

crunch. Strong federal support for all the UAE banks may help its economy in managing the current situation, but broader questions of speculative growth and irrational exuberance in housing and real estate sectors remain. Global capitalism is at a point where it must deal with the consequences of the previous phase of worldwide over-accumulation in these areas. As real estate prices continue to fall in the US, default and dispossession continue to increase. At the same time, the multiplier effects of the collapse of the construction sectors are still working their way through the global economy. This crisis has not only questioned the optimistic discussion of global recovery, but has also shown how this can affect the developing world.

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## Latin American crisis and Comparative Lessons from it for Eurozone crisis

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In 1981-83, the world economy suffered a steep recession. Just as the great depression made it hard for the developing countries to make payments to their foreign loans-quickly causing an almost inevitable default, the great recession of early 1980s also sparked a crisis over developing countries debt. The crisis began in August, 1982, with Mexico announcing its central bank running out of foreign reserves, and that it could no longer meet payments on foreign debt. In response, banks in industrial countries, largest private lenders to Latin America, started cutting off new credits and demanding payments on their earlier loans. The result was widespread inability of developing countries to meet prior debt obligation and a generalized default.

The crisis was mainly based on the debt build-up phenomenon. So the reasons underlying the crisis were mainly the factors that led to debt build up, which were as follows:

- There was collapse of Bretton woods system, which was accompanied by the re-emergence of international capital markets and an increase in international commercial banks. Also, in

1973 the OPEC quadrupled the oil prices, their surplus being deposited in international commercial banks.

- Oil importing countries of Latin America increasingly needed capital to finance their external deficits associated with the oil inflation.
- Change in loan structure in Latin America: from a long term official loans with low interest rates to short term commercial loans with variable high interest rates-this being a major factor in contributing to the debt crisis.
- A good part of Latin American debt went to finance the growing trade imbalances.
- Many Latin American nations kept the real exchange rate strong against inflation worsening the current account.
- The continuous real ex rate appreciation made international interest to be negative in real terms. This exacerbated indebttness.

### The lost decade and the Eurozone crisis

This lost decade of Latin America's growth was a result of misguided economic policies and institutions that brought on the crisis and worsened its effects.

There are obvious similarities among the various crisis and hence, there is a lot to be learnt from one crisis to tackle another. Here is a comparative analysis of Latin American crisis with the Eurozone crisis, and thus presenting a set of solutions to some of the mistakes that led to the lost decade for Latin America.

1. The first lesson of the Latin American debt crisis is that politics matters. To a

significant extent, the crisis of the 1980s had political roots. Latin American governments ostensibly borrowed from abroad to finance infrastructure projects and boost economic growth. In reality, however, much of the borrowed money was used to maintain consumption standards and, in that way, political support for incumbent governments.

This was especially true after 1979, with the second OPEC oil-price increase and then the sharp increase in interest rates by Paul Volcker's Fed designed to bring inflation out of the U.S. economy. Imported oil and payments on the foreign debt both having become more expensive, Latin American governments and households should have adjusted their borrowing and spending. Instead, Latin American debt more than doubled from \$159 billion to \$327 billion between the beginning of 1979 and end of 1982. Failure to rein in spending made the subsequent crisis inevitable.

Similarly for southern Europe, capital was meant for productive investment. In reality the imported finance fed an enormous consumption boom. In Greece there was a sharp increase in public-sector pay that spilled over to the private sector. Spain experienced a real-estate bubble and Portugal a combination of these problems. The underlying cause was the same: fall in interest rates to German levels and the ready availability of finance.

2. During Latin America's crisis, money center banks in New York engaged in the process of petro-dollar recycling

were flush with funds and hence were so willing to lend. The banks could not claim ignorance of the fact that there existed gaping budget deficits and other economic problems in Latin America. But given ample liquidity and the fact that the big U.S. banks were losing large corporations to the commercial paper market made loans to Latin America an attractive alternative.

We have seen precisely the same thing in Europe in recent years. The world economy was swimming in liquidity, and European financial institutions, in desperate competition with one another, were aggressively ramping up their leverage. Under these circumstances, German, French and British banks found it irresistible to lend to their Spanish and Irish counterparts, which turned around and lent to local property developers.

