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"Déjà vu" History: The European Crisis and Lessons from Latin America through the Glass of Financialization and Austerity Measures

Alicia Girón[a] & Marcia Solorza[a]
[a] National Autonomous University of Mexico (UNAM), Coyoacán, Federal District of Mexico City, Mexico
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"Déjà vu" History

The European Crisis and Lessons from Latin America through the Glass of Financialization and Austerity Measures

Alicia Girón and Marcia Solorza

National Autonomous University of Mexico (UNAM), Coyoacán, Federal District of Mexico City, Mexico

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Abstract: The scope of the current European crisis calls for a rereading of mainstream economic theory. Europe is experiencing a "déjà vu" history through which Latin America has already lived. The recurrent crises from the 1970s up to the Lehman Brothers bankruptcy are manifestations of the financialization process and relate to its different facets. The objective of this article is to analyze financialization in the current economic and financial crisis in Europe as well as its role in the Latin American debt crisis. A heterodox perspective is necessary to understand this long process of economic deterioration and discern the global fragility of the current financial system. An explanation of the structural crisis in the Eurozone implies an understanding of the financial and monetary agreements laid out in the Maastricht Treaty and the position of the Central Bank with regard to financial markets. Today, financial investors have been especially attuned to interest rate risks and profitability in the international financial system, in the same way that transnational banks owned Latin American sovereign debt years before.

Keywords austerity measures; European and Latin American crises; financial crises; financialization

> Austerity, initially a religious concept embodying the supreme virtue of renouncing pleasures of worldly life to attain the joy of afterlife, was transmogrified into an economic policy during the interwar period. It enshrines three principles or dogmas. I. The State must impose a decrease in consumption to force a rise in saving because savings are automatically transformed into investment, which is the sole source of growth. II. The State must strive to cut its expenditures and raise taxes in order to get a full balanced budget or a surplus. III. Austerity is imposed by the supreme law of scarcity, in which a choice is forced to be made and there is no escape from it in the present or future.
>
> —Alain Parguez, 2013

The Bretton Woods System that ended in 1971 represents the collapse of a regulated system that gave way to the strengthening of financialization, which has exercised increasing control on financing for development. The financialization process transferred activity from the real to

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Alicia Girón is a researcher at the Economic Research Institute, National Autonomous University of Mexico (UNAM). Marcia Solorza is a professor at the School of Economics, UNAM.

the financial sector, with the latter becoming one of the key elements or the center of gravity of contemporary economies. Financialization is a term that refers to the predominance of institutional investors in the financial sphere over financial transactions with credits often supported by central bank actions.[1] Furthermore, financialization has been accompanied by financial innovation whereby the banking model of "originating and distributing" credit and risk rests with a range of financial products facilitating the creation of a speculative bubble and crisis (Kregel 2008: 71).

The term financialization has been viewed from several perspectives. For Epstein financialization refers to the "increasing role of financial motives, financial markets, financial actors, financial institutions and financial elites in the operation of national and international economies" (Epstein 2005: 3), whereas Arrighi (1999: 7–8) identified long waves of economic development in global capitalism that involve hegemonic and geographic shifts. Arrighi emphasized that economic deceleration phases generate a process of financialization characterized by the leading power, initially with a competitive advantage in terms of production, shifting toward financial activities as the growth regime is exhausted and other players catch up. Stockhammer (2012: 45) states that financialization has deeply transformed developed economies and asserts that the financialization concept comprises changes in the existing relation between the "real" and "financial" system, giving more weight to financial motives and financial actors. Girón and Chapoy (2012–13) describe financialization as relating to the buying and selling of assets or financial securities that are transacted in the financial capital markets. The new joining of large conglomerates contributed to the phenomenon through off-balance-sheet transactions with derivatives or financial products and services that were the consequence of technological and financial innovations. The financial intermediaries' need for liquidity made it possible for the securitization of assets to take on a life of its own in financial transactions (Girón and Chapoy 2012–13: 168). Finally, Palley defines financialization as a process whereby financial markets, financial institutions, and financial elites gain greater influence over economic policy and economic outcomes. Financialization transforms the functioning of economic systems at both the macro and micro levels. These changes in macroeconomic models and policy objectives, namely, the achievement of cost and, particularly, price stability, are attributable to the evolution and dominance of the financial sector (Palley 2007: 2).

The depth of capital's internationalization already in the postwar Bretton Woods monetary system, up to 1971, established the subsequent path to the integration of international financial circuits in the capitalist orbit across a finance-dominated regime of accumulation (also called neoliberalism or financialization). Among its contradictions, we find income polarization and the deterioration of real wages caused by financial and commercial globalization and also the decline in trade union power. The latter is seen as one of the possible causes of the current stagnation and fall in demand (Stockhammer 2012: 54–57).

To Minsky, this stage of capitalism is characterized by huge pools of funds under professional management—pension funds, sovereign wealth funds, hedge funds, university endowments, corporate treasuries, and so on. Every money manager was under pressure to exceed the average return to retain clients, something that is, of course, not statistically possible collectively. However, with such incentives and with virtually no government regulation, this encouraged not only risky behavior but also ethically compromised actions.[2] The growth in these funds was caused by the success of earlier managerial welfare-state capitalism: the absence of depressions and the presence of relatively good growth, because even when financial crises came

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along and wiped out some wealth, each crisis was contained so that most wealth survived and growth could be quickly resumed. Particularly important was the dynamics created by the transfer of power from banks to "money managers" of "shadow banks" (Wray 2012: 7).

NEW PLAYERS THROUGH THE LENS OF FINANCIALIZATION

Following the breakdown of the Bretton Woods Agreements in 1971, financial instability became a constant feature of financial markets worldwide. In both developed and underdeveloped countries, recurring monetary, banking, and financial crises persisted for more than four decades. The great transformation in the circuits of internationalization and financial globalization is expressed in the world market through new players and nonbank financial institutions that encompass a large range of institutional investors: insurance companies, investment funds, money market funds, hedge funds, special purpose vehicles, and private equity funds, which modified the behavior of development financing and redefined the objectives of financial institutions and banking systems on a national level.[3]

The global financial space became a single market where, for more than two decades, high-risk financial instruments had been traded on the basis of profitability afforded by the prevailing interest rates in international markets.[4] The purchase and sale of contracts for financial services grew exponentially over a short period. Growth was not only exponential, but the purchase and sale of financial operations also extended the time frame for their execution. This time schedule for transactions in the securities market and stock market led to a deepening of financialization within the international financial circuits.[5] Meanwhile, the role of central banks was subordinated to the transformation of the financial circuits, ensuring a margin of capital efficiency to the new players in the financial sphere, controlling interest rates and inflation (Lavoie 2010: 2; Toporowski 2009: 37).

