Chapter 25

LATIN AMERICA: BREAKING THE TABOOS OF THE NEOLIBERAL AGENDA

"The issues are much too important for the Chilean voters to be left to decide for themselves."

-- Henry Kissinger, justifying the U.S. overthrow of Chile's elected leader Allende

Latin America in the 20th century was battered and bruised by invasions, hyperinflations, and bloody coups. Disillusioned with neoliberal dogma, some Latin American countries have been ignoring the old rules and experimenting with models that make strong use of government banks, with quite successful results.

The international debt spider was active in Latin America in the late 20th century, spreading debt, IMF austerity and inflation throughout the region. Rapid privatization of banking in the 1980s and 1990s led to disastrous results in Mexico, Chile, and other Latin American countries.[462] Adding to the skepticism of U.S. propaganda was political repression, including the U.S. overthrow of socialist government in Chile, military takeovers and disappearances in Brazil and Argentina, and 30,000 killed in Nicaragua.

Latin America also got hit with some of the worst hyperinflations in history. According to economist Michael Hudson, hyperinflation—the kind that goes into triple digits and beyond—is not caused by domestic spending but is virtually always a foreign debt problem. He writes, "Every hyperinflation in history has been caused by foreign debt service collapsing the exchange rate."[463]

In the typical syndrome, short sellers speculate against the distressed currency, shrinking its value on foreign exchange markets. The currency buys less and less, until wheelbarrows are needed to get it to market to buy groceries, as in the notorious German Weimar hyperinflation of the 1920s.[464]

In the last century, Latin American countries have suffered hyperinflations as high as 20,000 percent. They have also seen some dramatic economic recoveries, not from paying off their debts (which is usually impossible) but from defying their foreign creditors and walking away, turning their resources instead to developing their own industries and feeding their own people.

The Latin American response to repeated onslaughts to their economic and political institutions has been a new wave of self-reliance, solidarity, and rejection of foreign hegemony. They are taking control of their own economies and forming new alliances, both among themselves, with regional development banks and trade pacts, and with other countries. They are selling more to China in trade partnerships, and are borrowing from China rather than from international agencies and U.S. banks. They are willing to do this even when interest rates are higher, because China does not impose invasive and onerous loan conditions or treat its trading partners like economic colonies.

Today in Latin America, the trend is to reject both the "free market" prescriptions of the Washington consensus on the radical right and the radical socialism of the left. Many Latin American countries have adopted a mixed "coordinated capitalism" approach. They respect private property and encourage private businesses, but they do it under a government umbrella that makes strong use of public banks. Like China, these countries are showing less concern for the color of the cat and more for catching mice.

In a 2008 book titled *Government Banking: New Perspectives on Sustainable Development and Social Inclusion from Europe and South America*, Dr. Kurt von Mettenheim and co-authors describe a Latin America that is patterning itself less on the Washington consensus and more on the European model of socially-oriented banking. The trend is away from the excessive bank privatization and liberalization pushed in the 1980s and 1990s, toward an increased market share for public banks:

> Government banks . . . far from being doomed to being replaced by financial markets, appear instead still to be central agents of growth. . . . [S]avings banks and microfinance policies are capable of steering domestic financial systems toward better income distribution, social inclusion, political development, and democratization. . . .
>
> On the level of policy, this implies a return to traditional ideas from Europe about savings banks and local communities. Instead of radically reforming public banking sectors through privatization and liberalization, the experiences . . . from Europe and South America involve the reform, modernization, and integration of traditional public banking institutions such as savings banks.[465]

By 2000, neoliberal policies had reduced the number of public sector banks all across Latin America; but public banks still play a key role, remaining strong in major countries. The governments of Venezuela, Brazil, and Argentina retain control of 52 percent, 43 percent, and 30 percent of domestic bank assets respectively, with public and private banks in healthy competition for market share. Private banks do not have a monopoly and must keep their profits modest to remain competitive and retain their customer base.

