



# The Global Economic Crisis: Effects and Political Strategies



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## The Crisis, its effects, and political strategies

So far, analyses of the crisis have naturally been economic in nature. But the crisis will have social repercussions, which will in turn trigger serious political effects. These after-effects can undermine political stability and democratic sustainability in the region. This in turn will limit the capacity of governments to cope with the crisis. This paper delves into the sequence of these economic, social, and political effects, and suggests some political strategies for mitigating their negative implications.

It can arguably be said that we are facing a systemic crisis, for two reasons: first, because it affects both the financial sector and the real sector of the economy; and second, because it involves the entire global economy--industrialized countries, emerging economies, and developing countries, all of which are governed to a greater or lesser degree by free market principles.

Public policies that could help address the problem can be found in both the institutional and the economic fields.

## I. The political impact of the global economic crisis in Latin America and the Caribbean

The expectation that the global economy will make a soft landing in the wake of this crisis has vanished. Capital losses on international financial markets in 2007 and 2008 are unprecedented. One thing is certain at this point, and that is that there will be no speedy recovery, as suggested by the “V” model, and so now the objective has shifted to a “U” based recovery, to avoid the prolonged stagnation of the feared “L” effect, i.e., a sharp drop followed by a sustained recession.

If this future scenario holds true, our region could enter a time of social tension, conflicts over distribution of wealth, and great uncertainty in the expectations of economic agents. A smoothly functioning democratic system could serve as an appropriate conduit for debating and resolving the differences that will inevitably arise. However, a crisis of this magnitude requires a degree of national unity that goes well beyond the election process. It is through a system of political and social agreements that the democracies of our region could strengthen good governance and the political viability of the measures that will have to be adopted.

Among all the main players on the international scene, policies to deal with the crisis are based on dynamic government action. In the current situation, the role of the state is crucial. Yet in our region, governments generally do not have the institutional and political capacity required to perform the same functions as in the developed countries.

Agreements between political and social stakeholders are essential for ensuring political stability, reducing uncertainty, anchoring expectations, and shortening the recovery time.

**Just as the expectations of economic agents exacerbate the impact of the crisis, consensus-building serves as an antidote to a negative preventive approach.**

Agreements are a political signal needed to rebuild confidence in the market.

In our view, the political consequences of the crisis are as follows:

1. The sum of the economic, social, and political aspects affects all social sectors, bringing heavy pressure to bear on the government and the state. The result is an atmosphere of political and social tension, although its impact will depend on the actual situation in each country at the time of the crisis and on its duration.
2. The effects of the crisis may be reflected in heightened tension among the central, state, and local governments over the allocation of limited resources. This situation will primarily affect states with federal systems.
3. The crisis may also worsen as a result of the negative impact of the preventive positions or anticipations of economic agents (capital flight, drops in production, layoffs). There is a danger that this could amplify the intensity and duration of the crisis, and exacerbate the capital/labor conflict.

4. Due to the severity of the crisis, the countries of the region could see a considerable reduction in the autonomy they have achieved in the past five years, especially vis-à-vis international financial institutions. Although the new credit line opened by the IMF under the G-20 agreements goes in the direction of reducing conditionality and there is talk of an increased role to be played by regional financial institutions, we will have to wait until these measures are implemented before we can determine their effectiveness.

It is a fact that the region is in a better position to cope with this global crisis: its balance of payments and reserve position, as well as its fiscal situation, are better than at other times in the past. However, the shrinking of credit, the flow of capital to the central developed markets, the drop in remittances (which rose to \$287 billion dollars in 2008), and the price/quantity effects on international trade are greater than what can be offset by accumulated reserves without creating adverse effects, especially if the crisis is prolonged.

**In this context, political consensus is a key tool for dealing with limitations, such as weak government institutions, and for advancing policies to counter the crisis.**

The state must implement anti-crisis policies and reduce social conflict, which undermines its own capacity to act. Therefore, it is essential for the main political and social stakeholders to conclude timely agreements on an equitable distribution of the burden. This is an indispensable political condition.

**This response should seek to reduce the impact of the crisis on the poorest sectors and on productive sectors, especially micro-, small, and medium-sized enterprises that employ three out of every four workers in the region.**

The costs of the current crisis must not be borne by the most vulnerable sectors. Every recession has a tendency to concentrate income and widen the social gap. In twenty macroeconomic crises in Latin America, in every case the poverty index increased and remained at a higher level afterwards.<sup>1</sup> Inequality increased in 15 of the 20 episodes. The poorest quintile of the population was not always the most affected. As a rule, it was the middle quintiles that were hit the hardest. In most countries, the share of total income of the highest decile increased. Consequently, it was the middle class that transferred part of its income to the wealthiest sectors.

**In order to handle the crisis effectively, efforts must be aimed at preventing increased political instability and at shoring up democratic governance.**

The way out of this negative situation is to revise the way the system operates before these economic and social problems create conflict in the internal political arena and/or on the international front.

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<sup>1</sup> Lustig, Nora (2000), "Crises and the Poor: Socially Responsible Macroeconomics", IADB Technical Papers Series (February), Inter-American Development Bank, Washington, D.C.