On the one hand, an interventionist state deregulated and liberalized the economy, whereas the objectives of the central bank, namely, inflation targets and deregulation and liberalization of national financial systems, controlled the financial order based on the needs of international financial capital. Rating agencies took precedence over national interests in accordance with institutional investors. The importance of rating agencies even surpassed that of international financial organizations such as the International Monetary Fund (IMF) and the World Bank (WB), institutions that had been the pillars of international monetary regulation from 1944 to 1971.[6]

This new market setting, where rating agencies have an influence on nation-states that operate based on financial innovation, was instrumental in the development of the current crises and parallel financial system (Girón 2012) or shadow banking system. This parallel financial system also emerged as a significant offshore device used to evade taxes and it was an active force behind financialization. At the same time, the financial instruments resulting from financial innovation allowed huge profits even before the financial crisis. These instruments were traded for their high profitability and re-created the financial debt bubble in the period of a credit boom, which led to a dramatic increase in financial products. Nevertheless, changes made to financial deregulation and accelerated securitization have increased the size of the financial sector, have increased instability, and have tended to generate endogenous boom-bust cycles (Minsky 1986). These cycles have not been experienced in the same way by all countries due to differences in their financial systems. Some have had financial markets as pillars and others banking markets;

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moreover, they can be characterized by the way in which they have participated in growth and development financing.

From a long-term perspective, the Latin American external debt crisis was a result of the financialization process. According to Stockhammer (2012: 57), this was a typical exchange rate crisis preceded by a strong period of large capital flows that triggered their sudden exit. The struggle of big transnational banks for profitability and valorization of financial surpluses in the Eurodollar market resulted in large loans to borrower countries, such as Argentina, Brazil, and Mexico. In the long-term perspective, there is no doubt that the European and Latin American crises resulted from the postwar transformations of the financial system, whereby excessive growth led to financial fragility.

The increasingly frequent and severe European crises of the past decade represent a period that is somewhat analogous to the Latin American experience of the 1980s. Between 1982 and 1983, production and employment in Latin America fell, its gross domestic product (GDP) growth rate was −17.32 percent in 1982 and −9.57 percent in 1983, and unemployment rose from 8.8 percent in 1982 to 11.0 percent in 1983. Meanwhile in the Eurozone, GDP dropped from 2.34 percent to 1.05 percent during the critical years of 2008 to 2012, 2009 being the year with the biggest downturn −3.69 percent. Unemployment increased from 7.7 percent in 2008 to 12.1 percent in 2013, its highest level.

In the 1990s, before the current crisis in Europe, governmental liquidity injections allowed credit levels to rise. From 1993 to 1995, a recession began, mainly in the information and arms industry. In this case, the fall in interest rates to below the inflation rate and the increased central bank liquidity were unable to prevent a credit crunch, with the European monetary system suffering a cataclysmic event by 1995. All of these factors multiplied risks and increased debt issuance. According to Minsky (1986), to avoid a sequence of debt deflation and depression, "big government" participation is needed to accelerate spending. In this situation, the budget deficit would rise, allowing private balance sheets to strengthen as a result of larger government spending and tax cuts, therefore avoiding crises. Still, there is a risk in believing that the only remedy is a large short-term fiscal stimulus. The more sustainable solution involves massive government spending during a depression period to increase effective demand, to be followed by sustained longer-term fiscal stimuli to ensure the continued operation of unused plants and equipment.

Other interpretations, such as that of Stockhammer (2012: 56–57), exist about the crisis of the European monetary system during the 1990s. All these interpretations consider the crisis as a determining factor for the eventual acceptance of a monetary union with the adoption of the euro as a single currency, as well as a significant factor in the fall of the inflation rate and real rates of interest. This was so despite differentials in inflation rates among countries, mainly Portugal, Ireland, Italy, Greece, and Spain, vis-à-vis Germany.

THE MAASTRICHT TREATY AND THE EUROPEAN CENTRAL BANK: PLAYERS IN THE EUROPEAN CRISIS

The origin of the crisis in Europe cannot be understood without mentioning the Maastricht Treaty and the European Central Bank's role in the Eurozone. Both have key roles and are orthodox examples of economic theory becoming reality. Mundell suggested that to avoid exchange rate crises, the world should be divided into optimal currency areas on the basis of some factor

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mobility criteria. He also emphasized that the biggest obstacle is political because of sovereignty and symbols of identity of different national currencies. He pointed out that choosing a common currency involves comparing the high costs associated with the existence of national currencies and the benefits derived from optimal currency areas because larger amounts of national currencies mean higher conversion costs and less efficiency in fulfilling money's various functions. Although Mundell originally favored a flexible exchange regime, he was inclined to suggest it only for regions where factor mobility is poor (Mundell 1961: 662). Mundell emphasized that a single currency implies a central bank, which in the European context required it to be supranational. Thus, unlike the creation of the Federal Reserve Board and the national and international role of the U.S. dollar, Mundell's theory laid the basis for financial fragility in Europe, not only in the construction of the Eurozone but also for all those countries that gave up their monetary sovereignty, with the issuing of the euro being dependent on the European Central Bank (ECB) since the beginning of its creation.[7]

One of the most important points of the Maastricht Treaty, in Article 104—confirmed by the 2007 Lisbon Treaty in Article 123—is the rationale of how countries should obtain financing through appropriate fiscal policies and the refusal of the ECB to finance the budget deficit of the member states of the monetary union. The countries that formed the European Union lost their monetary sovereignty at this critical juncture. The Eurozone accepted a central bank that would indistinctively govern monetary policy in the countries comprising the currency area; yet it could not finance public deficits. Based on the conditions outlined in the Maastricht Treaty, countries would have to resort to financial markets for deficit financing. The size of these public debts would depend on the decisions of rating agencies and financial markets' funding, which would be necessary to achieve growth standards in countries with asymmetrically structured economies.[8]

Since the formation of the institutional framework of the European Monetary Union under Mundell's influence, the foundation was laid for the European currency to be financially fragile.

