THE GREAT RECESSION: AN OPPORTUNITY FOR BRAZIL TO CATCH UP THE DEVELOPED COUNTRIES



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The 'subprime' financial crisis and the collapse of the financial system, with the fall of the Lehman Brothers in the third quarter of 2008, triggered off a phenomenon with wide-ranging implications and distinct signs of a financial crisis, called the Great Recession. In this scenario, the economies of the central countries departed from normal patterns of behavior and began to be ruled by feelings of doubt, fear, panic etc in the logic of deleveraging that prevailed and which involved balance sheet recession, risk aversion and the demand for exchangeable assets and caused peraistent instability in these markets.

From a political or social standpoint, there ceased to be a consensus and the economic system, its institutions and the ideology that justified it, became dysfunctional and required constant state intervention. The 'liberalising' paradigm which had been in force since 1980, entered into a crisis and began to be questioned by facts and the growing dissatisfaction of the public.

How can one understand what will happen to the global economy in this context? What are the implcations for Brazil? Does the Great Recession represent a threat or an opportunity for us? In this study, we intend to draw on historical parallels by referring to similar experiences such as the Great Depression of 1890 and the Great Depression of 1930. On the basis of these historical parallels, we will make some conjectures and raise theories about what could occur in the next few years in Brazil.

The origins of the current crisis

The financial liberalization that began in the 1980s sparked off a wave of financial innovations and a huge expansion of credit on a global scale, leading to a massive accumulation of debt followed by crises that culminated in the big financial crisis that has affected the central global financial system itself.

The present crisis stems from a long sequence of credit bubbles that began in the 1980s. Each bubble

generated a financial crisis wich was abetted by new expansions of credit which, in their turn, led to new bubbles, thus following a successive pattern. This process began at the beginning of the 1980s with the banking crisis in the United States and was followed by crises in Japan, Mexico, Asia, Russia, Brazil, with the explosion of the Nasdaq bubble, Argentina, Turkey etc.

The bubble ceased to burst when the creditors of these debts began to distrust whether, if they all wanted to realize their value at the same time, they would have the right to obtain their assets from different GNPs [Gross National Product] which is impossible. When the bubble bursts, a large part of the financial assets are revealed to be fictitious without real substance in terms of production or income, even in the future. For this reason, everyone turns to liquidity and in this process, a large amount of financial assets are wiped out.

The financial crisis in itself refers to the problem of creditors who see their assets become worthless. However, it should be remembered that every financial crisis affects both creditors/ lenders and debtors/ borrowers of loans. Since, as a rule, creditors are more powerful than debtors, the governments tend to help the creditorsand not the debtors.

The reaction of governments to the crisis

It is for this reason that until now the FED has taken brutal measures to increase the money supply and reduce interest rates to near zero, or in other words, by allowing credit at negative rates, it has helped the creditors. This has prevented trillions of dollars worth of assets from becoming worhtless. Furthermore, by taking on the responsibility of lender of last resort, it has absorbed in its balance sheet, a part of the dubious assets from the private sector. Until now, there have not been any specific measures taken to help the debtors who have lost their employment, had their financial assets (the value of their property and shares) destroyed by the crisis and now have to consume less to pay off their debts.

Strictly speaking, the FED camouflaged the problem of solvency by expanding credit, allowing the banks to shore up their balances to their past financial value by means of zero interest rates and to purchase dubious assets. When the bubble bursts and the assets comne to be valued, suddenly they are without a market and the liquidity provided by the market disappears; that is, the assets have no fixed price since they have been devalued and there is a lack of 'funding' It is an example of Keynes' preference for liquidity.

What the FED is allowing, through its provision of infinte resources with zero interest rates, is for the financial institutions to continue shoring up their reseerves with these dubious assets, which arfe well below their historic value. In this way, it is able to conceal the problem of solvency and, after a sufficiently prolonged period of time, even resolve the problem of insolvency, in so far as some institutions will be able to gradually absorb the losses.

And this was the initial reaction of all the governments. However, when this policy is put into effect, the public deficit increases and in countries without a dynamic economy, (that is without a stong, competitive manufacturing sector, and already with a high level of public debt), this becomes a serious problem and gives rise to a crisis of sovereign debt. This is the case of Greece, Iceland and other countries in the south of Europe.

In Europe, despite the resistance of Germany, the Central European Bank ended up acting in the same way. Following the appointment of the new Italian president, the Central European Bank also turned into a lender of last resort and boosted the credit available to banks and lowered interest rates.