## Economic, social, and political effects of the crisis

	First generation effects (economic)	Second generation effects (social)
<b>1. Fall in international price of raw materials.</b>	<ul style="list-style-type: none"> <li>a. Contraction of exports and decrease in capital flows.</li> <li>b. Drop in tax revenue from exports</li> <li>c. Deterioration in current balance of payments account.</li> <li>d. Deterioration in fiscal situation (deficit).</li> <li>e. Pressures on the exchange rate and prices.</li> <li>f. Reduction in investment.</li> </ul>	<ul style="list-style-type: none"> <li>a. Increased unemployment in export sectors, expansion of the informal sector.</li> <li>b. Contraction of available income.</li> <li>c. Increase in poverty and inequity indices.</li> </ul>
<b>2. Reduction in flow of remittances.</b>	<ul style="list-style-type: none"> <li>a. Reduced consumer spending, investment.</li> <li>b. Deterioration in current account.</li> </ul>	<ul style="list-style-type: none"> <li>a. Contraction of disposable income.</li> <li>b. Return of migrants to country of origin.</li> <li>c. Increase in poverty and inequality levels.</li> <li>d. Increase in unemployment and the informal sector.</li> </ul>
<b>3. Contraction of tourism</b>	<ul style="list-style-type: none"> <li>a. Reduced foreign currency flows.</li> <li>b. Reduced consumer spending, investment.</li> <li>c. Deterioration in current account.</li> <li>d. Deterioration in fiscal situation (deficit).</li> </ul>	<ul style="list-style-type: none"> <li>a. Increase in unemployment in the tourist sector, informal sector.</li> <li>b. Contraction of disposable income.</li> <li>c. Increase in levels of poverty and inequality.</li> </ul>
<b>4. Rationing of sources of international/national financing</b>	<ul style="list-style-type: none"> <li>a. More expensive public and private financing sources, and limited access to them.</li> <li>b. Deterioration in fiscal situation (deficit).</li> <li>c. Contraction of investment.</li> <li>d. Pressure on exchange rate, prices.</li> </ul>	<ul style="list-style-type: none"> <li>a. Contraction of public, social, and capital expenditures.</li> <li>b. Increase in informal sector, levels of poverty and inequality.</li> </ul>
<b>5. Instability on regional financial and capital markets.</b>	<ul style="list-style-type: none"> <li>a. Capital outflow (deteriorating BoP)</li> <li>b. Increase in interest rates.</li> <li>c. Bankruptcy risk in the financial sector.</li> <li>d. Pressures on exchange rate, prices.</li> <li>e. Reduction in savings and investment.</li> </ul>	<ul style="list-style-type: none"> <li>a. Contraction of permanent income (pension funds, social security).</li> <li>b. Increase in informal sector, poverty and inequality indices</li> </ul>
<b>6. Exchange rate volatility.</b>	<ul style="list-style-type: none"> <li>a. Pressure on prices.</li> <li>b. Contraction of real wages.</li> <li>c. Capital outflow (deteriorating BoP)</li> <li>d. risk of sharp depreciation/devaluation.</li> <li>e. Pressure on the financial sector and bank deposits.</li> <li>f. Contraction of investment</li> </ul>	<ul style="list-style-type: none"> <li>a. Drop in disposable income (loss of purchasing power).</li> <li>b. Increase in informal sector and poverty.</li> </ul>

The first generation effects refer to the short and medium term economic impact. The second generation effects identify those factors that increase distribution disparities. The third generation effects focus on the elements that impinge on the demands of social actors to the state and on the political stability.

Most vulnerable social agents			Third generation effects (political)
Sector of activity	Income level (urban/rural)	Geographical area	
a. Primary: agriculture. b. Secondary: metals and mining industries.	a. Low income (rural).	a. Entire region.	a. Increased social conflict b. Demands of the state to compensate the drop in income. c. Pressure on tax policy. d. Coverage and potential mobilization of broad social sectors.
a. Primary: agriculture. b. Secondary: construction. c. Tertiary: services.	a. Low income (urban and rural). b. Middle income (urban and rural).	a. Central America. b. Caribbean.	a. Sharp increase in tensions with low-middle and low income sectors especially affected by the crisis. b. Differentiated from the rural case. c. Two sectors with strong demands are combined. d. Coverage and potential mobilization of social sectors.
a. Tertiary: services.	a. Low income (urban). b. Middle income (urban).	a. Central America. b. Caribbean.	a. Little immediate political effect in terms of conflict
a. Primary: agriculture. b. Secondary: light and heavy industry. c. Tertiary: services.	a. Low income (urban and rural). b. Middle income (urban).	a. Entire region.	a. Growing tension in SME sectors. b. Demands on state regarding credit and tax policies (reduced taxes)
a. Primary: agriculture. b. Secondary: industry. c. Tertiary: services.	a. Middle income (urban and rural).	a. S. Cone b. Andean region	a. Political uncertainty. Demands for greater certainty due to need to restore financing and credit sources. b. Increased government intervention
a. Primary: agriculture b. Secondary: industry c. Tertiary: services	a. Middle income (urban and rural).	a. Entire region.	a. Tension with medium-sized and large firms linked to foreign trade b. Conflicts reduced in number but with a strong political impact due tot the size of the players involved. c. Wage demands.

#### Systematic implications of the crisis

- The sum of these impacts mobilizes all social sectors, creating strong pressure over the government and the state. As a result, an environment of strong political tension arises.
- The state, having to satisfy demands, loses its capacity to assure the liquidity and expenditure levels required by the economic system, which are essential conditions for the effective application of anti-crisis policies.
- The effects of the crisis can become major tensions between state, local, and central governments due to the allocation of limited resources. This situation could particularly apply to federal states.
- The crisis could also deepen due to the negative effects of anticipated preventive measures of economic players. At the same time, there is a risk of a deepening of the intensity and the duration of first generation effects, as well as an exacerbation of the capital-labor struggle.
- The severity of the crisis can considerably reduce the autonomy that has been reached by countries of the region in the last five years, especially with respect to international financial organizations. Currently, there is a risk of the reappearance of conditionality.

## II. The linkages between politics and economics

Since the advent of democracy in the region and up to the middle of this decade, a number of presidents elected by popular vote were forced to cut short their terms of office and hold early elections, or else their administrations were interrupted by an economic crisis before they were over. Of the fifteen presidents who did not finish their terms of office between 1985 and 2004, seven were forced out by an adverse economic situation, characterized by high inflation (or in some cases hyperinflation), a fiscal deficit, a loss of value in their national currency (sharp devaluation), a crisis in the banking system, or an increase in rates for public services and taxes, among other factors. In the past five years, however, an expansion in the political base of governments and an ostensible improvement in the economic and social situation also considerably reduced political instability. In view of the previous history, it is altogether possible that the crisis—and especially its social implications—and the measures governments try to implement to contain it, will once again alter this situation.

Nonetheless, there are reasons not to be pessimistic in this regard, both because there will be a large number of elections held in the region in the next two years, and because of certain implicit consensuses among the different forces in most countries, which make it unlikely that new factors of instability will emerge.

### Elections as a way of channeling social and political conflict

The political tensions and social discontent potentially triggered by the crisis, the severity and duration of the crisis, and even the anti-crisis measures adopted could be channeled through electoral processes. Thus the presidential and legislative elections that will take place in various countries in the region between 2009 and 2010 could serve as a way of reducing tensions and the likelihood of social unrest and destabilized governments.

