result of a profitability analysis of the latter, considered inadequate. This is what in fact explains that, all things being equal, the financial profits derived from this new activity do not revert, or not much, to investments in the principal activity. Conversely, the only thing needed would be a modification of the competition conditions, an increase in investment profitability — due to an increase in effective demand resulting from changes in the macroeconomic environment —, or a drop in financial profitability, for financial profits to be partly used for investment.

In the medium and long term, this “breeding ground” function of investment is, however, not central, and the financialization of firms tends to occur in Latin American economies.

The rent-seeking behaviour of Latin American investors, which we have already highlighted, impacts upon labour management, hampering evolution of real wages and productivity of labour, enhancing flexibility and job insecurity, lowering productive employment, increasing the use of casual

labour in relation to total employment. *We assume that the source of returns is in labour.* Because it feeds on labour, the development of financial activities impacts upon employment, upon wages, and upon the forms of domination in the workplace.

The new forms of domination in the workplace are the result of several technological, social and financial constraints. Let us review them. The modernization of the productive apparatus occurs as a result of the opening up of these economies and of the large-scale introduction of sophisticated equipment goods.<sup>32</sup> It induces significant changes in the organization of work, except that there are degrees of liberty in the choice of this organization. In fact, it is not uncommon that, within the same technological group, there can be different modes of organization of work in the various subsidiaries of a multinational firm producing the same good, but situated in different countries (Humphrey, ed. 1995).<sup>33</sup> The *nature* of the manufactured products also impacts upon the organization of work and the search for “functional” (or qualitative) flexibility, aiming at a greater adaptability of labour. We know that, once the middle class has reached a certain level of purchasing power in these countries, demand changes and diversified products are generally preferred to standardized products.<sup>34</sup> The relationship between demand and supply is thereafter situated more towards the lower end than the upper end of the chain. The diversification of demand, the emphasis on quality, leads to a rethinking about stocks and delivery schedules. The organization of production changes: just-in-time processes are applied and stocks are cut down. Work organization now is likely to change radically: prescribed work is reduced and team work is stressed, together with the use of multiskilled jobs. There is job insecurity, annualized work, intensification and skill increase, to the detriment of qualifications.

To these factors contributing to the imposition of new forms of domination in the workplace, one should add the *inadequate investment* in the Latin American economies, on the one hand, and the *effect of liberalization of foreign trade, along with the withdrawal of the State*, on the other. When the *volume* of investment grows insufficiently, altering its form becomes urgent. So, idle time is reduced, and work is intensified, reorganized and annualized. For similar reasons, the lowering of labour costs is sought through a

policy of wage “moderation” and increased mobility of labour, thanks to greater job insecurity (by resorting to the use of casual labour and by making redundancies easier). The externalization of a number of activities, considered insufficiently profitable for the firm, makes it possible to considerably modify working, employment and work organization conditions in the context of activities that are not the direct responsibility of these firms. The hiring or rehiring of workers by subcontractors, who earlier would have found jobs in the large firms, is done under very different conditions. Externalization is thus a means of imposing labour flexibility, by especially laying stress on wages, annualization of the work schedule, easier layoff terms, the nonrecognition of qualifications in favour of underpaid skills, and work reorganization, depending on the circumstances.

Generally speaking, the real improvement in the productivity of labour in Latin America, since it came out of the inflationary cycle, can be explained partly by the different modes of domination in the workplace, and partly by the installation of new equipment. The particularity here is that, since the rate of investment increased more slowly than in the eighties, work organization played a greater part in the productivity increase. In an environment of acute competition, the reduction in the unitary cost of labour, for want of sufficient investment, forcibly meant the search for greater flexibility of the work force, without the latter being necessarily linked to the nature of the technologies used. And, as insufficient investment is partly explained by the importance given to financial activities, the greater weight of finance in the firms’ balance sheet today, compared to the past, gives more weight to the search for greater labour flexibility.

## CONCLUSION

The effects of debt servicing and financial development are not the same in the two periods under consideration. In the former period, the purchasing power of a majority of the population was reduced in absolute terms. In the latter, the changes in the purchasing power and labour productivity were perceptibly de-linked. In both cases, the negative aspects of financial development prevailed over the positive aspects, but more so in the first than in the second period.