On the side of the debtor, both families and companies became greatly in debt, during the 'boom' period of credit, and had to be deleveraged. The families achieved this by increasing their savings and ceasing to consume and the companies by no longer investing productively so that they can be in aposition to pay off their accumulated debts. With the destruction of financial assets and the loss of employment, the families have to consume less and pay off debts and this permanently reduces the total demand in the economy. The companies also give priority to paying off debts and even those that are profitable, are not given any stimulus to invest in a productive way, given the fall in total demand and the persistent high level of unemployment.

The Great Recession is a problem for the debtors/recipients of loans. We are in a liquidity trap; monetary policies, even reducing interest rates to zero, do not succeed in stimulating total demand. Nobody is willing to get firther into debt either by consuming or investing. Only an active fiscal policy can revive the economy by drawing on the increase in private savings and

re-injecting it into the economic system to boost demand.

The response of society

Since the US [*Translator's note – best to avoid the word 'North American' because this includes Canada which is an independent country with different policies from the US ?] Government decided to help the creditors that is the bankers, thousands of working families have been left unable to meet their financial obligations and have lost their mortgaged dwellings and this has resulted in a growing political opposition. In the next few years, we are bound to witness a slow and gradual decline in the power of US financial plutocracy and its allies, which has openly displayed its power, particularly since the 1980s.

In the light of this, there is beginning to be a political and social reaction against the ruling class. In the context of high unemployment and families losing their dwellings, giving help to the banks does not meet with the approval of the general public. The ruling class is losing both its credibility and legitimacy and this is opening up space for the activities of radical groups and has made it practically impossible to maintain a fiscal policy in an attempt to sustain the level of economic activity.

There is strong pressure on those who hold real political power – the financial plutocracy, together with the directors of services – to make a fiscal adjustment and to cease financing their deficits and destroying bonds with the rise in interest rates that results. It is a game of survival. In the current situation, fiscal policies which could revive economic activity and reduce unemployment, are halted and become pro-cyclical mnaking it very likely that we will experience a new contraction in the level of activity which will aggravate the problem of the public deficit even further. Thus, only when this second contraction is deep and prolonged enough to the point of worsening the fiscal situation (owing to a fall in revenue), will the brakes come off on the politics of anti-cyclical fiscal policies.

Facing the crisis in Brazil

The fall of the Lehman Brothers and the panic caused in the international financial market in the final quarter of 2008, had a sharp effect on Brazil and showed as much about the capacity of the government to react as about the economy itself. The financial crisis initially came to Brazil through the contagion that existed in the financial sector which caused panic in the banks. Immediately, all the banks in the country ended their credit operations, causing a climate of great uncertainty for companies and also paralysing about half the number of productive investments and there was a fall in the GNP figures.

It was only in 2009 that the crisis affected the commercial sector and there was a fall in exports. It is worth remembering that this traditional sector, which has dramatically affected exporting countries like Japan and South Korea, has not had the same effect in Brazil because it remained one of the most 'closed' countries in the world from the standpoint of the outside business world.

The most surprising thing was the subsequent reaction in the Brazilian economy. The government reacted by taking fiscal measures for the public banks, not only by increasing the offer of credit to small banks but also by releasing the brakes on the movement of financial transactions and, following this, stimulating consumption and reducing taxes on durable consumer goods. The initial action by the Central Bank was disastrous since it increased interest rates on the eve of the crisis and maintained high rates in the midst of the liquidity crisis. However, it corrected the error, although rather belatedly, and reduced interest rates in December 2008.

Turning to what is really important, it should be noted that industrial production fell in the last quarter of 2008 but demand for consumer goods underwent a slight fluctuation and then grew at an accelerated rate, as a result of the government stimulus. The contraction of credit led to an abrupt halt in investment and production but the final consumer demand was hardly affected. In other words, on reaching Brazil, the financial panic, had an impact on the supply side through strong credit restrictions, but did not reach the point of affecting consumers. This fact explains why today we have an extremely dynamic domestic market and, more importantly, that this dynamism was caused in an endogenous way.

The Great Recssion

The current Great Recession should not be as deep as the Great Depression of 1929-39, if we learn something from it, but it will be as wide-ranging and long-lasting.

It will be wide-ranging in the sense that it is a global crisis, unlike the Japanese crisis; owing

to their commercial integration and financial globalization, all countries are interlinked. The Great Recession is centred on the United States and Europe. The BRICs, the emerging countries and the countries in development, were not very affected by the financial crisis and, suddenly, began to lead the growth of the world economy. Nations that are very dependent on the growth of exports will undergo more problems or rather, will have to restructure their economies and rely more on the domestic economy, like China. However, countries like Brazil and India, whose growth does not depend a great deal on exports, will be able to transform the threat of a financial crisis into a historic opportunity. In this way, the decline of the United States and Europe and the rise of the BRICs and emerging countries, will lead to a huge shift in the balance of global power.