If we look at the number and quality of the elections that have taken place in the past five years (the OAS has observed about thirty of them), in every case they were clean, competitive, with had a good turnout, and their results, even when close, were accepted by all the contenders (although this acceptance was not immediate in a couple of cases). The options presented in all of these processes were varied, and frequently antagonistic, and the fact that the results were validated is a sign of the democratic maturity of the region today.

Although the slowdown in economic growth and the persistence of high rates of poverty in recent decades have caused a loss of confidence in democracy on the part of a number of citizens, surveys show that large proportion of the people support the system, despite the discontent that it may currently generate.

All of this leads one to believe that, despite the fact that elections can increase internal discord and that the crisis may be viewed by the opposition as an opportunity for political gain, in those countries where elections will be held in the coming years, these elections will serve as an adequate democratic vehicle for processing differences and setting aside temptations to resolve disputes by other means.

Even though there may be strong tensions and some institutions may deteriorate to some extent, our supposition is that democracy will stand up to the crisis. In some cases, however, electoral processes could also exacerbate and prolong the impact of the economic crisis if, as frequently occurs, elections are characterized by a significant increase in current spending and the emergence or worsening of the primary deficit, regardless of the ideology of the parties in power. This situation could diminish the response capacity of governments and aggravate the impact of the crisis.

Thus, it is important for our societies and our political forces to seek solid agreements that can withstand the current crisis, to avoid the temptation to take political advantage of the situation, and to generate adequate public policies that involve all the different stakeholders.



### III. Consensus: a basic instrument for lessening the effects of the crisis

Political consensus is a tool to interrupt the vicious circle involving the real situation and the expectations of economic agents. By formulating a system of agreements among key stakeholders, political stability is strengthened.

In our region, it is clear that we have the necessary capacity to generate agreements. In fact, based on recent experience, our societies have spontaneously built an implicit consensus on a variety of issues and public policies of different sorts and to different degrees. It does not form a homogeneous whole, nor is it definitive, but over and above the differences between our governments, today very few of them would disagree that our region needs the following:

1. Free, clean, and regular elections.
2. Stable governments and improved public institutions.
3. Respect for the right to decent work and for strengthening and developing workers' organizations.
4. Strict control over inflation.
5. A fiscal policy that ensures sustainable expenditures and public investment.
6. Promotion of international trade as a key to economic expansion.
7. Priority granted to policies to reduce inequality.
8. Priority granted to fighting poverty.
9. Measures to combat informal and precarious employment.
10. Active policies that focus on measures to fight public insecurity and drug trafficking, and that promote social security, education, and health.
11. Implementation of public policies for preservation of the environment.

In the past, these issues created divisiveness and conflict in our societies, but today they are the subjects of general consensus in public debates.

In view of the crisis closing in on our region, the problems encountered by our governments in coping with it, and the potential debilitating effect of an exacerbated conflict in income distribution, the democratic mechanisms available to us could generate consensuses that will maximize the operational capacity of the states in our region.

There is a danger that the crisis, social conflict, and urgent needs will erode this consensus. If it should be altered, we would lose heavily in terms of capital and a key instrument for ensuring agreements to counter the crisis. For instance, if measures to control inflation or fiscal

sustainability were ruled out, this could weaken the capacity of governments and the impact of anti-crisis measures.

**Finally, considering the serious impact of the crisis on our region and the fact that it could undermine good governance, we believe that it is urgent to promote the mechanisms that are inherent in democracy, namely, resolution of issues through dialogue and agreements to maximize the national capacity during times of crisis such as the present one.**

The economic crisis was not anticipated and we do not have the means to prevent it. We cannot say the same of its political consequences. They are clear, foreseeable, and require action to be taken in advance.

**To close our eyes to the political effects is to jeopardize political stability and the fruits we have begun to reap in the social arena after years of work.**

In fact, after twenty years in which socio-economic results in most countries were meager, finally in the last five years considerable progress was made, and we were able to begin to resolve the serious shortcomings of the region. Unfortunately, the international economic and financial crisis will halt this progress, and could ultimately entail high costs in terms of political stability, and hence our democratic system.

#### IV. The cycle of scarcity-recovery-new dangers

Despite the profound political and economic reforms implemented in the 1980s and 1990s, in most countries the primary socio-economic indicators did not show results on a par with the efforts made until just a few years ago. In other words, the reality of the situation, especially in Latin America, did not line up with the magnitude of the reforms introduced.

Table 2 clearly shows how per capita GDP, poverty, indigence, and concentration of income did not on average undergo substantive changes with the arrival of democracy. In the majority of our countries, twenty years of democracy has not changed the living conditions of our inhabitants. Our democracy, which expanded considerably in the area of political civic-mindedness, has revealed important shortcomings in civil and social attitudes.

This divorce is exacting a heavy toll. The representation crisis is worsening and distrust of the capacity of democracy to change living conditions is growing. Although the inhabitants of the region have continued to support the democratic system, disenchantment with it entails a risk that our democracies will face a crisis of legitimacy. Nobody can say how far this erosion has gone, but there is no doubt that this trend has undermined the sustainability of democracy. As mentioned, in the 1990s fifteen presidents did not complete their terms of office. Although there were no coups d'état and the constitutional provisions for succession were followed, it is also true that this was a sign of the growing disenchantment of the people. They were not yet ill-disposed to democracy, but there was a growing sense of unease within democracy.

This trend changed in the last five years. Poverty levels went down, income went up, economies grew, unemployment was reduced, and signs of an improvement in income distribution began to be seen. Without overestimating the link, it is true that during this time, no constitutional presidents saw their terms interrupted. The prolonged, intensive efforts made were finally bearing fruit.

The international economic crisis unexpectedly erupted, striking a heavy blow to the highly developed countries. Now it is approaching our region. It is probable that many of our countries will feel its impact in the second half of this year.

## Reform and reality.

The columns in orange show a setback in the past decade.