Today, the “balancing” of the inflows and outflows of the balance of payments is done by adjusting interest rates, the key variable of economic policies. The hike in interest rates, not to say maintaining them at relatively high levels, a necessary but not sufficient condition to attract capital when the latter is in short supply, on the one hand makes banks more vulnerable by lowering the value of their assets, in turn inciting them to offer junk loans, and also by increasing the risk of debtors defaulting on payments; on the other hand, it raises the cost of borrowing considerably, thereby weakening the position of the states vis-à-vis the federal State, and adds to the budget deficit, which cannot be contained merely by reducing public expenditure. It also leads to a reduction in the investment projects of firms for two reasons: one linked to cost, the other to the possibility of purchasing treasury bonds, more profitable than investment. The recessive effect of the hike in interest rates creates a vicious cycle: any hike of this rate aggravates budgetary difficulties, brings about a recession, leads to a new hike in the interest rates and to a devaluation/depreciation of the exchange rate. This self-sustained movement becomes very difficult to stop, and its effects in terms of social vulnerability are considerable.

The paradox in the situation of numerous countries today is that the situation, on the one hand, can improve, and on the other, worsen: not only would there be a slowdown of growth, but above all it could become highly volatile, there would be an acute social vulnerability and the impossibility under this growth regime to obtain any significant reduction in the widespread poverty. The financial logic underlying the functioning of a “casino economy” produces great instability in the economic activity, making it difficult to prevent financial crises or — and the two are connected —, as a consequence of the eruption of the crises. The financial logic of these modes of insertion in the global economy gives a growth profile similar to a roller coaster. Eventually, this type of growth is poised on a “razor’s edge”.

## APPENDIX

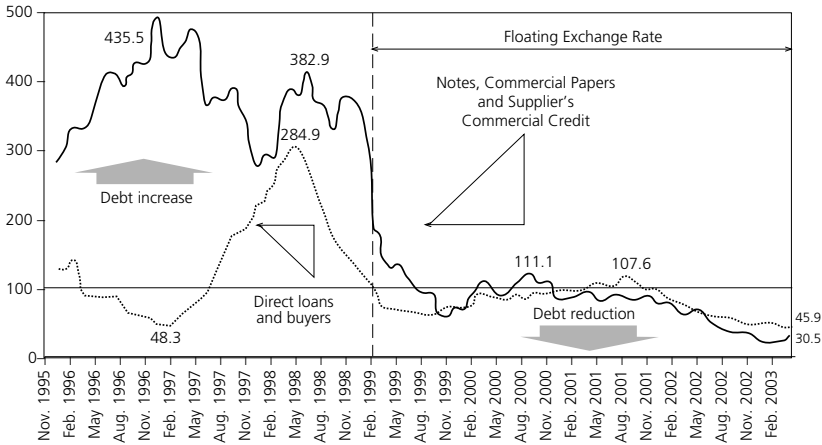
### A moderate growth of sophisticated industrial exports

Compared to emerging Asian economies, the growth rate of sophisticated industrial exports is moderate. This can be explained by the low rate of gross fixed asset formation, by the powerful rise in foreign investment (which is increasingly directed towards the service industry), by poor efforts in the R & D sector, and by the lack of sophistication of the goods exported, even today. Let us briefly take up these factors one by one. The rate of gross fixed asset formation, which is two or three points higher than what it was in the eighties, remains moderate, and is approximately three-fifths of that of the main South East Asian countries. Foreign investment has grown immensely in the last decade, to the extent that, for a country like Brazil, the share of international capital on the production side is nearly twice that of the United States. Foreign firms, equal in size to the domestic firms, are exporting more than the latter in the manufacturing sector. They also import more. Apart from Mexico — where a large portion of direct foreign investment, approximately half, makes its way mainly to the assembled goods industry (*maquilladoras*) —, direct investment, more so than in the past, is finding its way into the service industry, a sector that does not export but rather imports.<sup>35</sup> The degree of sophistication of exported industrial goods continues to be rather poor, despite indubitable progress. If we divide the exported goods into four categories, according to their degree of growth — very dynamic, dynamic, not very dynamic and stationary —, the figures for the growth in international trade from 1990 to 1998 are: 186% for the first category, where we find a concentration of high-tech goods (computers, telecommunications, pharmaceuticals etc., but also other less sophisticated goods such as textiles for home furnishings), 96% for the second, and 67% and 49% respectively for the last two. When we compare the exports of this group of goods with their international growth, we find that the diagnosis on Latin America as a whole is disturbing: exports by Latin American countries fell by 8% compared with international trade to Latin American countries in the case of the most dynamic goods category; exports by Latin American countries to industrialized countries increased by 93% compared with the growth of international trade in this category of goods to this re-