> First, the monetary sovereignty of the central banks of the member countries became dependent on a central body (ECB). Second, the ECB is independent of the political power of the European Union member states. Third, private investors would have to provide for financing public deficits. Fourth, only commercial banks would be financed by the central banks. Fifth, the financing of companies and public administration is forbidden. (Guillén 2011: 115)

In this sense, Toporowski (2012) emphasizes that the Eurozone is the result of a deficient institutional design due to the limitations that the Maastricht Treaty imposes, specifically the restrictions imposed on government deficits, and also due to a bad combination of policies, such as the requirement to keep the debt coefficient of GDP below a maximum level, which is impossible for almost all countries to achieve simultaneously, especially following financial shocks.

The decision to respect the Stability and Growth Pact, which perpetuates and reinforces the Maastricht Treaty criteria regarding public finances, is key to understanding the financial crisis within the Eurozone. Unlike the causes of the U.S. economic crisis, the European crisis arose from "a series of policy decisions that shook the real economy. Policies of a predatory nature destabilized the real economy and this damaged the financial structure that sustained it, which explains how we arrived at a capitalism of autonomous finances that violated the law of value" (Parguez 2010: 214). In other words, the conditions for stability were violated over a long period, provoking a "butterfly effect," or the triple collapse of the Eurozone foundations: (1) financing

during the prefinancial crisis period ignored the real economy,[9] (2) European banks asked for large sums in foreign currency—dollars, yen, Swiss francs—to recycle the borrowing of non-European residents that were offered high interest rates, and (3) bankers violated economic stability in order to sustain government deflationary policies that sought to reduce the public debt. These three factors led to the collapse of much of the European banking sector, with many of these banks having become insolvent following the international financial crisis.

Since the famous "Mitterrand conversion" of 1983, "a permanent shock therapy policy that focused on getting rid of automatic economic stabilizers was applied, reducing public spending and increasing taxes on the middle class" (Bliek and Parguez 2008: 30). European society thus had to accept a decrease in state spending, which led to the disappearance of the welfare state. Many sectors of the population saw their earnings drop and were forced to work in an informal economy, where they had limited access to adequate educational, health, and cultural services. The single-focused goal of achieving zero public deficits and generating quick surpluses to pay off public debt led present and future generations into poverty. This was the birth of the continuous application of economic austerity policies.

Given the negative macroeconomic consequences of austerity on the real economy, it was impossible for any state to achieve the dream of zero public deficits, which accelerated deflation. Far from a positive impact, these deficits may have had a negative result for the private sector, where they affected profit flows due to negative expectations. Companies consequently reduced employment, on the basis of expectations of more deflation (Parguez 2010: 219).

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"DÉJÀ VU": LESSONS FROM LATIN AMERICA

"Too big to fail, too big to rescue" transnational banks were the central players in the Latin American story of debt. The massive liquidity of the Eurodollar market[10] could channel significant amounts of financing to countries whose import substitution model required it, through large American, French, German, and Japanese transnational banks.[11] Capital flows to finance big infrastructure projects benefited countries like Mexico, Brazil, and Argentina, and military dictatorship spending in the Southern Cone also received financing.

The problem of Latin American external debt could not be understood without mentioning Paul Volcker's position at the U.S. Federal Reserve and Ben Bernanke's position—as a professor—regarding the "twin deficit" problem.[12] The rise in interest rates to attract capital flows influenced the external debt servicing costs of borrower countries. The Mexican government's inability to meet its external debt-servicing commitments led to a default in August 1982. The IMF, the World Bank, the Federal Reserve, and the Bank for International Settlements (BIS) quickly responded by providing a bailout to prevent default. Before the Brady Plan, external debt negotiations and austerity measures implemented by the IMF resulted in capital outflows of $64,253 million, which represented 67 percent of Mexico's external debt in 1984. GDP fell by 3.49 percent. The 1980s became the "lost decade" for Mexico and Latin America.

The strategies to solve the external debt problem, reduce the debt, and achieve economic growth included: "rescue loans," a "race against time" in renegotiations to postpone payment and allow time for the large transnational banks to cover bad debts, "structural adjustment with growth" or cross-conditionality of the IMF, World Bank, and the Baker Plan—which promised loans of $20 billion to the fifteen countries with the most debt and created a new mechanism

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called the "market options list" as a way to transfer debt into bonds, after discounts—the implementation of the Brady Plan, renegotiations, and restructuring of external debt and debt swaps.

The Brady Plan was proposed at the end of the 1980s when the Mexican government suggested that no debtor could continue paying its creditors unless there was economic growth. The Venezuelan government implemented a severe adjustment program in 1989 under IMF guidelines, disrupting the existing social order. In response, the U.S. Treasury Department introduced the Brady Plan, which would be implemented for the first time in Mexico in the early 1990s, and later in Chile, Costa Rica, and Venezuela. In Venezuela, the neoliberal policy failed, while Argentina and Mexico renegotiated their debt with the Paris Club in 1989 and 1991, for $4.15 billion and $2.4 billion, respectively.

The Brady Plan was an international strategy for debt management that incorporated its own approach to achieve a market solution. This plan was aimed at a direct and extended gravitation of the international financial institutions into the private market in order to alleviate the debt service of the most indebted countries. The main objectives were to reduce the transfer of funds abroad by reducing principal and interest, and to channel new credits to stimulate national economies.

The main mechanisms and techniques to reduce debt included in the Brady Plan consisted of combining several credit instruments to convert liabilities into capital and make operations in secondary markets and in the voluntary market of external debt to reduce the principal and service of the debt. Buyback operations for repurchasing debt in secondary markets allowed indebted countries to cancel debt with discounts. The purchase of zero coupon bonds (through the acquisition of U.S. Treasury bonds) was useful to exchange the old and new debt equally. Exchange of debt-equity swaps was also applied in secondary markets. Loan conversion practice consisted of the exchange of one loan for another and was employed to substitute debt, which allowed some banks to sell their participation in certain countries. With this debt conversion, loans were transformed into capital or interbank debt and also into bonds emission in international markets (Girón 1995: 110–12, 128–35).