Decade	Year	General Reform Index (1)	Electoral Democracy Index (2)	Human Development Index (3)	Extralegal Executions (4)	Torture (4)	Mortality rate by homicide (100,000 persons) (5)	Mortality rate due to minor vehicle accident (100,000 persons) (5)	Mortality rate: motor vehicle/Homicide (100,000 persons) (5)
	1970	0.475							
	1971	0.473							
	1972	0.474							
	1973	0.467							
	1974	0.474							
	1975	0.496		0.65					
	1976	0.504							
	1977	0.520	0.28						
	1978	0.540							
	1979	0.548							
<b>1970s</b>		<b>0.497</b>	<b>0.28</b>	<b>0.65</b>					
	1980	0.549		0.68					
	1981	0.560			0.89	0.67			
	1982	0.554			0.89	0.67			
	1983	0.537			0.94	0.56			
	1984	0.527			0.89	0.50			
	1985	0.532	0.69	0.69	1.11	0.39			
	1986	0.558			1.06	0.72			
	1987	0.581			0.94	0.67			
	1988	0.598			1.11	0.56			
	1989	0.632			0.94	0.44			
<b>1980s</b>		<b>0.563</b>	<b>0.69</b>	<b>0.68</b>	<b>0.98</b>	<b>0.57</b>			
	1990	0.675	0.86	0.71	0.72	0.44			
	1991	0.722	0.87		0.94	0.61			
	1992	0.766	0.84		0.83	0.39			
	1993	0.783	0.85		0.78	0.56			
	1994	0.792	0.85		0.89	0.44			
	1995	0.805	0.88	0.73	1.17	0.50	19.7	16.6	0.8
	1996	0.813	0.91		0.89	0.61	18.9	16.0	0.8
	1997	0.826	0.90		1.11	0.61	18.6	17.1	0.9
	1998	0.832	0.92		0.89	0.44	19.6	17.7	0.9
	1999	0.830	0.90		0.94	0.22	19.4	17.6	0.9
<b>1990s</b>		<b>0.784</b>	<b>0.88</b>	<b>0.72</b>	<b>0.92</b>	<b>0.48</b>	<b>19.2</b>	<b>17.0</b>	<b>0.9</b>
	2000	0.828	0.91	0.75	0.89	0.17	19.8	16.2	0.8
	2001		0.94		1.00	0.39	19.9	15.8	0.8
	2002		0.93		1.00	0.61	20.4	15.4	0.8
	2003		0.95	0.77	0.83	0.33	19.2	14.8	0.8
	2004		0.93	0.78	0.94	0.28	20.4	15.5	0.8
	2005		0.92	0.79	1.06	0.44	23.4	16.5	0.7
	2006		0.95	0.79	0.94	0.56	20.8	17.8	0.9
	2007		0.96						
	2008		0.96						
<b>2000s</b>		<b>0.83</b>	<b>0.94</b>	<b>0.77</b>	<b>0.95</b>	<b>0.40</b>	<b>20.6</b>	<b>16.0</b>	<b>0.8</b>

The data are all regional averages of 18 Latin American countries, with one exception. For data on inequality, the average also includes Guyana, Haiti, Jamaica, St. Lucia, Surinam, and Trinidad and Tobago.

1. The "General Reform Index" is from Morley, Machado & Pettinato, ECLAC 1999. The index goes from 0 (no reform) to 1 (perfect reform).

2. The data on EDI are from Gerardo L. Munck: "Latin American Citizens: Current Status, Trends, and Challenges," prepared by the Secretariat for Political Affairs, Organization of American States (OAS), December 11, 2008. 0 is equal to "no democracy," and 1 indicates that the Dahlian requirements for democracy were met.

3. The HDI is only comparable chronologically if the series given on pages 229-238 of the 2007/2008 Human Development Report are used.