gion. This increase is explained essentially by the very high share of assembled goods industries in El Salvador, Honduras, Guatemala and Mexico; in Brazil, where this type of industry is not frequently encountered, the figures are eloquent:  $-12\%$  and  $-79\%$  for goods in the first category, with this loss of “market share” taking place in the most industrialized country in Latin America (Benavente, 2002).<sup>36</sup> These results match those obtained by Unctad (2002).<sup>37</sup> When we consider 20 of the most dynamic products exported from 1980 to 1998, we see that the share of exports by developing countries in the global trade increased from  $14.1\%$  to  $28.7\%$ , which seems positive. This impression is confirmed when we note that, out of the 20 products most exported by this group of countries, eight belong to the 20 most dynamic products at the global level (the ratio is fifteen out of 20 for the industrialized countries). But when we analyse these figures by groups of countries, we find different results: the South American economies (which, by definition, exclude Mexico and Central America) only export two out of the 20 products: soft drinks and accessories — computers and electronic equipment being exported mostly by Asian economies. This diagnosis is even more severe when we take a closer look at the Mexican example. Products are defined on the basis of a three digit classification, so that goods that are classified as “high-tech, necessitating highly qualified labour” — such as computers, telecommunications, pharmaceuticals etc. —, and which are characterized by an export boom in developing countries, are in fact mostly goods assembled in factories. Specifically, it concerns the labour intensive segments of the production lines of high-tech products, of which a more detailed breakdown would have given a clearer picture. Many high-tech goods are not so in reality — this deceptive aspect is due to the lack of precision in the classification. This applies to Mexico (with the exception of the automotive industry) and most of the Asian countries. Except for South Korea, these countries chose this type of specialization, without opting for an industrial policy that seeks to integrate, within the national economy, the delocalized segments of multinational firms of the industrialized countries (Jomo, 2001).<sup>38</sup> Consequently, the value added locally is very little. They have, moreover, neglected the research and development aspect by not developing, or by doing so only negligibly, special high-tech zones.

Figure: capital inflows less amortization over amortization in Brazil



Source: Bradesco

On the whole, Latin American exports have increased on the same lines as the general movement of global trade: on average, global trade grows more quickly than the GDP worldwide. This is the result of the modernization of most Latin American economies, but it is also indicative of the accumulation of decades of backwardness and, *a contrario*, of the need for a selective industrial policy, which is the only thing capable of giving sufficient impetus to this movement, an impetus all the more necessary as financial dependence increased in the nineties. Achieving a more substantial and sustainable positive balance of trade — outside recessive phases — might reduce financial vulnerability and, in so doing, check the pernicious effects on the poorer categories of the population.

The breakdown of certain capital inflows, classified according to their specification (bonds, credits), is useful for analysing the modification of some external constraints and the margin of manoeuvre of governments. The following diagram shows, for Brazil, the evolution of the ratios “inflows less reimbursement of amortization”, according to the different types of capital inflows. When this ratio exceeds a hundred, there are more inflows than outflows, and vice-versa for a particular type of financial product. The debt generated by this financial product increases. If the ratio is lower than a hundred, it decreases for this product. These ratios can also be interpreted

in another manner and express tensions and difficulties in obtaining capital inflows under a particular form (bonds, notes, credits) corresponding to the financing requirements. When these requirements have been stabilized, but the ratio falls, this evolution can indicate tensions, a decline in the reserves and a rise in the *spreads* on the interest rate.