3. The reluctance of the United States and other creditor countries to contemplate debt forgiveness reflected not any deeply held belief in the sanctity of contracts but simple fears for the stability of their banks.

The loan portfolios of the money center banks were more than double their aggregate capital.

Thus, significant write-downs, on the order of 50 per cent, would have bankrupted them and precipitated a major financial panic.

So U.S. regulators, in their wisdom, insisted that Latin countries were able to pay. They piled more debt on the borrowers' existing debts, through official loans co-financed by the IMF

and the creditor countries. They insisted on structural adjustment, programs as a condition for the extension of official credit. But spending cuts meant recessions, which produced an even larger debt overhang, discouraging investment.

The result was Latin America's lost decade.

All this made debt restructuring inevitable. And the inevitable finally came starting in 1989. By that time the money-center banks had fortified their capital base, enabling them to withstand it. But much better would have been for the U.S. to have recapitalized its banks in 1982-83 in order to avoid this destructive seven-year delay. This is precisely the situation in Europe today. French and German leaders are deluding themselves into thinking that debt restructuring can be avoided. In demanding that restructuring be avoided at all cost, they are consigning the Euro-zone periphery to a lost decade. A better use for their funds would be to adequately recapitalize their own banks, rather than co-financing emergency loans to the crisis countries.

#### Conclusive remarks

In recent years, the international economy and market have undergone vast changes that have strengthened and diversified international financial flows. The problems of the present needs tailor made solutions. I, therefore, strongly recommend handling of future economic crisis in developing countries on a case-by-case basis.

Prevention is better than cure. Industrial countries should continue to reduce fiscal deficits, implement prudent monetary policy, and face up to structural challenges so that interest- rate shocks do not recur and sustained growth is realized. Emerging market economies

should reinforce their commitment to fiscal balance, exchange-rate realism, and ongoing structural reforms, which have played the major role in the normalization of emerging capital markets in the 1990s. The IMF for its part should continue to improve its surveillance efforts by strengthening its dialogue with private market participants.

Sustainable and sound economic policies must be favored over populist policies.

## ‘Occupy Wall Street’: Call for a fairer Society

**Bhavyaa Sharma**

The year 2011 was unusual in a variety of ways. From a tsunami triggering a nuclear disaster in Japan to the busting of countless scams in and out of the corporate world, the previous year was eventful to say the least. But what makes it so different from the past years were the unprecedented revolts, both peaceful and violent, across almost all continents. One uprising led to another, heralding the emergence of a new society, which prefers to uphold the ideals of democracy, to make its voice heard by those at the higher echelons of bureaucracy and corporations rather than keeping mum.

One such protest that has been gathering steam ever since it was initiated (in September, 2011) and quite fortunately refuses to die down is the OWS protest in USA. One may call it the child of the Arab Spring or the product of the

frustration of countless Americans with their economy in the doghouse, but on a different note, it has also helped the eternal debate between capitalism and communism to resurface. Economic slowdown with unemployment at a dismal 9% and the continued widening of the income gap between the rich and the poor (as can be inferred from the self explanatory slogan- WE ARE THE 99%) sponsored by the excessive corporate loot and lobbying in addition to the excessive financial bailouts by the government has led to widespread anger, dissent and despair.

Between 1979 and 2007 incomes of the top 1% of Americans grew by an average of 275% vs. just 40% for 60% of the Americans in the middle of the income scale. Over the last 30 years, the tax burden has grown more on the ‘99%’ rather than the higher income group. Yes, definitely prior to 2008, the U.S. economy grew at a decent pace but that was mostly on account of the rich getting richer. Post 2008, the condition has worsened. With the U.S. capital markets crashing to touch a record low, the U.S. government decided to bailout the big banks (while completely neglecting the smaller ones) making them ‘too big to fail’, who after leveraging up and gambling with the taxpayer- insured deposits lost big in the 2008-09 crisis. However that has only made the corporations more reckless than ever. Most of them are either sitting on \$2-\$3 trillion of bailouts or are investing them almost without thought in the market. Here is when ‘crony capitalism’ enters the story. If the investments turned out to be profitable, the winnings were privatized, while the risks, if realized, meant an overwhelming burden on tax payers, i.e., the losses were socialized. While increasing corporate influence