The Great Recession will also be wide-ranging in the sense that it will be a social, political and ideological crisis. One of the deepest and most indirect causes of the financial crisis was the weakening of the labour unions and the North American traditional middle-class, which witnessed a sharp reduction in its national income, as a result of the process of de-industrialization and the transfer of factories to China and other countries which have a cheaper labor force, as aresult of the pro-rich tax regime introduced by Ronald Reagan (1980-1989). In reality, the election of Reagan meant the rise of a liberalizing ideology and marked the beginning of the predominance of a financial plutocracy in the 'establishment 'that held political and social power. Since then, there has been a huge shift from income based on salaries to profits and as a corollary, from the real to the financial sector of the economy. In the last 10 years, the average salaries of North American families have been reduced by more than 10%. It is in this scene that the policies of a stong expansion of credit has allowed families to increase their consumption and investment in housing and be able to sustain economic growth. The result has been excessive indebtedness and the consequent financial crisis.

The Great Recession will last as long as the crisis of the 1930s and the Japanese crisis of the 1990s, or perhaps longer, because the current economic contraction is the outcome of the bursting of a superbubble, that is a succession of bubbles where the explosion has only been avoided by extending further credit and thus creating new bubbles. It should be remembered that a financial crisis is always preceded by a credit boom which ends up by producung new bubbles and the financial crisis is an explosion with terrible implications for the real economy.

Historical significance

The Great Recession should have a historical significance similar to the Great Depression of the 19th Century which marked the beginning of the decline of British hegemony and the rise of the United States.

What was the historical significance of the Great Recession? This is a crisis centred on the United States and Europe and hence, as is apparent, it is a crisis at the very center of the global system of power with all its implications. What is in play is a type of capitalism that has reached its limits and the probable rise of a new type of capitalism and globalization. The rise of plutocracy meant the withdrawal of the nation state from its regulatory and controlling role where it was dominated by doctrines such as the efficient market, that is always kept in balance and capable of self-regulation. It was under the dominion of the doctrine of the free market that globalization gathered pace. The market was turned into a principle for organizing the capitalist economy that was opposed to the nation- state.

Today, even figures such as Alan Greenspan, the former president of FED, who espoused these doctrines, recognize the absurdity of the destructive power that was caused by a deregulated market and how it exploded into a financial crisis and the Great Recession. If there had not been massive intervention by the State with considerable help, the deregulated financial market would have acquired a self-destructive power that was on such a scale that the financial system would have practically disappeared. It is to ensure the survival of capitalism itself that the nation-state is playing its regulatory role again and controlling the markets in a process of adaptation.

Without doubt, this adaptive process between the market and the State will be long because the financial plutocracy is still the hegemonic power and will resist any attempts to control it. However, the greater the resistance, the longer will be the period of the dominance by the free market as an organizing economic principle and the greater will be the crisis needed to ensure that the adaptive principle can function. Clearly, this process is complex and the rules of the game may undergo changes which can

occur suddenly since, on the whole, they depend on the political game. In whatever way it occurs, what we are suggesting is that, in a stage when the actor who ruled over growth and globalization was the market (banks, financial institutions and multinational companies), the process must tilt in the direction of the nation-state.

In the next few years, both the United States and Europe, will have to give absolute priority to reviving their economies, and eventually resort to protectionist measures to face the rise of China and the emerging countries. When the loss of credibility and legitimacy by the ruling class which we referred to above, is added to this, it is clear that there will be a radical change in global governance. In the decades to come, we will see an interregnum , with the absence of a central authority that dicates the rules of the game, exercises political and ideological leadership or imposes its economic ideas.

At the beginning of the 1980s there was a rising financial plutocracy within these countries, allied to the industrial sector which led to the deregulation of the financial system and the introduction of various forms of capitalism, organized under the principle of the free market, where the expansion of credit and the valuing of financial assets, controlled the growth of the economy. Externally, the financial hegemony unleashed the process of freeing the movement of capital, with the opening up of the economy and its integration in a system of globalization. It is this model, dictated by the financial plutocracy that has experienced a crisis as a result of the Great Recession.