In this way, private firms and the public sector in Latin American countries during the 1990s went back to the Eurobonds markets, financial capital returned with foreign direct investment starting to flow again, and portfolio investments in stocks and banks were being channeled through American Depositary Receipts (ADRs). Mexico, Argentina, and Brazil were the major negotiators of foreign debt under the Brady Plan, although other Latin American countries such as Chile (1990), Peru (1995), and Uruguay (1991) also adhered to this strategy.

In 1990, Mexico entered into an agreement for $48 billion with the creditor banks and the results were: (1) 47 percent of the total ($22.56 billion) was subject to a reduction in interest rates from 9.81 percent to 6.25 percent (reduction of $7.75 billion for par bonds), (2) 41 percent of the total ($19.68 billion) was exchanged for bonds at a discount of 35 percent of their value, representing a decrease of $7.2 billion, and (3) 12 percent or $5.76 billion corresponded to new loans (ECLAC 1990: 112). In this case, the signing of the Brady Plan and the debt renegotiation with the Paris Club contributed to the reduction of principal and interest, as well as to the entry of new financial flows and the signing of the North American Free Trade Agreement. All of these factors influenced Mexico's growth.

In 1992–93, Argentina restructured $21 billion in medium and long-term debts, $7.8 billion corresponding to interest payments. The debt restructuring was carried out under the following

measures: (1) a discount bond swap for 35 percent of their value, (2) a swap paying a margin of 13/16 percent above LIBOR, and (3) a swap for thirty-year bonds paying a fixed maximum interest rate of 6 percent. This agreement represented an immediate $1.5 billion reduction of the debt plus interest payments. In addition, the government restructured another batch of debt as follows: (1) a swap with international commercial banks for $20 billion in medium and long-term debts for thirty-year par bonds, (2) a swap involving $7 billion of discount bonds at 65 percent of their value, paying interests at 13/16 percent above LIBOR, (3) $13.5 billion exchanged for par bonds paying 4 percent interest in the first year and 6 percent in the sixth year, and (4) a $700 million cash payment to clean out $8 billion in back interest and cover the rest with bonds issued at floating rates (Girón 1995: 111–12).

In 1994, Brazil issued bonds that were valued at approximately $43 billion under the Brady Plan, which was a measure that helped restore its access to capital markets while trying to curb high inflation rates and overcome economic recession. In 2006, the Brazilian government repurchased all of the Brady bonds issued in 1994, covering the $6.64 billion corresponding to the nominal value of the securities.

The result of applying different strategies to solve extreme external public indebtedness implied a structural change for Latin American economies and their reintegration to global financial circuits—as will certainly happen to Europe—under a new face of the capitalist financial system. These changes were also due to the new international division of labor, where key sectors of underdeveloped countries assumed a role different from the one they played during the international accumulation process of the earlier postwar period.

The relation between the state and finances in Latin American countries was modified in the 1980s, going from favoring industrial entrepreneurs to emphasizing financialization driven by increased interest rates that encouraged financial activities and discouraged productive investment by raising credit costs. In the Latin American context, this occurred with high and volatile interest rates. Banks stopped providing credits to firms and instead granted them to governments that underwrote and issued highly profitable debt bonds. Industrial profitability fell and, due to low investment, was unable to recover, as occurred in some developed economies and Southeast Asia with the use of more intensive technology.

Nonetheless, in the 1990s, with a more liberalized market, Latin American countries regained access to international financial markets and began to finance their debt service mainly through capital inflows. In the beginning, these capital flows covered their negative entries in the commercial balance, while debt interest and capital amortization were financed through bank lending and direct financing from international financial institutions. In the first decade of the twenty-first century, Latin American economies managed to reverse negative items in their current account balances, but this was accompanied by a drastic drop in direct investments due to less-than-satisfactory coverage of financial needs.

EUROPE REPEATS LATIN AMERICAN AUSTERITY POLICIES

In the 1960s, Milton Friedman's monetarist ideas (Friedman 1962, 1966; Friedman and Schwartz 1971) started to flourish among Latin American governments and they began to distance themselves from Keynesian thought. It was not a matter of chance that there was a resurgence of dictatorial governments in the region between the 1970s and 1980s. The emergence of such

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economic policymakers was backed by the entrance of the IMF and its indiscriminate austerity programs, which led to a deep decline of GDP, as is happening now with the so-called GIIPS countries of Europe (Greece, Ireland, Italy, Portugal, and Spain).

This is why it is important to revisit Kregel (2006), who stated that developing countries were obliged to adopt Ponzi financing profiles that were inherently unstable. The structural changes in Latin American economies and the renegotiation of external debt of debtor countries corresponded to some extent to a new articulation of the capitalist system. This was the result of a new international division of labor, in which the financial circuits and the world economy sought a restructuring of transnational capital so that key sectors of developing countries would play a principal role in the international accumulation process, different from that established during the earlier postwar period. The priority is now to ask ourselves whether the public debt haircuts in Greece and the general stability plans in GIIPS economies—an attempt to reduce fiscal deficits—will enable these countries to resume growth without facing insolvency risks or casting doubt on alternative debt solutions; or whether Greece will remain in the European Economic and Monetary Union as well as the broader European community.

The economic policymakers were guaranteed by the entrance of the IMF and its indiscriminate austerity programs that caused a deep fall in GDP as is currently happening in the GIIPS countries. The GIIPS economies are in a similar situation to Latin America during the lost decade of the 1980s. This can be seen in the comparison in Table 1 of annual GDP growth rates in the 1980s in Latin America and the twenty-first century for the European Union and the GIIPS countries. The external debt crisis in underdeveloped countries happens when the rise in interest rates is combined with the fall in the price of their export products. Table 2 offers a comparison of debt levels in Latin America and Europe, with emphasis on Mexico and Greece.