Venezuela: Banking as a Public Service

In Venezuela, the government began an aggressive campaign to nationalize its banks after they were exposed as systemically weak and corrupt following the banking crisis of 2009-10. Some banks were engaged in questionable business practices. Others were seriously undercapitalized. Others were apparently lending top executives large sums of money. At least one financier could not prove where he got the money to buy the banks he owned.[466]

Unlike in the United States, the government did not bail out these corrupt, insolvent banks but simply took them over. In 2009, it nationalized seven Venezuelan banks, accounting for around 12 percent of the bank deposits in the country. In 2010, more were taken over. The government arrested at least 16 bankers and issued more than 40 corruption-related arrest warrants for others who had fled the country. These interventions followed government takeovers of eight small private banks, after a scandal involving fraud in the country's banking sector in late 2009. Four of these banks were liquidated, and the other four were nationalized and merged with the state-owned bank Banfoandes. The result was a new public investment bank called Banco Bicentenario. Ten bankers and public functionaries were arrested.[467]

By the end of March 2011, only 37 banks were left in the country, down from 59 at the end of November 2009. State-owned institutions took a larger role, holding 35 percent of assets as of March 2011, while foreign institutions held just 13.2 percent of assets.

Analysts say the banking system is now financially sound.[468] As of March 2011, the largest bank in Venezuela is the state-owned Banco de Venezuela, with 14.1 percent of banking sector assets. This bank was acquired by the government in 2009 from Spain's Banco Santander, one of the largest banks in the world. Venezuela's second-largest bank, Banco Bicentenario, is also state-owned and held 12.5 percent of banking assets in March 2011.[469]

In 2010, over the howls of the media, the late President Hugo Chavez took the bold step of passing legislation defining the banking industry as one of "public service." The legislation specified that 5 percent of the banks' net profits must go towards funding community council projects, designed and implemented by communities for the benefit of communities.

The Venezuelan government has increasingly become involved in the operations of private financial institutions, directing the allocation of bank credit to preferred sectors of the economy. By law, nearly half the lending portfolios of Venezuelan banks must be directed to these particular mandated sectors, including small business and agriculture.

In an April 2012 article titled "Venezuela Increases Banks' Obligatory Social Contributions, U.S. and Europe Do Not," Rachael Boothroyd wrote that the government has required Venezuelan banks

to give back. The new legislation increases the percentage of net profits that banks must grant in credit to national social programs. Housing in Venezuela has been declared a constitutional right, and Venezuelan banks are obliged to contribute 15 percent of their yearly earnings to securing housing for the population. The government's Great Housing Mission aims to build 2.7 million free houses for low-income families before 2019. It is all part of a government drive to create a social banking system that contributes to the development of society rather than simply siphoning off its wealth. Boothroyd writes:

> It is not that Venezuelan financial speculators and bankers care more about the wellbeing of the national population, but rather that Venezuelans are in the fortunate position of having a national government which prioritizes their life quality, wellbeing and development over the health of bankers' and lobbyists' pay checks. If the 2009 financial crisis demonstrated anything, it was that capitalism is quite simply incapable of regulating itself, and that is precisely where progressive governments and progressive government legislation needs to step in.
>
> . . . [T]hrough restructuring the banking system, the [Venezuelan] government is attempting to "orientate the use and investment" of the banking system's funds towards the "public interest," in order to "really create a social state of law and justice." The Law of the National Financial System also outlines the legal framework through which the Venezuelan people can "participate and supervise the management" of the country's financial system through "social control" of the sector.
>
> . . . Venezuela has proved that, despite the globalised nature of the banking system, these changes can be implemented when the government is on the side of the people and not the financial institutions.[470]

Governments on the Right: Mexico and Chile

A strong public banking sector is to be expected in countries such as Venezuela on the political left, but public banking is also strong in parts of Latin America leaning to the political right.

Mexico has a right-leaning president, but it also has a publicly-owned development bank and a publicly-owned bank for the military, called Banjercito—the National Bank of the Army, Air Force and Navy.[471] Chile also has a right-leaning president, yet it has a strong tradition of public savings banks that goes back over 150 years.