The Great Recession thus has two meanings. On the one hand, there is the beginning of the decline of American political hegemony, which was obtained during the 2nd World War, with the redistribution of power and leadership in the world economy. On the other, there is the decline of an economic paradigm that has prevailed in the last three decades and the rise of a new order that is still being built. However, there is going to be a long period of transition: the GNP pf China, in terms of the current value of the dollar, will only be greater than the United States in 2018 and we are still in the preparatory stages of a global power game. We can thus define the next years as a period of a global hegemonic interregnum in which there will be a growing vacuum of dominant power, with a thaw in its ideology and economic thinking, and a greater political consensus. New rules of the game will have to emerge but none of this will have a continuous and linear evolution.

A new interregnum

At a global level, in the coming decades, we are going to experience a long interregnum, with the decline of the United States and the rise of China and the emerging nations. Both the United States and Europe, will have to concentrate their energies on recovery and reviving their economies in the context of growing opposition and political polarization.

It is only with the rise of a new coalition of political forces that a new international order can be formed. This means that the model of a liberalizing form of globalization controlled by financial interests, will gradually enter into a state of decline. In this climate of a Great Recession, it is very likely that concepts such as sovereignty, the nation-state, and nationalism will acquire political force and mobilize the masses because they will be stirred up by a growing protectionism, that is already in full progress, and by the fact that unemployment will always be a national problem.

With the rise of China, there is a natural candidate for a country that can gradually become the dominant economic model in the decades ahead, by employing a new form of State capitalism to replace the model of global liberalization. If this occurs, the free market will be replaced with a "national-State" as the dominant principle for organizing and controlling national economies and be like a new stage of globalization

In countries that have allowed 'liberalization' to progress excessively and as a result, are in a financial crisis, the State will broaden its regulatory and controlling powers over the markets. These countries will only be able to recover from the Great Recession through more state intervention. In a short period of time, those that believe in the free market as an organizational principle for dealing with facts, will cease to predict the imminent collapse of China, as was the case many years ago, and adapt to the new world, with new principles and a new dominant way of thinking about economics. In countries where the power of the State is the main organizational agent, it should be broadened.

Historical parallels

As a way of understanding the Great Recession in Brazil, we will analyze contemporary changes by looking at similar historical situations ;

these include the aftermath of the big financial crisis of 1873 and the Great Depression that followed in 1890, followed by the Great Depression of 1930.

The Great Depression of 1890 marked the beginning of the decline of British hegemony, with the rise of the United States as a world power. In this long period of hegemonic interregnum, we also witnessed the long decline of British financial plutocracy and the rise of the industrial power of the US, which was plainly apparent at the end of the 2nd World War.

In this period between the Great Depression of 1890, with the beginning of the decline of British hegemony, the Great Depression of 1929-39 and the establishment of US hegemony after the 2nd World War, Brazil underwent a profound change and began the project of building a modern, urban and industrial society.

It is worth recalling some historical facts here. With the abolition of slavery in 1888, we freed work from the "black stain" (to use an expression of that time) and formed a free market which allowed the arrival of a huge wave of immigrants from Europe, driven by the Great Depression, which provided a great stimulus to economic growth in Brazil. With the proclamation of the Republic, the constitution of the modern national State was formed with the devolution (until then timid and controlled) of political and civil rights. And, with the expansion of coffee production, and an awareness of the long period of economic stagnation which characterized the end of the 18th Century and the beginning of the 19th Century, the first stages of industrialization in the interior of the country occurred.

In the hegemonic interregnum, space was also opened up for some intellectuals to begin to free themelves from the grip of a colonial mentality and to think about Brazil with their own minds and turn their attention to the reality of our circumstances. It was in this context that some of the most important interpreters of Brazil emerged: Oliveira Vianna, Manuel Bonfim, Sergio Buarque de Hollanda, Caio Prado Jr., etc . After a big debate about whether Brazil would be an essentially agricultural country or if we should become industrialized to achieve development in the course of time, a final thought arose, which began to be a central feature of a national development project which had gathered momentum with the Great Crisis of 1929.

All this occurred in this period of interregnum when hegemonic power had to be viewed from within and led to a power vacuum and ideas dictated from the center. In this period, Brazil began to think with its own mind, discover its potential and then construct a development project. The construction of this project began in the last decades of the 19th Century and came to maturity with the Great Depression of 1930. It was from 1930 that as a result of the Great Depression, the dynamic pole of the economy was shifted from outside (through coffee exports) and within the country (by industrialization replacing imports).

Opportunites for Brazil

This panorama raises the question of whether the Great Recession is a threat or an opportunity for Brazilian development. What future can be predicted for Brazil? And what will happen to Brazil in the next interregnum? Are we prepared to take advantage again of a period when there is a power vacuum and speed up a new project of sustained development?