TABLE 1
Gross domestic product (annual rate of change)

Period	*Latin America (current prices)*	*Latin America (PPP)*	*Period*	*GIIPS (current prices)*	*GIIPS (PPP)*	*Eurozone (current prices)*	*Eurozone*
1982	1965.68	5.59	2002	5.68	1.92	9.11	2.46
1983	−9.57	0.93	2003	13.83	2.17	23.27	2.73
1984	4.09	7.57	2004	9.51	3.03	14.51	4.86
1985	8.17	6.30	2005	3.20	3.05	3.83	4.86
1986	−1.02	6.01	2006	4.36	4.06	5.98	6.43
1987	6.39	5.90	2007	9.88	3.50	15.10	5.72
1988	12.68	4.44	2008	6.43	1.07	9.90	2.34
1989	13.32	4.78	2009	−6.22	−2.55	−8.65	−3.69
1990	11.24	4.24	2010	−2.76	1.06	−2.10	3.19
1991	7.10	7.20	2011	3.70	1.10	7.80	3.58
1992	9.41	5.58	2012	−6.21	−0.43	−7.02	1.05
1993	12.21	6.44	2013	1.70	−0.10	4.30	1.04
1994	13.32	6.99	2014[a]	3.07	1.56	5.50	2.71
Average	**157.9**	**5.5**	**Average**	**3.6**	**1.5**	**6.3**	**2.9**

Source: International Monetary Fund, Database from World Economic Outlook 2014.

Notes: Latin America average includes twenty countries. The term GIIPS includes Greece, Ireland, Italy, Portugal, Spain. Gross domestic product based on purchasing-power-parity (PPP) valuation of country GDP.

[a]Estimates for 2014.

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TABLE 2
Government consolidated debt (percent of GDP)

Period	*Latin America*	*Mexico*	*Period*	*GIIPS*	*Greece*	*Eurozone*
1982	24.7	21.4	2002	38.09	101.66	68.075
1983	27.3	23.9	2003	41.01	97.444	69.262
1984	27.6	23.8	2004	42.67	98.862	69.674
1985	26.9	23.5	2005	42.71	101.228	70.32
1986	27	25.1	2006	42.79	107.469	68.656
1987	28	25.1	2007	43.01	107.232	66.425
1988	27.3	24.3	2008	46.83	112.902	70.265
1989	27.0	22.1	2009	49.07	129.688	80.07
			2010	53.48	148.329	85.738
			2011	58.43	170.32	88.106
			2012	60.67	153.496	92.772
			2013	65.35	168.467	95.207
			2014	68.24	169.275	95.585

Sources: Eurostat (http://epp.eurostat ec.europa.eu/) Economic Commission for Latin America and the Caribbean (ECLAC). International Monetary Fund (2014). Database of World Economic Outlook.

Notes: Latin America average includes twenty countries. The term GIIPS includes Greece, Ireland, Italy, Portugal, and Spain. European Union average includes twenty-seven countries.

The accumulated value of public debt requires transferring the resources to creditors, generating a removal of financing and economic decline, which is difficult to reverse in the short term. This then leads to economic policy adjustments, which divert resources from new infrastructure, public services, education, and health as well as from the productive sector. Thus, the structural features of the peripheral European economies are undergoing transformations similar to the changes that occurred years ago in the Latin American countries. Unemployment and household debt are worsening; poverty rates reflect the pauperization of the middle classes and the economic destitution of formerly poor sectors to levels previously unseen in Europe.

In Mexico and Latin America, financial investors posted huge profits during the debt-refinancing process by taking advantage of financial opportunities provided by two U.S. government initiatives to restart economic development, which were to alleviate the impact of external debt and to enable some countries to once again float their securities in international capital markets. A series of measures converged to face the payment of sovereign debts, mainly of Argentina, Brazil, and Mexico. Payment alternatives dramatically influenced Latin American growth. These alternatives were adjustment plans, associated with severe cuts to public spending and employment. The first measure was the Baker Plan, intended to ease the burden for the most exposed commercial banks. Later, this plan completed the cleanup, associating investment funds with the emergence of a secondary market for risky securities. Thus commercial banks were able to restore their profits, even on bonds that had been downgraded to their original value on the balance sheets, and transferred the riskiest repurchase agreements to marginal holders.

The external debt burst culminated in the so-called lost decade and would continue for the last five years into the 1990s (1995–1999). The measures taken to reactivate the countries mentioned above were: first, reduction of the total amount of debt; second, debt cancellation; third, cut in interest rates; fourth, financial reform within the framework of the Washington Consensus; and fifth, central banks' goals would be reduced to inflation control instead of economic growth and development.

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In Latin America, economic policy choices to solve the increasing external debt in the 1980s were such that lessons can be drawn for those peripheral countries of Europe facing increasing debt problems. Indeed, the problem may even be more acute for Europe, because while Latin American economies held debts that represented almost 30 percent of GDP, European economies have surpassed 60 percent of GDP. Economic policies to face external debt service with creditor banks had a bearing on the name of the "lost decade," which the Economic Commission for Latin America (ECLA) designated for those years. This is why we are obliged to ask ourselves if the measures taken by the IMF, the ECB, and the EU are adequate, and also if it is even convenient to keep a single currency.

The same restructuring strategy has been used by the GIIPS countries since May 2010, when the Stabilization Fund was created. The ECB used this fund to repurchase defaulted securities from banks, with heavy subsidies for interest rates. In the first quarter of 2012, the fund was expanded and strengthened in the Greek debt-swap agreement accepted by private investors, mostly banks. Reduced bank portfolios and debt haircuts reached 53 percent of the nominal value of the bonds, with losses nearing 75 percent. According to the European Banking Federation (EBF), the banks took some time, not enough though, to discount their losses.

Today Greek bonds held by private investors are worth about 21.5 percent of what they were, in accordance with an agreement to restructure the country's debt. The pact between Greece and the investors, through which the latter agreed to a 53 percent haircut, a reduction in the nominal value of bonds, will therefore translate into actual losses of 78.5 percent for all banks and mutual funds holding Greek debt securities. This is because the final loss not only contemplates the nominal 53 percent haircut but also calculates the real current value of the bonds received in the swap exchange, taking into account the term, interest rates, and other factors (BIS 2014).