#### NOTES

1. Firms in developing countries finance 70% of their assets through self-financing, 20% through loans, and 10% through share issues. In Latin America, in the nineties, these figures were respectively 80% for self-financing and 20% for the rest, according to Bebczuk of the CEF, who adds: "(...) developed economies have a credit stock approximately equivalent to 110% of the GDP: in Argentina, during the Currency Board period, it was 34%, and in 2003, a little under 10%."
2. To briefly recapitulate, a firm is driven into a Ponzi-type situation when its anticipated profits encourage it to borrow excessively. Here, it is banking upon the previous period's cash flow to reimburse (interest plus capital). When the expected profits are not realized due to overoptimism and when, in addition, the interest rates increases to check additional investment, the cash flow becomes insufficient. The firm's financial structure causes an imbalance and a financial crisis erupts. For an application of Mynski's theory on Latin American countries, see Kremer G. (1988): "Le modèle d'instabilité financière de Minsky", document from Greitd, mimeo, Paris.
3. As opposed to what we thought in 1996 in: "La financiarisation excluante, les leçons des économies latino américaines", in F. Chesnais (ed.) (1996): *La Mondialisation Financière, Genèse; Coût et Enjeux*, Ed. Syros, Paris, but in conformity with our study undertaken in 2000. See Salama P. (2000): "Du productif au financier et du financier au productif en Asie et en Amérique Latine", Conseil d'Analyse économique, La Documentation française, n. 25, published in Portuguese (2001) in: *Revista da Sociedade Brasileira de Economia Política*.
4. Very often analyses that are either Marxist in inspiration, or adopt a Marxian approach, have a tendency to dwell upon the cost factor alone. See, for example, Argitis G. (2003): "Finance, Instability Crisis: The Marx, Keynes and Minsky Problems in Contemporary Capitalism", mimeo, University of Cambridge. But they forget that Marx analysed capital accumulation in terms of a cycle, namely the productive capital cycle.
5. We could add that the negative net transfer is equivalent to excess saving, but the excess does not help to finance investment because it services the debt. A corollary of this excess saving is less consumption and, therefore, a fall in effective demand. According to the Keynesian interpretation, one could say that this reduced effective demand has negative effects on the estimations made by entrepreneurs, so that there is a decrease in investments.
6. "Remember Keynes's evocative representation: the problem of financing is to ensure mobilization of real resources. A good financial system will facilitate the transformation

of stone into bread. Today, we are suffering from a financial fixation which could well transform bread into stone”, reminds H. W. Singer, former director of the World Bank, in an interview given to the journal *Alternatives économiques* (February 1994).

7. This liability partly explains the importance of the destruction of capital in the wake of the open border policy in Mexico and Argentina, and the importance, but also the suddenness, of the trade gap.
8. The increase in public expenditure is mainly explained by the rapid rise in the internal debt and external public debt servicing.
9. I have expanded upon this mechanism in: “La financiarisation excluante, les leçons des économies latino américaines” in F. Chesnais (ed.) (1996), *op. cit.*
10. In the large firms, some index-linking to prices does occur. Even in this case, which is an advantage — when compared with the situation of workers who do not benefit at all, or only nominally —, the real wage is reduced by half the difference between the peak and the trough salaries, calculated during the nonindexed period, except if indexing is automatic (which does not happen). In the case of financial products, indexing is not *ex post* but *ex ante*, and the opposite mechanism to that of wages can then be seen. The bibliography on this subject is considerable, often of Kaleckian inspiration. We can refer to J. Ros (1993) (ed.): *La Edad de Plomo del Desarrollo Latino American*, Fondo de Cultura Economica (Mexico), and, for a presentation of these analyses, to our book written jointly with J. Valier (1994): *Pauvreté et Inégalités dans le Tiers Monde: la découverte* (France, translated into Spanish and Portuguese), or to our book: *Riqueza y pobreza en America Latina* (1999), Fondo de Cultura Economica (Mexico).
11. In Brazil, during the period 1990-2002, on an average, this rate was slightly lower when compared to the eighties, and much lower than in the seventies, when calculated on the basis of the 1980 price index. However, the lowering of import duties — with the opening up of the economy and the purchase of equipment abroad (mostly state of the art technology) —, replacing locally produced goods incorporating older technologies, gave to investment a capital saving aspect (in the sense defined by Joan Robinson, that is a decline in the value of capital goods in relation to consumer goods). We can evaluate this effect to approximately two points of the GDP, so that we can consider that the rate of gross formation of the previous period is underestimated to two points, when we calculate it on the basis of the 1980 prices.
12. To recapitulate briefly:  $S - I = Y - A = X - M$ , where  $S$  corresponds to private saving,  $I$  to investment,  $C$  to consumption,  $G$  to public expenditure,  $Y$  to national income,  $A$  to absorption (or  $C + I + G$ ),  $X$  to exports and  $M$  to imports.