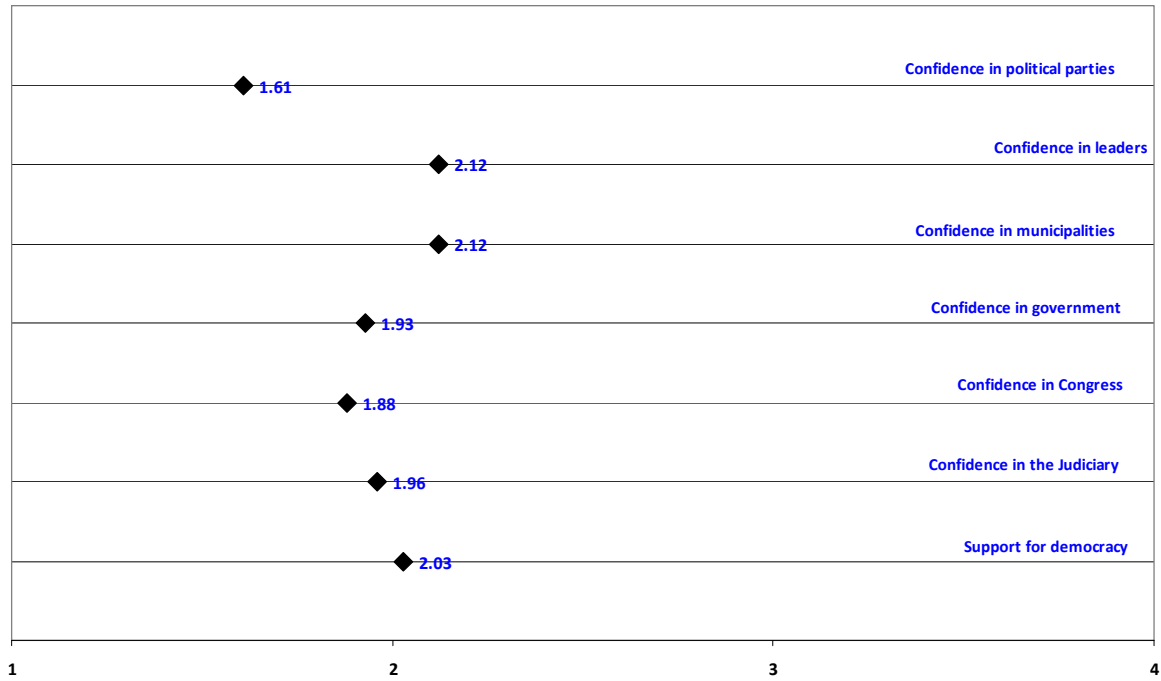
Increase in GDP (%) (6)	Urban unemployment (%) (6)	Population (millions of inhabitants) (6)	Regional real GDP (millions of 2000 US\$) (6)	Regional GDP per capita (2000 (US\$))	Increase real GDP per capita % (6)	Poverty (% of population) (6)	Indigence (% of population) (6)	Gini Index (6)
		265.50	745,478	2,808				
5.7		272.41	790,668	2,902	3.4			
6.0		279.43	844,879	3,024	4.2			
7.2		286.56	913,846	3,189	5.5			
5.6		293.79	972,836	3,311	3.8			
2.8		301.11	1,006,934	3,344	1.0			
5.6		308.56	1,063,428	3,446	3.1			
6.0		316.14	1,115,671	3,529	2.4			
4.7		323.80	1,162,196	3,589	1.7			
3.3		331.50	1,239,744	3,740	4.2			
<b>5.2</b>		<b>297.88</b>	<b>985,568</b>	<b>3,288</b>	<b>3.2</b>			
4.3	6.4	339.19	1,318,421	3,887	3.9	40.5	18.6	
2.0	6.8	346.87	1,327,799	3,828	-1.5			50.14
-2.3	8.2	354.58	1,316,595	3,713	-3.0			
-1.8	9.2	362.31	1,283,862	3,544	-4.6			
2.5	9.2	370.03	1,329,426	3,593	1.4			50.31
1.3	9.6	377.73	1,363,160	3,609	0.4			
3.3	8.8	385.39	1,412,105	3,664	1.5	43.3	20.7	
3.6	8.0	393.04	1,457,302	3,708	1.2			51.63
1.0	8.3	400.68	1,466,196	3,659	-1.3			
1.4	8.0	408.32	1,480,802	3,627	-0.9			
<b>1.5</b>	<b>8.3</b>	<b>373.81</b>	<b>1,375,567</b>	<b>3,683</b>	<b>-0.3</b>	<b>41.9</b>	<b>19.7</b>	<b>50.69</b>
1.8	8.1	415.96	1,485,620	3,572	-1.5			
4.3	8.4	423.60	1,548,785	3,656	2.4			
5.3	8.4	431.25	1,604,333	3,720	1.7			
4.4	8.5	438.89	1,666,559	3,797	2.1			51.65
4.4	8.2	446.53	1,747,989	3,915	3.1	45.7	20.8	
3.7	9.0	454.15	1,754,541	3,863	-1.3			
3.5	9.7	461.81	1,817,785	3,936	1.9			51.73
5.3	9.2	469.50	1,918,634	4,087	3.8	43.5	19.0	
3.5	9.1	477.16	1,966,713	4,122	0.9			
0.7	10.4	484.70	1,971,069	4,067	-1.3	43.8	18.5	52.95
<b>3.7</b>	<b>8.9</b>	<b>450.35</b>	<b>1,748,203</b>	<b>3,873</b>	<b>1.2</b>	<b>44.3</b>	<b>19.4</b>	<b>52.11</b>
2.8	10.6	492.03	2,049,775	4,166	2.4	42.5	18.1	
1.4	10.8	499.07	2,056,246	4,120	-1.1	43.2	18.5	
0.6	11.0	505.89	2,047,132	4,047	-1.8	44.0	19.4	53.48
2.8	11.2	512.60	2,090,750	4,079	0.8	44.2	19.1	
6.1	10.3	519.31	2,218,604	4,272	4.7	42.0	16.90	
5.7	9.7	526.13	2,326,226	4,421	3.5	39.8	15.4	51.73
6.3	8.9	533.12	2,457,674	4,610	4.3	36.3	13.3	
6.5	8.0	540.20	2,598,957	4,811	4.4	34.1	12.6	51.50
5.2	8.0	547.29	2,719,166	4,968	3.3	33.2	12.9	
<b>4.2</b>	<b>9.8</b>	<b>519.52</b>	<b>2,284,948</b>	<b>4,388</b>	<b>2.3</b>	<b>39.9</b>	<b>16.2</b>	<b>52.24</b>

4. The data on human rights were prepared by Gerardo Munck, based on data from David L. Cingranelli and David L. Richards: "The Cingranelli-Richards (CIRI) Human Rights Dataset", Version 2008.03.12 (2008). The scale goes from 0 to 2, with 2 indicating satisfaction of the minimum standard of respect for human rights.

5. The data on mortality and homicides were taken from the Pan-American Health Organization ([www.paho.org](http://www.paho.org)).

6. The data on economic growth, employment, poverty, and income inequality are from ECLAC'S Social Indicators Data Base (Badeinso) and from the World Development Indicators of the World Bank. The GINI index measures concentration of income. The scale goes from 0 to 1, with 1 representing the most extreme inequality.

## Perception of citizens



Statistical compendium, table 141, UNDP Report, Democracy in Latin America, 2004. In asking persons for the degree of confidence they have in each of the institutions and groups referred to, they could answer: "none," "a little," "some," or "a lot." Values ranging from 1 to 4 were assigned to each of these alternatives. The higher the number assigned, the greater the confidence in the item indicated.