This final 78.5 percent loss is deducted from the result of the credit default swap (CDS) auction that set the value of Greek bonds at 21.5 percent. The insurance companies will thus pay 78.5 cents for every dollar in Greek bonds that were held by the insured investors, especially in hedge funds, for which a total payment of about $2.5 billion—or €1.89 billion—will be made for this agreement, according to different market valuations.

Default insurance will be activated because the investors who had this coverage refused to assume the debt reduction voluntarily, but were forced to. Athens managed to come to an agreement with the large international banks for a 53 percent reduction on all Greek debt held by private investors, which involves about $206 billion, through a bond swap that exchanged the existing bonds for others. This agreement with creditors cut the Greek debt by €100 billion. This measure is linked to the injection of €130 billion in loans by Eurozone countries and the IMF, which contributed €28 billion.

The vast majority of private creditors accepted these losses, but investors with debt securities worth €25 billion tried to reject the deal and were also forced to accept it. Greece was able to do so by activating some collective action clauses (CACs), which implies that if the holders of at least two-thirds of the debt agree to the haircut, the rest will be required to follow suit. The International Swaps and Derivatives Association (ISDA), an organization of hundreds of financial groups that sets the rules of the derivatives game, ruled that there had been a "credit event" or de facto default in Greece, once the CACs were activated, which has led to the payout of CDSs.

Regarding public debt in the GIIPS economies, the current financial situation of European transnational banks (German, French, British, and Spanish) and institutional investors is much worse than it was in Latin America in the 1980s. The European situation facing

financial circuits and investors is exacerbated by the insolvency of firms, a danger that has not been limited to the "stress tests" previously performed to simulate situations of economic collapse. Debt in peripheral European countries has reached an unprecedented level, in part due to massive fiscal imbalances—despite all measures taken and the fact that Spain and Italy are promoting fiscal consolidation, but also because the banks have not been able to transfer their credits—loans and guarantees—to third parties. These conditions have led the European Parliament to ban short-selling transactions of default insurance linked to sovereign debt, the so-called credit default swaps,[13] and to tighten rules on the short-selling of stocks and bonds.[14]

In addition to the reasons outlined above, the fact that first world countries are highly in debt (France 81 percent of GDP, Germany 80 percent, Japan 220 percent, the United States 91 percent) prevents the simple management of GIIPS debt. At some point, holding so much debt became a time bomb for developed economies. The G-20 asked for an increase in IMF resources to help the Eurozone, and the European Union was forced to strengthen its rescue fund for indebted countries from €500 million to €700 million, plus an additional reserve of €240 million available for emergency situations. The latter was only effective until mid-2013.

However, using the Brady Plan for Greek or European debt issues leads merely to implementing deflationary policies that often run counter to continuing with refinancing programs. The idea is to sustain the debtor with new bond issues in the hope of easing the future debt burden. Although such plans appear to provide greater consideration to debtors, these initiatives are based on the same demands of privatization, cuts in social spending, and modifications to pension policies. Far from reducing the financial burden, these programs only solidify the debtor country's dependence on banks. It is therefore wrong to assume that this refinancing will be more palatable if applied in conjunction with measures to regulate finance, control financial speculation, or eliminate tax havens. Nor will Greece be able to find relief simply by reducing interest rates, as long as payments to creditors remain in progress. The size of the debt is so monumental that even with continued 8 percent annual growth for twenty years, Athens would be unable to reduce its liabilities to the levels initially stipulated by the European Union. It therefore would appear that Greece is merely delaying its final declaration of insolvency, as was the case for the indebted Latin American countries.

Latin American lessons for Europe represent not only a lost decade but also the precedent for generating later crises. The relations between indebted countries and big creditors were limited to stabilization plans oriented to external debt payment. Austerity measures were accompanied by galloping inflation, as Table 3 shows, a situation that has not been experienced by the Eurozone.

Public deficit reached levels that exceeded the payable capacity of a country, even when public spending was reduced drastically, and increasing unemployment also occurred at the same time as a fall in wages.

Adjustment plans along with different renegotiations canceled the Latin American "import substitution" model and reinforced dependence once again on primary exports. More renegotiations took place between banks and governments up to the appearance of the Brady Plan in 1989.

Democratic governments approved the Washington Consensus on the basis of the deregulation, economic liberalization, and financial liberalization framework, which established

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TABLE 3
Annual inflation

Period	*Latin America*	*Period*	*GIIPS*	*Eurozone*
1982	91.77	2002	3.71	2.37
1983	119.36	2003	3.32	1.95
1982	136.74	2004	2.61	2.35
1983	127.45	2005	2.67	2.30
1984	68.18	2006	2.96	1.93
1985	168.43	2007	2.63	3.10
1986	263.50	2008	3.54	1.63
1987	439.40	2009	−0.14	0.92
1988	352.68	2010	1.67	2.21
1989	131.06	2011	2.77	2.76
1990	156.70	2012	2.28	2.22
1991	224.99	2013	0.56	0.85
1992	137.80	2014[a]		1.01
Average	**186.00**	**Average**		**2.0**

Sources: International Monetary Fund, Database from World Economic Outlook 2014. Eurostat.
Notes: Latin America avergae includes twenty countries. The GIIPS includes Greece, Ireland, Italy, Portugal and Spain. Latin American average includes twenty countries.
[a]Estimates for 2014.

the foundations for the Argentinean, Brazilian, and Mexican banking crises. The financial reform established central bank autonomy and contributed to the nondevelopment path, a path characterized by inflation control, increased inequality, and foreign appropriation of the productive and financial sectors. The deregulation process and financial liberalization along with

TABLE 4
Unemployment rate

Period	*Latin America*	*Period*	*GIIPS*	*Eurozone*
1982	8.8	2002	9.2	8.6
1983	11.0	2003	9.3	9.1
1984	9.3	2004	9.0	9.3
1985	9.6	2005	8.3	9.2
1986	9.9	2006	7.6	8.5
1987	8.6	2007	7.2	7.6
1988	7.0	2008	8.6	7.7
1989	7.1	2009	12.1	9.7
1990	7.5	2010	13.6	10.2
		2011	14.8	10.2
		2012	17.7	11.4
		2013	19.1	12.1
		2014		11.9
Average	**8.8**	**Average**	**11.4**	**9.6**

Source: International Monetary Fund, Database from World Economic Outlook 2014.
Notes: Latin America avergae includes twenty countries. The GIIPS includes Greece, Ireland, Italy, Portugal and Spain. Latin American average includes twenty-seven countries.
[a]Data up to August 2012.