If  $T$  is public expenditure, we get:  $Y - T = C + I + (G - T) + (X - M)$

$S$  being private saving, we get  $S = Y - C - T$ , from which we obtain the basic accounting identity:  $X - M = (S - I) + (T - G)$

The deficit (or surplus) of the trade balance corresponds to deficits (or surpluses) of net private and public saving. It pertains to an accounting identity. The liberal current interprets it as an economic relation, and deduces that the trade balance deficit, the source of debt, is the result of excess consumption, both private and public, that should be curbed. The opening up of the economy should enable a better allocation of re-

sources and an international specialization in conformity with factorial allocations; the budget surplus should make it easier to service the public debt, the excess of private saving over investment the servicing of the private debt. The inflow of capital should help to minimize this effort and also help financially to service the debt. We realize that, according to this approach, the recommended economic policy should be one of open markets, including that of capital, liberalization of markets and the end of financial repression (hence a rise in interest rates), and primary budget surplus. This approach is different from that proposed by the Keynesians, who give more importance to supply: an increase in investment (the deficit is permitted for a certain period) should lead to an increase in income and, consequently, saving; currency ranking — the currency of emerging countries — does not weigh much in the balance when compared to the dollar. We have seen (cf. *infra*) that this gives rise to a series of particularly pernicious mechanisms, since the State has to buy the currencies that it needs: high interest rates, an extremely onerous internal debt, and a cutting down of other expenditures, the strictness of which depends on IMF stipulations with regard to the primary budget surplus.

13. The opening up of these economies led to a restructuring of the industrial fabric and the relativizing of industry in relation to other sources of wealth, such as agriculture or raw materials. The industrial fabric was restructured when capital goods incorporating new technologies were imported. They had become less expensive as a result of the liberalization of external trade and the appreciation of the currencies, although there was periodic currency depreciation during the financial crises. These imports — combined with a new organization of work and greater flexibility of labour — facilitated, outside the periods of economic crisis, the sustained growth of labour productivity, which was itself responsible for the increase in exports. In some countries, this process had further implications: entire segments of the industrial apparatus vanished, and the growth of exports was the result of the greater specialization of primary agricultural and mining products. Two examples of this were Argentina and Chile. In other countries, such as Mexico and several Central American States, foreign investment increased in order to produce for the domestic market (Mexico), or production was meant for external markets, with very little national value added (Mexico, Central America). See Lautier B. *et alli*, 2003.
14. We concur with J. Kregel's analysis (2003): "The Perils of Globalization: Structural, Cyclical and Systemic Causes of Unemployment", working paper.
15. We have tried to theorize this process in an article written in honour of Celso Furtado: "La tendance à la stagnation revisitée" (2003), mimeo, to be published.
16. We have analysed the causes of the growing disparities in Salama P. (2002): "La pauvreté prise dans les turbulences macroéconomiques en Amérique latine", Problèmes d'Amérique latine, n. 45, La documentation française, Paris, published in Portuguese (2002) in: *Revista da Sociedade Brasileira de Economia Política*.
17. The Argentina of the nineties illustrates this type of behaviour: enhanced valorization of capital in the large enterprises, with substantial repatriation of capital until the Currency Board was finally shelved.

18. The only difference, however, is that the level of inequality in which the process took place in Latin America was much greater in comparison to the United States: in 1998, according to the BID, the Gini coefficient applicable to 100% of the population of the United States was 0.38, and that of 90% of the not so well-off population was 0.35. The ratio of the two Gini coefficients was thus not very high. This does not apply to Chile, a small country which is an extreme example in Latin America: the figures are respectively 0.58 and 0.27. For the record, the Gini for Brazil, a big country, according to the BID, is close to 0.6 for the total population and 0.44 for 90% of the population. The difference between the 90%/100% ratios of these countries and the United States is thus significant.
19. The more recent body of literature on this subject is now becoming extensive. Apart from A. Saludjian's thesis (2003), let us mention the IPES-IADB document (2004): *Good Jobs Wanted: labor market in Latin America*; D. Rodrik (2001): "Por que hay tanta inseguridad economica en America Latina", *Revista de la Cepal* n. 73, Chile; N. Lustig (2000): "Crisis and the Poor; Socially Responsible Macroeconomics"; Inter-American Development Bank (IADB), Technical Papers Series, Washington; G. Moguillansky (2003): "Inversion y volatilidad financiera en America Latina", *Revista de la Cepal* n. 77.
20. The initial crisis occurred in the mid-nineties. Mexico's trade deficit grew to such an extent (-20 billion dollars in 1994) that foreign investors began to have doubts about the Mexican government's capacity to meet all its obligations. Fearing a devaluation, national and foreign capital fled the country. The currency was devalued twice. The American government offered a massive aid package to the Mexican government in order to cope with the withdrawal of huge sums of money. This was a new type of crisis: it was the first manifestation of the effects of the sudden and massive liberalization of these economies. It created conditions favouring the outflow of capital in other fragile countries such as Argentina (*tequila* effect).
21. B. Lautier, J. Marques Pereira, P. Salama (2003): *Régime de croissance, vulnérabilité et protection sociale en Amérique Latine. Les conditions macro de l'efficacité de la lutte contre la pauvreté*. Cepal, série financiamiento del desarrollo, n. 140.
22. To some extent, we find the same assessment in Calvo G., Izquierdo A. and Talvi E. (2002): "Sudden Stops, the Real Exchange Rate and Fiscal Sustainability: Argentina's Lessons", Inter-American Development Bank, working paper. Calvo designates the not so open, indebted and *de facto* dollarized (CDM) economies as economies that are particularly sensitive to capital movements, especially if the home banks have little interaction with foreign banks, and if the public debt is significant. The introduction of a flexible exchange rate could play a certain role (although this will depend on the quality of the country's institutions) if these characteristics (CDM) are tempered (greater openness, less debt and dollarization). The skepticism about the effectiveness of an exchange rate policy — when the quality of institutions has not improved at the fiscal, financial and currency levels — has been developed in Calvo G. and Mishkin F. (2003): "The Mirage of Exchange Rate Regimes for Emerging Market Countries", NBER, working paper.
23. In fifteen years (from 1985 to 2000), the value of exports increased five times in Mexico, three times in Argentina and doubled in Brazil. For reasons already indicated (see box),