An interregnum opens up gaps and spaces and with the rules of the game being changed, and countries like Brazil will be able to act strategically to achieve its objectives. In the case of countries that were once dependent and have a strong colonial heritage, the process of globalization involved an opening up to the exterior and an increase in its relative importance vis-a-vis the internal sector of the economy. This relative importance does not only refer to economic and financial conditions but in particular, to ideologies and the dominance of hegemonic economic thinking. Owing to the interregnum, the autonomy which allows countries to pursue national objectives regarding economic policies, changes considerable.

Industrialization was the driving-force in the process of development from the 1930s until the external debt crisis in 1980. Since that time, we have been completely dependent on the financial sector and with the opening up of capital accounts and financial integration, we have returned to a colonial mentality. This dominates the way we give priority to flows of capital from the outside world, the regime of flexible exchange rates and macroeconomic stability, to the detriment of growth and reforms directed at the market, and it introduces economic reforms that reduce restrictions on foreign capital and privatization, with

flexible labor laws and the liberalization of the financial market.

Until 2004, the Brazilian economy was dominated by what Celso Furtado called the "dynamic insufficiency" of the Brazilian productive framework. Although its industry has changed and become relatively developed, the Brazilian economy was characterized by an unlimited offer of jobs. With an excess of workers, the salaries of the working-class were extemely low and most of them worked in the informal economy. This explains why Brazil had one of the worst profiles in the world with regard to rates of income and salaries.

With a sharp fall in the birth rate in the middle of the 1980s, the population of young people stopped growing in 2004 and has declined since then. At that time, the Brazilian economy underwent a structural change of great importance from the standpoint of self-sustained economic growth.

This meant there was a dramatic change in the dynamics of the labor market. Owing to the shrinking of the absolute number of young people seeking their first job, the salaries of those at the base of the economic pyramid began to increase in real terms and the number of those that managed to obtain formal jobs also began to rise. For the first time, since the great wave of immigration in the first part of the 20th Century, we have begun to face a situation where there is a scarcity of manpower.

The most important thing in this scenario is that companies react by increasing productivity to offset the increases in salary, thus causing a 'virtuous and dynamic circle'. Since our industry and above all our services, are far from the boundaries of technology, there is great scope for increasing productivity at work with simple 'catch-up' schemes. It is only a question of copying and bringing capital goods from the last generation to ensure that productivity can make great strides. It is not a question of innovation but only of current technology. And in fact, the data show that, from that date, the path taken by productivity underwent an alteration and gathered momentum in Brazil.

Thus, a dynamic virtuous circle took place in which the reduction of the offer of work at the base of the pyramid, put pressure on salaries and this, for the first time, compelled entrepreneurs to update their technology and increase productivity. In addition, it expanded the demand for consumer goods which stimulates productive investment. This investment has been self-financed by the companies themselves because, as a result of the increase of productivity, the unit cost of work does not increase and either maintains or even widens the profit margin of the companies. In fact, the data from IBGE shows that in the last few years, Brazilian companies have saved much more than they invest productively or in other words, the profits that are retained are greater than the amount of money invested.

The end of a period of an unlimited supply of labor and the creation of this dynamic virtuous circle has a parallel in our economic history. This corresponds with the displacement within the country from the dynamic 'pole' in 1930 with the introduction of scheme for replacing imports which allowed industry to be established in Brazil and which led to self-sustaining dynamic effects until 1980.

Following this, there was a quarter of a century of semi-stagnation with the external debt crisis, an increase in foreign dependence and the attempt to shift the dynamics to the outside world with the liberalization of capital accounts, privatization and the transfer of important sectors in exchange for foreign capital. From 2004 onwards, there was a new shift in the dynamic pole within the country with the creation of a domestic market that was able to grow in a self-sustained way.

If we could now display a minimum of competence as we have done in the past, history could repeat itself with half a century of growth, although of a moderate kind, and we could complete the project that was begun in the last decades of the 19th Century and have a modern, democratic and prosperous society.

To conclude, we should mention that, in the short term, we are still restricted by certain traditional features such as the very high interest rates, a rate of exchange that is appreciating and negative government savings and these factors keep the growth of the Brazilian economy at a lower level than it could be. Innovation is a vital factor when we approach our productive framework for the technological frontier. When we are freed from these restrictions, the Brazilian economy can follow a path to a higher level of growth potential and in less than three decades, attain the current level of per capita income of developed countries.