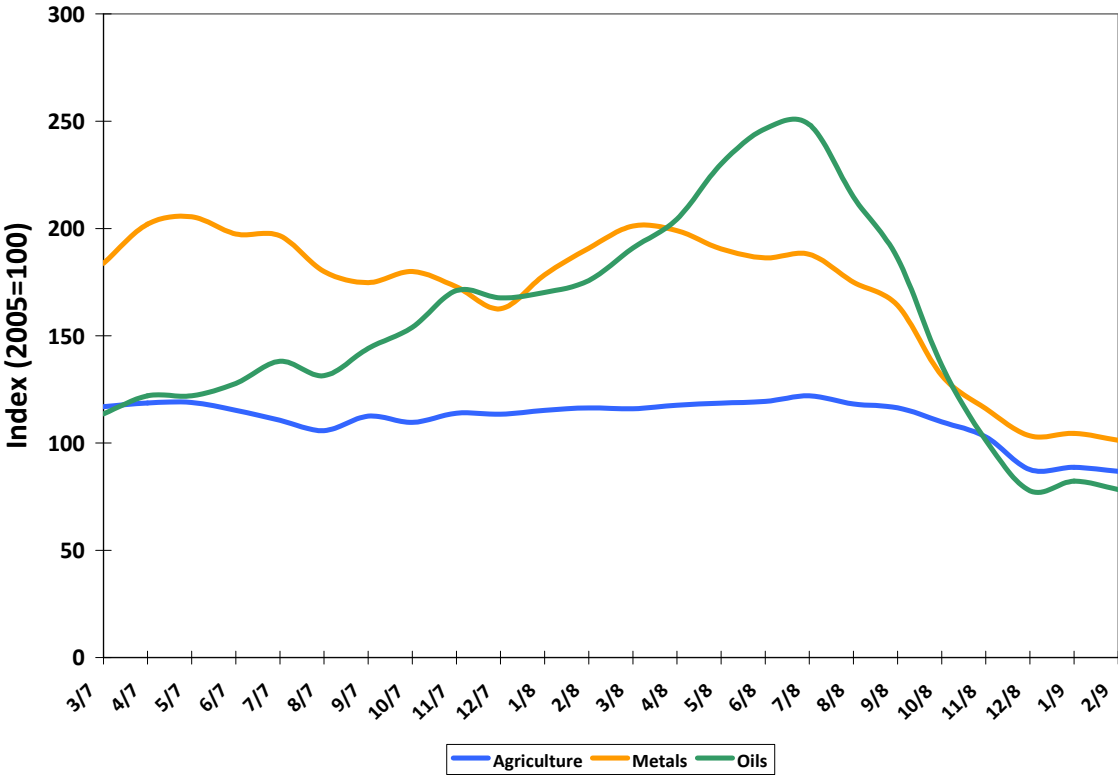
## V. The macroeconomic effects of the crisis in Latin America and the Caribbean

The current crisis is characterized by sharply restricted liquidity on most global financial markets and widespread contraction of aggregate demand. For Latin America and the Caribbean, the consequences of the crisis go beyond the emergence of external and internal imbalances. There is a high risk of losing the gains achieved in recent years in the reduction of poverty and inequality.

### Drop in international commodity prices

Recent estimates point to a sharp contraction in the international price of raw materials since 2008. Thus, world prices for hydrocarbons (oil) and minerals (copper, zinc) are expected to fall by nearly 35%, and a decrease of around 28% is anticipated in international prices for farm products, such as corn soybeans, and wheat.<sup>2</sup>

**Commodity Prices**  
International Monetary Fund (2009), Commodity Price Moves and the Global Economic Slowdown.



<sup>2</sup> IMF (2009), Commodity Price Moves and the Global Economic Slowdown.

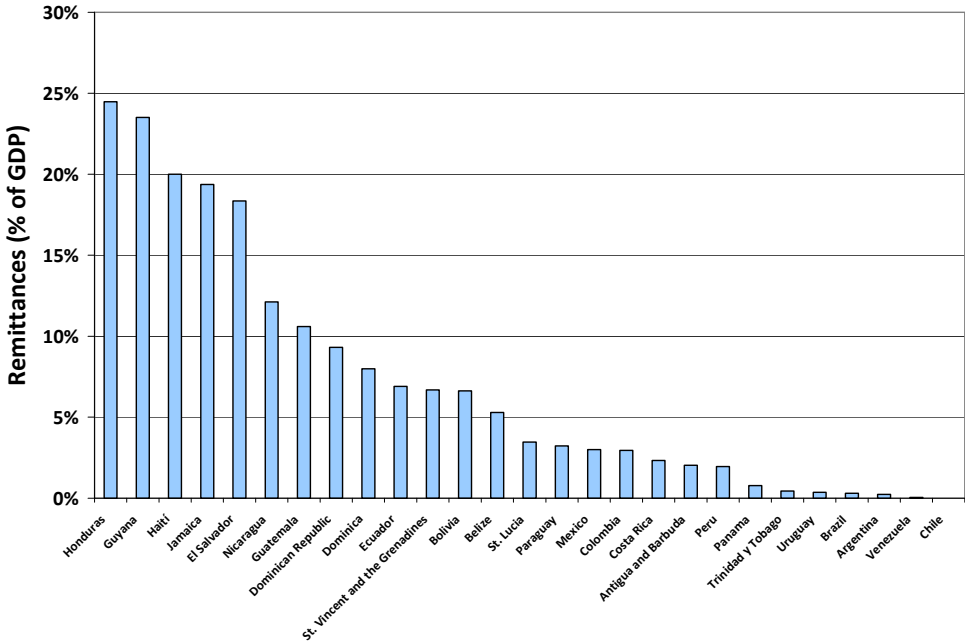
The drop in international commodity prices leads to a reduction in the value of exports and ultimately to a possible deterioration in the current balance of payments account. The emergence of external macroeconomic imbalances therefore jeopardizes sustained internal equilibrium. From a fiscal standpoint, the crisis in export sectors inevitably entails a decrease in public revenues and an increased for implementation of production incentive and social protection policies, especially on the labor market. In addition, emerging fiscal imbalances, together with a real contraction in commodity-producing sectors, exert heavy pressure on the stability of regional monetary units and domestic price levels.

**Reduction in flow of remittances**

Over and above the negative impact of reduced remittances on the current external account and the exchange system, the greatest risk involves the immediate contraction of disposable income and the impoverishment of the affected population. The decline in consumption and savings, and the possible return of migrants to their countries of origin pose additional major challenges that will have to be met in the medium term.

Remittance flows to developing countries could shrink by 6% in 2009.<sup>3</sup> The impact is expected to be particularly marked in Central America and the Caribbean, regions where remittances are an important source of income. In the cases of Honduras, Guyana, Haiti, Jamaica, El Salvador, Nicaragua, and Guatemala, they range from 10% to 25% of GDP.

**Remittance Flows to Latin America and the Caribbean as a percentage of GDP**  
 World Bank (2009). Revised Outlook for Remittance Flows 2009-2011.