we can say that Brazil and Argentina remained relatively closed economies despite a sustained effort at opening up, and that Mexico is now an open economy. This assessment needs to be qualified: Mexico, no doubt, has opened up considerably in comparison to other economies, but a not negligible part of its export boom (and imports) is due to the development of *maquilladoras*, for which the rate of integration varies between 2% and 5%, depending on the sectors. We are in a scenario which is the complete opposite of that found in most emerging Asian economies, where their greater integration is the result of industrial policies. In Mexico, the greater openness has some “artificial” aspects and leaves the economy extremely vulnerable to the conditions prevailing in the neighbouring countries (see P. Mejia Reyes, 2003): “Fluctuaciones ciclicas en la produccion *maquilladora* de Mexico”, Revista de la Frontera norte, n. 29, Tijuana. We must bear in mind that according to official statistics (Informe de comercio exterior, Feb. 2003), the trade deficit from March 2002 to February 2003 was 6,895 billion dollars. The *maquilladora* industry produced an 18,919 billion dollar surplus, the rest of the industry a deficit of 25,714 billion dollars. The exports of the *maquilladora* industry were of the order of 78,084 billion dollars, and those of the other industries, 64,038 billion dollars.

24. This is what happened a few months prior to Lula’s assuming office in Brazil, until he gave a full guarantee to the IMF that he would continue his predecessor’s policies.
25. To say that the key variable is the interest rate can seem paradoxical if we look at the balance of payments figures in a superficial manner... They actually indicate that portfolio investments (bonds and shares) have declined considerably in favour of direct foreign investment and the credit available with official institutions. We can therefore consider the impact of the interest rates to be negligible. In fact, it would imply that gross inflows have been confused with net inflows. The figures given are generally net figures. They thus “mask” the volume of inflows and outflows. The aim of the high interest rates policy is to retain and attract capital. The variations in interest rates are not enough to avert major currency depreciations in the case of a flexible exchange regime. It is interesting to note that there can be a difference between internal and external interest rates. The former are composed of the prime rate and spreads (risk linked to the probability of exchange rate variations, default in payment and a change of policy); the latter are an expression of government policy. The gap in favour of the latter has a twofold objective: to ensure that the capital stays — i.e. capital is attracted by these interest rates on the one hand —, and to increase external credibility, which should lead to a reduction in the risk premiums and stop pressure on the exchange rate. The cost in terms of recession and the burden of the internal debt is considerable. See Farhi M. (2003): “A permanência da vulnerabilidade externa” in: Política econômica em foco, n. 1 (Unicamp), Brazil. In the same issue, it is interesting to read the article by Belluzo L. and Carneiro R.: “Globalização e integração perversa”, which deals with external vulnerability in relation to the restoration of a flexible exchange rate in Brazil.
26. It is not our intention here to discuss the comparative advantages of the fixed and flexible exchange rates. We have already referred to Calvo and Mishkin’s arguments. It should be noted that, in the early nineties, the various governments were forced to announce fixed exchange rates rather than flexible exchange rates — the financial markets