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the adjustment programs had a high economic, social, and political cost for Latin American societies, as in the GIIPS countries today. The route of these economies was transformed, productive chains were broken, many jobs were lost, and a significant portion of the population was impoverished. But these countries at least had a central bank and could assert monetary sovereignty, even though they belonged to the dollar orbit. This is not so in the Eurozone. This is why the fall of employment in the GIIPS economies has been more severe than the one experienced in Latin America throughout the 1980s (see Table 4).

Those hard lessons of the Latin American experience suggest that what is needed is a policy shift in favor of Keynesian macroeconomic policy stabilization. Perhaps we ought to take up the interpretations of Rudolf Hilferding (1910) and Rosa Luxemburg (1913) once more to have a global vision of the crisis framed in the process of the internationalization of capital. The true alternative response to the crisis in the Eurozone is to return dynamism to these failing economies by a collective commitment to high employment via a public investment strategy, which means taking up the ideas of Keynes and Minsky as indispensable.

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CONCLUDING REMARKS

The collapse of the Bretton Woods system, when the U.S. dollar was decoupled from the gold standard, provided the dollar with market liquidity. Yet it also laid the groundwork for the current financial crisis by establishing a parallel or "shadow" financial system. For the next four decades, new economic players such as pension funds, hedge funds, and rating agencies have become the privileged domains for financial gain. A minimalist state and central bank policies in favor of low inflation fit well with this dynamic.

In conclusion, we note that some theorists have called the origin of the crisis, the "Minsky moment."[15] However, a final analysis reveals that the roots of the crisis are more closely associated with what Minsky referred to as "money manager capitalism." The world crisis that was nurtured by these Minskian transformations and by what has also been referred to as a process of financialization, in Europe has not only been accompanied by bank insolvencies, but it has also raised questions as to whether the weakest countries in the periphery of the Eurozone would be able to sustain their public debts and remain in the European Monetary Union. Since 2007, bankruptcies throughout Europe have continued unabated, a trend that has only intensified since the collapse of Lehman Brothers.

Social movements to counter these adjustment programs have changed the political scene during the past few years. The current panorama is characterized by financial fragility, unemployment, social demands, nonperforming loans, decline in average industrial production, and a mortgage crisis. The ECB, IMF, and European Commission, known as the troika, are a reminder of the Latin American experience and the close relationship between the Federal Reserve Bank and the IMF in the 1980s, along with the resulting severe economic, political, and social disasters.

The crisis in Europe is the result of an imbalance between core and peripheral countries inherent to the European economic model. Buoyed by monetary unification and financial deregulation, core countries in the Eurozone pursued export-led growth policies, or more specifically, "beggar-thy-neighbor" policies, at the expense of mounting imbalances and debt accumulation in noncore countries. This is further worsened by the fact that during crises, governments

must increase expenditures—even if only through automatic stabilizers—in order to mitigate the fallout, even if revenues tend to decline.

The crisis is emblematic of internal imbalances between central and peripheral countries within a financial architecture that proved unsustainable in the long run. Imbalances in a monetary union are bound to occur when its member states are economically heterogeneous and different. Therefore, part of the solution to the European crisis requires a profound institutional reform of the euro and its fundamental principles, not simply a fiscal or financial reform. It requires that debtor and creditor economies share the burden of recycling surpluses and an economic adjustment. Countries with surpluses should organize a system whereby they recycle their resources toward debtor countries in order to revitalize aggregate demand and production in weaker economies.

The true alternative response to the crisis in the Eurozone would be for Greece to declare its insolvency and for the GIIPS countries to pressure the European Union to look beyond its borders and generate new global capacity to restart the economy, breaking the chain of adjustment policies imposed by the troika. Similarly, in Latin America the Brady Plan and negotiations with the Paris Club demonstrated that agreements were needed to resolve tension and avoid a prolonged deepening of the crisis. Currently, any plan aiming to stabilize the world economy depends on agreements between the United States, China, Germany, France, and Japan. It would appear that the Treasury and the U.S. government are not interested in this route, preferring instead to turn back to the economic policies championed by Ronald Reagan, Paul Volcker, and James Baker in the 1980s, a new Plaza Agreement.

The depth of the banking and financial crisis in Europe today demands a Keynesian perspective once again, and no doubt Latin America can be an important lesson for the mistakes it made in facing its creditors and paying the service of external debt during the 1980s. This is especially the case because the lessons that this region teaches us conform to a series of measures and economic programs of a “neoliberal” type that deepened into a structural change of the import substitution model and their cost seriously affected employment, income, and the standard of living of Latin American families, as is now occurring in peripheral countries of Europe. Transnational creditor banks of Latin American debt and the IMF played a decisive role in the conflict over external debt. Although the European crisis is different, it is similar in certain aspects such as the dispute over sovereign funds and the institutional investors’ interest in the profitability of their sovereign debt titles.

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NOTES

1. Since the time of Walter Bagehot, the central bank has had to guard the sole banking reserve of the country to preserve it throughout all the variations of the money market and all movements caused by decisions in moments of panic, such as what should be anticipated, in what amounts, and for what dates to fulfill its role as lender of last resort (Bagehot 1968: 134).

2. In the 1960s and 1970s, Minsky stated that financial fragility and instability were linked to the business cycle and caused financial crises (1964, 1982 and 1986). Minsky's financial instability hypothesis thus describes the transformation of an economy with a robust financial structure into one with a weak financial structure. The deterioration of credit conditions in the stage of economic growth encourages risk taking in order to acquire liquidity, which increases instability and therefore leads to a financial crisis (a change from stability to instability). This situation requires government intervention (Minsky, 1986:69–72).

3. The democratic task of the state consisted in the democratization of financial markets and workers' pensions in a context of austerity. Institutional investors who were able to increase their profitability through the financial market managed pension funds. The transfer of pension funds from the state to the private financial industry was an undeniable part of the financial reform. In many countries, this was undertaken within the framework of financial privatization, not only of public banks and public services but also of institutions such as insurance companies on an international level.