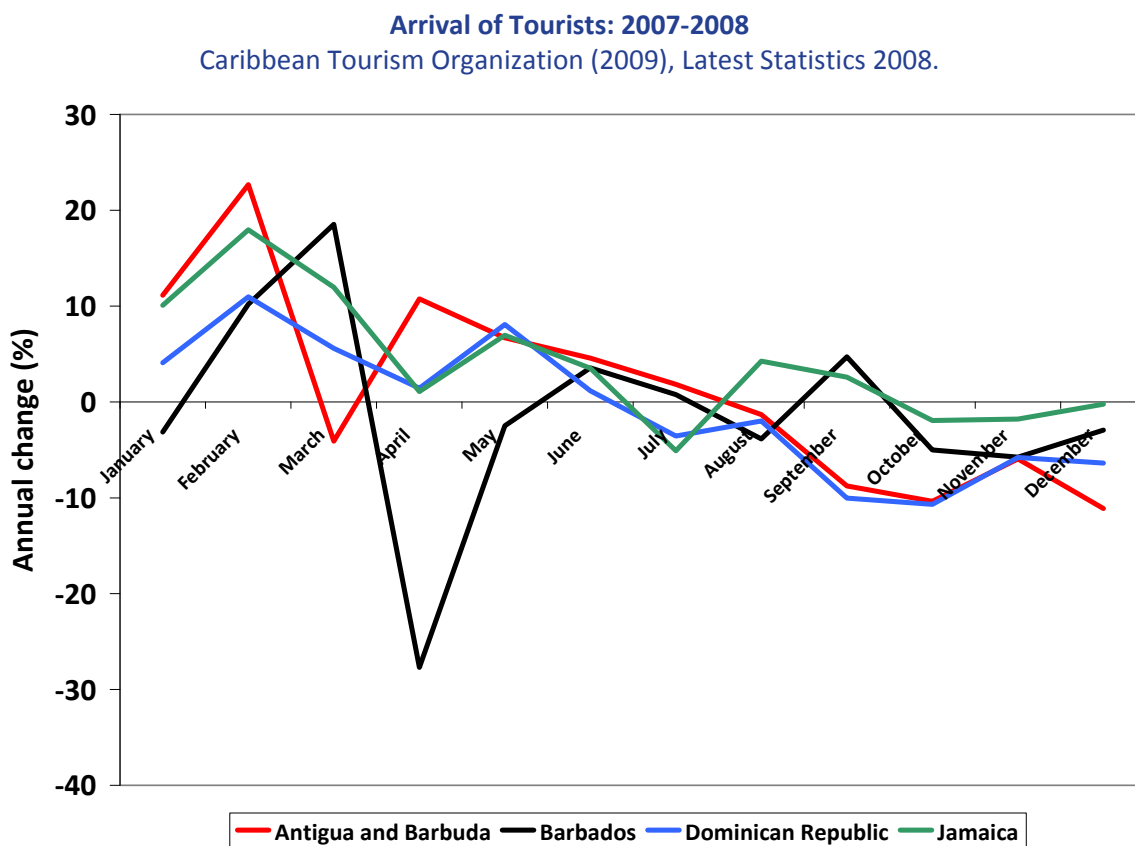




## Contraction in tourism

During the last quarter of 2008, the Caribbean countries experienced a sharp reduction in tourist flows. In Antigua and Barbuda, a country where the tourist sector accounts for nearly 20% of GDP,<sup>4</sup> this decrease was more than 10% over the figures for the same period in 2007.<sup>5</sup>

The reduction in foreign currency flows associated with the decline in tourism has a direct impact on the external accounts of the affected countries, thereby undermining the stability of the exchange system and limiting the governments' capacity to react. In addition, the destruction of direct employment and growing uncertainty on the labor market heavily influence levels of poverty and inequality.



## Rationing of financing sources

It is estimated that capital flows to Latin America and the Caribbean will shrink by 50% in 2009.<sup>6</sup> Debt issues in developed countries, added to the volatility of emerging markets, have contributed to

<sup>3</sup> World Bank (2009). Revised Outlook for Remittance Flows 2009-2011.

<sup>4</sup> Based on ECLAC data.

<sup>5</sup> Based on CTO data.

<sup>6</sup> ECLAC article in the press (27/03/09 El Clarín).

the accelerated and significant deterioration in the capital and financial accounts of the balance of payments.

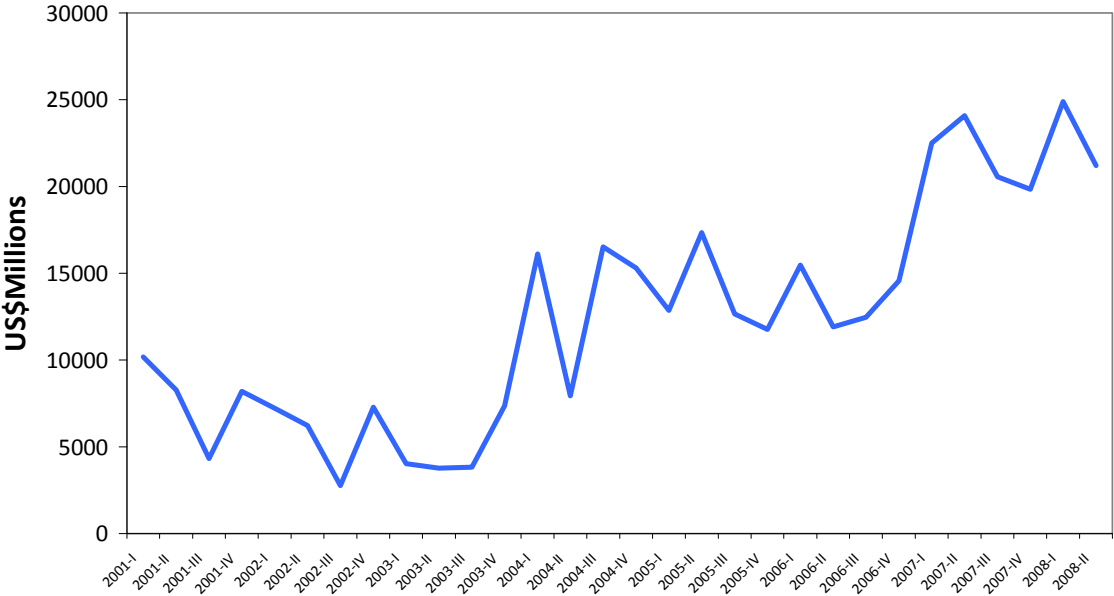
The scarcity of external resources for both the public and the private sectors considerably increases the pressure on domestic markets and the fiscal capacity of the governments in the region to cope with the contraction in real activity, increased unemployment, and deteriorating social conditions.