- would not have recognized their creditworthiness otherwise. On this aspect, a large body of literature is now emerging; see Alesina A. and Wagner A. (2003): “Choosing (and Reneging on) Exchange Rate Regime”, NBER, working paper. For a comparison between exchange rate regimes adopted by Asia and Latin America, see Takatoshi Ito (2003): “Exchange Rate Regime and Monetary Cooperation: Lessons from East Asia for Latin America”, LABEA, working paper n. 9.
27. But with a small reservation, namely that sometimes not following the IMF’s “recommendations” can prove beneficial for the economy and that, in return, the latter can have a positive effect on the exchange rate: after a major devaluation, the currency can start to appreciate once again. The example of Argentina in 2003 is a convincing one in this regard.
  28. This is what explains the skepticism expressed by Calvo *et alli* (*op. cit.*) with regard to the efficacy of the exchange rate regimes and the importance accorded by him to an improvement in the quality of institutions (*cf. infra*). It is also this search for creditworthiness which has led governments to opt for a fixed exchange rate (within a band, “pegged”) and to go for a more or less flexible exchange rate — to announce a fluctuating exchange rate would not have been received kindly, and the credibility of such a policy for coming out of the crisis would have been poor.
  29. The examples are numerous, whether in Mexico, with the *tequila* effect, or in Brazil, during the 1998-99 crisis. It is not our intention here to analyse the more or less erroneous assessments of the extent of the financial crisis on the part of governments, assessments that were ordinarily supposed to prevent a crisis, but which *de facto* ended up creating one. For an analysis of the Mexican example, see Griffith Jones St. (1996): “The Mexican peso crisis”, discussion paper, IDS, Brighton. For an analysis of the Brazilian crisis, we can refer to Palma G. (2003): “The 1999 Brazilian financial crisis, how to create a financial crisis by trying to avoid one”, working paper, ILO and University of Cambridge. It is also not our intention here to analyse whether other avenues — apart from the ones advocated by the IMF — can be followed. Numerous examples attest to this possibility. On this point, we can refer to two works by Stiglitz (2002 and 2003): “La grande désillusion” and “Quand le capitalisme perd la tête”, published by Fayard, and to research conducted by ATTAC, for example.
  30. Conversely, the use of Minsky’s contribution to study the effects of “financialization” on the behaviour of enterprises in South Asia is relevant. See Salama P. (2000): “Du productif au financier et du financier au productif en Asie et en Amérique latine”, *op. cit.* See also Schroeder S. (2002): “A Minskian Analysis of Financial Crisis in Developing countries”, CEPA, working paper n. 9; Crotty J. and Dymli G. (2002): “Can the Global Neoliberal Regime Survive Victory in Asia? The Political Economy of the Asian Crisis”, PERI, published study.
  31. The credit system is less developed in Argentina and in Latin America than in other countries: in the nineties, enterprises in developed countries financed 70% of their assets through self-financing, 20% through borrowings, and 10% through share issues. The respective figures for Latin America are 80% through self-financing, and 20% for the rest. Investment, which dropped in 2002 and went up in 2003, was mainly financed



- through earnings and very little through loans. These earnings were also supposed to finance debt reduction. The advanced economies had a credit stock approximately equal to 110% of the GDP; in Argentina, at the time of the Currency Board, it was 34%.
32. “The growth of direct foreign investment partly explains this modernization, in contrast to what had been observed in the sixties and seventies. During this period, multinational companies sought to satisfy the domestic markets in each Latin American country by exporting their production lines — considered obsolete in Europe and the United States — by appealing to the government to maintain protectionism in order to protect the appreciation of their productive capital (...) devalued elsewhere.” Salama P. (1978): “Spécificités de l’internationalisation du capital en Amérique latine”, *Revue Tiers Monde*, n.74, Paris.
  33. See n. 1, v. 23, of “World Development” (1995), under the direction of Humphreys J.
  34. One should, however, point out that this trend in the demand towards ever more sophisticated products — due to an increase in the middle classes’ purchasing power, which was a characteristic of industrial growth in Brazil, as well as in Argentina and in Mexico, during the thirty years following World War II —, has lost its momentum, with negative consequences on the purchasing power of most of them because of the foreign debt service. “The lower and middle” middle classes are getting relatively poorer, while the “upper” middle class is getting richer, although less so than the “upper” class (10% of the population). In the nineties, this distortion in the Lorentz curve towards income bipolarization will feed a trend towards economic stagnation.
  35. In Brazil, for example, 64.7% of total investment was made in the industrial sector in 1995, 22.7% in 1996, 13.3% in 1997, 11.9% in 1998, 26.6% in 1999, 17% in 2000, then there was a rise in 2001, with 32.80% (SOBEET, 2000). Let us, however, not forget that, from 2001 onwards, there has been a considerable decline in direct foreign investment.
  36. Benavente J. M. (2002): “Cuan dinamicas son las exportaciones intraregionales latinoamericanas?”, Cepal, macroeconomic series on development, n. 12, Santiago, Chile.
  37. UNCTAD: “Trade and Development”, report, 2002, Geneva.
  38. Jomo K. S. (2001): “Growth after the Asian crisis: what remains of the East Asian model?”, Unctad, G-24, discussion paper n. 10, Geneva.