4. These factors are, for example, globalization, labor force, and productive and financial capital mobility, as well as the absence of an international state, international monetary exchanges, and development alternatives inside the hierarchy of power between states and nations (Guttman 2010: 185).

5. As Toporowski (2010: 37) states, "Typically, banks and financial institutions respond to higher perceptions of risk by restricting new loans, or charging higher margins over central bank interest rates. This reduces the liquidity of small and medium-sized non-financial businesses which find themselves unexpectedly unable to roll over debts, or having to pay prohibitive interest in order to avoid default".

6. In 1971, the dollar was decoupled from the gold standard, thereby breaking the Bretton Woods Agreements and transforming the international financial system. New economic actors were to prevail over the decisions of international financial institutions. They were to be represented by institutional investors and rating agencies with a strong state and central bank presence.

7. The beginning of the 1990s is significant because under the leadership of Germany and France—without the participation of Great Britain—a currency zone was created with fiscal and monetary stringency in order to design an economic and political strategy to deal with the influence of the yen in the Asian currency area and the influence of the dollar in other countries.

8. Maastricht Treaty, Article104 and Lisbon Treaty, Article 123 prohibited uncovered authorizations or concessions of any type of credit by the European Central Bank and by central banks of member states, called hereafter "national central banks," in favor of community institutions, central governments, regional or local authorities or other public authorities, public rights organisms, or public enterprises of member states, as well as the direct acquisition of debt instruments from any of them by the ECB or national central banks. Since the Treaty of Maastricht was signed, investors have tried to satisfy the financing demands of banks, companies, and public administrations of sovereign countries and member states of the currency area. This financing comes in the form of mutual funds, pension funds, and hedge funds. On December 2011, Mario Draghi announced that the ECB would give unlimited credit to distressed European Banks with three years validity. Draghi, president of the ECB, deactivated the financing crisis that many financial institutions faced. Altogether, banks took over more than €500,000 million in loans and achieved more liquidity than they had imagined. The ECB was also flexible about the acceptance terms for financial assets as collateral or guarantee. This enabled institutions with high exposure to issue some of their most toxic assets, including vulnerable sovereign debts on the balance sheet of the central bank, in exchange for money.

9. When the financial structure is based on the creation of credits, as is the case with the modern or current capitalist nucleus, the monetary circuit can collapse if one or some of the sectors or groups applying for a credit—state, companies, families, or the network of foreign spending in the national economy—do not generate enough value or income to repay debts to the banking system, while also investing and spending. Likewise if there is depreciation in the real value of some assets operating as collateral. These conditions could lead to the collapse of asset prices or turn these into negative values.

10. The Eurodollar market originated at the end of the 1940s when China, the Soviet Union, and Czechoslovakia decided to deposit their dollars in banks located outside the United States—London and Paris—for political reasons. This took place at the time of the expansion of multinational companies and transnational banking with the recycling of petrodollars in the 1970s. It constituted an integrated financial system with global coverage, made up of an international network of banks, branches, subsidiaries, and affiliates that accepted deposits and provided loans in strong currencies—dollar, mark, yen, and pound sterling. The U.S. dollar represented 70 percent of transactions in this system. Latin American debts in the 1980s were settled in Euromarkets, which is also a reason why Europe suffered a crisis derived from the payment problems of Latin American countries.

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11. Until the mid-1960s, most Latin American debt was contracted with the World Bank, the International Development Bank (IDB), and the Eximbank. Afterward, external debt underwent banking transnationalization, mainly with American banks. As Rosario Green (1983, 636) said: “Provided with unprecedented liquidity, international banks looked for new clients, giving rise to ferocious interbank competition, still reflected in a variety of pressures on the users of funds”.

12. From 1980 to 1988, as president of the U.S. Federal Reserve, Paul Volcker implemented a restrictive monetary policy and, at the same time, the Reagan administration instrumented an expansive fiscal policy—tax reduction and public spending increase—achieving an important decrease in inflation and a real appreciation of the dollar of 40 percent. The problem in the 1980s was that the United States stopped being a creditor country and became a net debtor in the international financial sphere. In this way, the costs of Reagan’s administration were associated with long-term imbalance, high interest rates, huge fiscal deficits that increased public debt, and trade deficits.

13. In October 2011, the European Parliament banned short-selling CDS transactions. Previously there was no EU standard that regulated such operations. CDSs are derivatives that cover the risk of a payment default on behalf of a country or company. They were directly related to the outbreak of the global financial crisis in September 2008. Within CDS transactions, the most risky are those undertaken through “short-selling”—that is, investors do not have corresponding bonds, and therefore they benefit from the coverage without really being exposed to the risk of default. It is precisely these swaps that the new European regulation prohibits, with certain exceptions, because the European Security and Markets Authority (ESMA) can authorize such operations within twenty-four hours before they are done. The justifications for their approval include situations in which the sovereign debt market “is not working properly” and when the ban could have a negative impact on sovereign CDSs. Another argument for their authorization may be that interest on sovereign debt has risen or is already too high, or that the restriction affects the amounts of bonds that can be traded.

14. Short-selling is when investors sell stocks with the expectation that they will decline in value and the intention to buy them later at a lower price and profit from the difference. To sell short, in the case of both shares and sovereign debt, an investor must have borrowed the corresponding financial instrument, have entered into an agreement to lend or have an agreement with a third party whereby the latter confirms that the action is located and that they have taken steps to ensure that the investor can have “reasonable expectations” that the agreement will be executed. In the case of European sovereign bonds, there are special arrangements to notify regulators, and these have to be made only if there are important net positions in European Union sovereign bonds.

15. The “Minsky moment” is when investors reach such a state of euphoria that banks and lenders extend credits even to dubious borrowers. At this point, different financial instruments are created to participate in the euphoria with greater profit returns than in the productive field. The need to profit rests on speculation that induces a Ponzi effect until reaching its peak. From this point on, some begin the exchange of financial instruments for cash and risk becomes real, associated with a drop in company stock prices. This is when panic breaks out, and with it the collapse of financial institutions.

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