Banking in Chile is dominated by the giant publicly-owned Banco Estado, which boasts over $20.5 billion in assets as well as Chile's largest network of bank branches and ATM machines, half of its savings accounts, two-thirds of its mortgages, 60 percent of payments, 45 percent of the micro-business bank market, and 80 percent of public sector banking. Banco Estado has a strong record of serving the public. It mobilizes household savings to finance sustainable economic and social development, provides equal access to banking and finance, and increases competition in the banking sector. It has a mandate to promote entrepreneurship, invest in human capital and culture, lead infrastructure investment, finance social spending, and contribute to financial stability, public confidence and national development.[472]

These contributions to national and social well-being have not hurt the bank's profitably. To the contrary, from 2000 to 2005 Banco Estado posted solid growth, with annual loans growing an average of 9.1 percent, and before-tax earnings rising an average of 4.6 percent. In 2005, Banco Estado and its subsidiaries obtained before-tax earnings of $192.7 million and generated a before-tax return on equity (ROE) of 24.4 percent, outperforming the rest of the banking system.[473]

The bank's profitability was also not hurt by the credit crisis that hit globally in 2008-09. To the contrary, Banco Estado made more loans in that period than any other bank in Latin America and the Caribbean. Based on figures reported by the Economic Commission for Latin America and the Caribbean (ECLAC), the Chilean state-owned bank increased its loans by 20 percent between December 2008 and September 2009; and its profitability was reported at 22.2 percent, exceeding 2008 figures. State-owned banks in Colombia and Brazil also increased their lending, by 18.6 percent and 17.1 percent respectively.

Chilean private banks reduced their lending by 3.6 percent during the same period.[474]

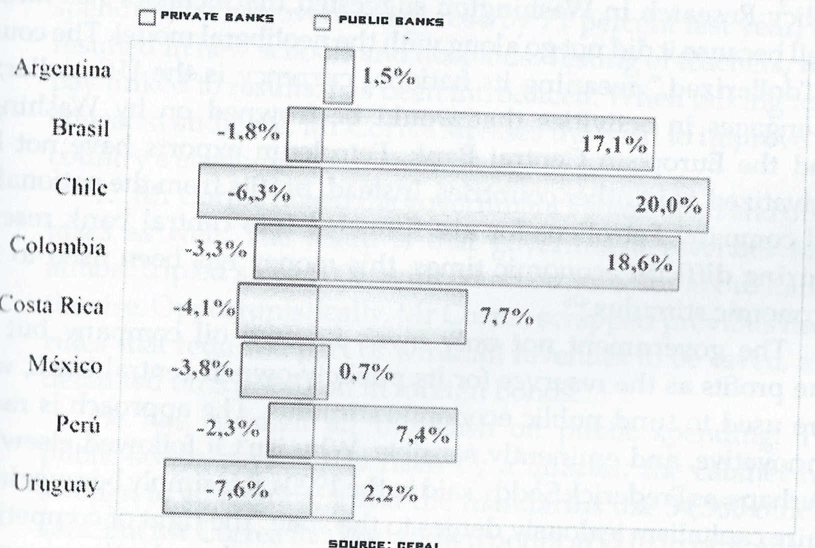

***Figure 11.* Countercyclical lending of Latin American public banks in the post-2008 downturn.**

Source: CEPAL - Comisión Económica para América Latina y el Caribe

Ecuador: Central Banking in the Public Interest

Ecuador is another Latin American country that suffered less than other countries during the banking crisis of 2008–09. It did this despite—or perhaps because of—having defaulted on $3.2 billion in foreign bonds. President Rafael Correa claimed that the securities were illegitimate and illegal. Critics said the move would shut Ecuador out of international credit markets; but by mid-2011, its bonds were rewarding investors with the best performance in Latin America, as Chinese loans and higher oil prices boosted confidence in the country's ability to repay its debts.[475] Ecuador is one of those countries choosing to get development loans from China rather than the IMF, because

China does not attach "conditionalities" to them. Ecuador came out of the recession after only three quarters of declining GDP; and by 2012, its poverty and unemployment levels were well below pre-crisis levels.