## REFERENCES

- ALESINA, A., WAGNER, A. (2003) “Choosing (and renegeing on) exchange rate regime, *NBER Working Paper*.
- ARGITIS, G. (2003) “Finance, instability crisis: the Marx, Keynes and Minsky problems in contemporary capitalism”, University of Cambridge, (mimeo).
- BENAVENTE, J. M. (2002): “Cuan dinamicas son las exportaciones intraregionales latinoamericanas?”. *Cepal Macroeconomic Series on Development*, n. 12, Santiago, Chile.
- CALVO, G., IZQUIERDO, A., TALVI, E. (2002) “Sudden stops, the real exchange rate and fiscal sustainability: Argentina’s lessons”. *Working Paper Inter-American Development Bank*.

- , MISHKIN F. (2003) “The mirage of exchange rate regimes for emerging market countries”. *NBER Working Paper*.
- CROTTY, J., DYMSLI, G. (2002) “Can the global neoliberal regime survive victory in Asia? The political economy of the Asian crisis”. PERI published study.
- FURTADO, C. (2003) “La tendance à la stagnation revisitée”, mimeo.
- GRIFFITH. JONES ST. (1996) “The Mexican peso crisis”. Discussion paper IDS, Brighton.
- JOMO, K. S. (2001): “Growth after the Asian crisis: what remains of the East Asian model?”. Discussion paper n. 10, Unctad, G-24, Geneva.
- KREMER, G. (1988) “Le modèle d’instabilité financière de Minsky”. Document from Greitd, Paris (mimeo).
- LAUTIER, B., MARQUES PEREIRA, J., SALAMA, P. (2003) “Régime de croissance, vulnérabilité et protection sociale en Amérique Latine: les conditions macro de l’efficacité de la lutte contre la pauvreté”. *Cepal, série financiamiento del desarrollo*, n. 140.
- LUSTIG, N. (2000) “Crisis and the poor; socially responsible macroeconomics”. Inter-American Development Bank (IADB). Technical Papers Series, Washington.
- MOGUILLANSKY, G. (2003) “Inversion y volatilidad financiera en America Latina”, *Revista de la Cepal*, n. 77.
- PALMA, G. (2003) “The 1999 Brazilian financial crisis, how to create a financial crisis by trying to avoid one”. Working Paper. ILO and University of Cambridge.
- RODRIG, D. (2001) “Por que hay tanta inseguridad economica en America Latina”. *Revista de la Cepal*, n. 73, Chile.
- ROS, J. (1993) (ed.) *La edad de plomo del desarrollo Latino American*. México: Fondo de Cultura Economica.
- SALAMA, P. (1978): “Spécificités de l’internationalisation du capital en Amérique Latine”. *Revue Tiers Monde*, n. 74, Paris.
- (2000) “Du productif au financier et du financier au productif en Asie et en Amérique Latine”. *Conseil d’Analyse économique*, n. 25. La Documentation française, Paris. Published in Portuguese (2001) in: *Revista de Sociedade Brasileira de Economia Política*.
- (2002) “La pauvreté prise dans les turbulences macroéconomiques en Amérique Latine”. *Problèmes d’Amérique Latine*, n. 45. La Documentation française, Paris. Published in Portuguese (2002) in: *Revista da Sociedade Brasileira de Economia Política*.
- SALUDJIAN, A. (2003) *Good Jobs Wanted: labor market in Latin America*.
- SCHROEDER, S. (2002) “A minskian analysis of financial crisis in developing countries”, *Cepal Working Paper* n. 9.
- STIGLITZ (2002-2003) “La grande désillusion” and “Quand le capitalisme perd la tête”. Published by Fayard, and to research conducted by ATTAC.
- VALIER, J. (1994) *Pauvreté et Inégalités dans le Tiers Monde: la découverte*. In: Pierre Salama, *Riqueza y pobreza en America Latina* (1999). México: Fondo de Cultura Economica.