A study reported in May 2012 by the Center for Economic and Policy Research in Washington suggested that Ecuador has fared so well because it did not go along with the neoliberal model. The country is "dollarized," meaning its national currency is the U.S. dollar; but it engages in activities that would be frowned on by Washington and the European Central Bank. Petroleum exports have not been privatized as in other countries. Instead, profits from the nationalized oil company PetroEcuador are funneled into central bank reserves. During difficult economic times, this money has been used to fund economic stimulus.[476]

The government not only owns its own oil company but uses the profits as the reserves for its publicly-owned central bank, which are used to fund public economic stimulus. The approach is radical, innovative, and eminently sensible. Why isn't it followed elsewhere? Perhaps, as Frederick Soddy said in the 1920s, it is simply because laissez faire capitalism jealously denies to the state "the right of competing in any way with individuals in the ownership of productive enterprise, out of which monetary interest or profit can be made."[477]

Ecuador, like China, has preserved the ideal of a "national" central bank—one serving the interests of the nation. The central bank serves the government and the economy rather than the other way around, and so does the nation's oil wealth.

Bill Black is associate professor of economics and law at the University of Missouri-Kansas City. In a February 2013 article titled "Correa's and Ecuador's Success Drive *The Economist* Nuts," he wrote:

> In 2009, *The Economist* practically licked its lips in eager anticipation of what it hoped would become Corea's (and Ecuador's) failure due to "the country's acute financial problems." . . . The problem is that Correa, and Ecuador, refuse to fail. Indeed, the most popular elected head of state in the Americas is Correa—by a considerable margin.

The *Economist* article Black was discussing was dated February 2013 and was titled, "Ecuador's Election: The Man with the Mighty

Microphone." It began, "Having mixed the good, the bad and the ugly during six years in power, Rafael Correa is heading for another term." The author was hard-pressed, however, to identify much that was bad or ugly about Correa's presidency. He conceded:

> Mr Correa appears to be uncorrupt. The giant increase in public spending he has overseen (it rose by 71 percent last year) has resulted in new schools and hospitals. Testing of teachers, with pay linked to results, has been introduced. When talking to an educated audience, Mr Correa stresses the need to improve the country's economic competitiveness.
>
> . . . Mr Correa raised the government's share of oil and other taxes as well. The result is that government revenues have almost tripled since 2006, with oil accounting for about half of the rise. Opportunistically, Mr Correa scrapped previous fiscal rules that required part of windfall revenues to be saved, and defaulted on $3.2 billion in foreign bonds.
>
> He has lavished all this cash on public spending. The public-sector payroll has risen by a quarter; the cabinet has swollen to 40 members; and the mandarins use 34,500 official cars. But Mr Correa has also shown political skill in ramping up social spending in a country where provision was inadequate and poverty reached 64 percent in 2000 (it is now 27 percent). Many Ecuadoreans sense that the oil wealth has at last trickled down to them. And Mr Correa has largely eschewed the expropriations of private companies and the smothering economic controls practised by Mr Chávez.[478]

Contrary to the insinuations of *The Economist*, it seems that Ecuadoreans knew what they were doing in re-electing this very popular and successful president.

Uruguay

Like Ecuador and other Latin American countries, Uruguay is thriving after rejecting the neo-liberal agenda. The economy expanded by 8.5 percent in 2010 and continued its high growth in 2011. Unemployment has been low, at 6.6 percent in early 2011 and 6.7 percent in 2010.[479] As of December 2008, only two of Uruguay's 14 banks were state-owned.[480]

But these two banks (República and BHU) dominated the sector, representing about 50 percent of assets as of the end of 2007.[481]

Across the political spectrum, Latin American countries have asserted their independence by taking a pragmatic path that transcends ideologies in an effort to create better lives for their citizens. The possibilities and pitfalls of pursuing that independent path are particularly evident in Argentina, a complex case that deserves a chapter of its own.