**Instability on financial and capital markets**

The country risk in the region has increased by about 50% since the beginning of the fourth quarter of 2008.<sup>7</sup> Limited access to international financial markets, together with marked external imbalances and exchange rate pressures are feeding the growing volatility of expectations. These factors taken together are adversely affecting the stability of regional financial markets, worsening internal imbalances, and hampering the capacity of national regulatory agencies to ensure adequate levels of liquidity.

**Direct Foreign Investment in Latin America**

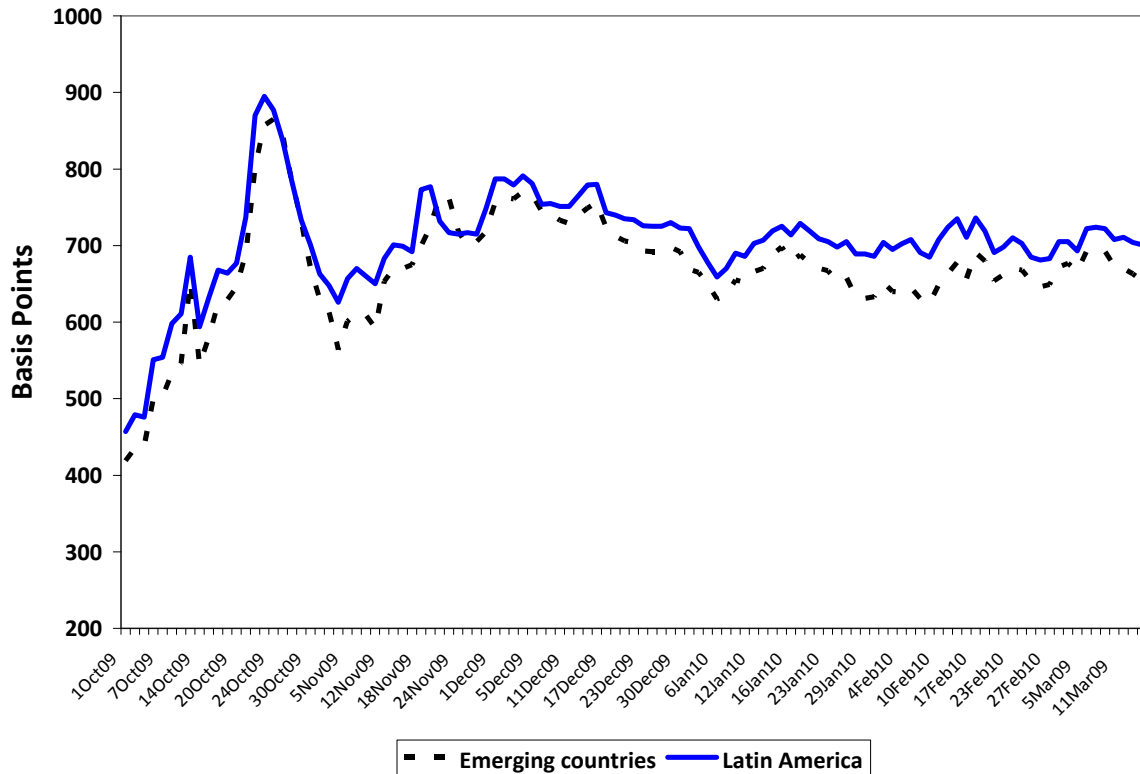
Based on ECLAC data for the following countries: Argentina, Bolivia, Brazil, Chile, Costa Rica, Ecuador, El Salvador, Paraguay, Uruguay, and Venezuela



<sup>7</sup>Based on JP Morgan data.

## Country Risk (EMBI)

Emerging Markets Bonds Index, JP Morgan



### Exchange rate volatility

The uncertain economic and financial climate has increased exchange market volatility. The instability of the dollar has had an asymmetrical effect on the region, leading to the nominal appreciation of some currencies and the depreciation of others.

Exchange instability has contributed to the reduction of capital flows to the region, and it has weakened local financial markets, limited the savings and investment capacity of economic agents, and exacerbated the shrinking, precarious labor market. Moreover, it has a negative impact on the stability of domestic prices and undermines the purchasing power of the different social groups.

## VI. Effects of the crisis in other areas

It is obvious that the effects of the crisis will not be limited to macroeconomic factors, but will be strongly felt in other areas, and especially security, employment and social welfare, the energy and environmental sectors, and the area of sustainable development and trade.

### Public Security

In Latin America and the Caribbean, the homicide rate in 2006 was 20.8 persons out of every 100,000 inhabitants.<sup>8</sup> On average, throughout the region homicides are the primary cause of death among youth 15 to 29 years of age, at a rate of 83.2, and the rate is even higher among youth in middle- and low-income groups, where the figure rises to over 100 out of every 100,000 inhabitants.

The challenge posed to governments by organized crime can be better understood in the light of the income it generates. Drug trafficking brings in approximately \$320 billion a year, a figure that exceeds the GDP of most of our countries.<sup>9</sup> The economic relevance of crime links it directly with the crisis.

Impunity is another aspect of the problem. Information on crime determines the capacity to deal with the problem. At present, it is easy to detect discrepancies in the figures provided by various institutions within the same country, and technical and technological weaknesses in gathering and presenting such data, compounded by difficulties in access to the public in general. Our laws will have to be updated, but even more importantly, our legislators will have to be given the means needed to enact laws, and regulate and monitor decisions and action taken to combat crime.

### Employment and social welfare

The ILO anticipates an increase in the global unemployment rate, from 6% in 2008 to 7.1% in 2009, equivalent to an additional 40 million people without work.<sup>10</sup>

Unemployment will increase throughout the Hemisphere. In the United States, the jobless rate in February 2009 was 8.1%, which is equivalent to 12.5 million people without work and an increase of 5 million unemployed in the last 12 months.<sup>11</sup> In Canada, the unemployment rate was 7.7% in February 2009, equivalent to 1.4 million jobless persons.<sup>12</sup> For Latin America and the Caribbean, the ILO estimates that the unemployment rate will increase from 7.3% in 2008 to 8.3% in 2009, a figure that represents approximately 23 million people out of work.

ECLAC emphasizes the fragility of the job market in Latin America and the Caribbean, where the informal sector accounts for around 52%. These are poor quality, unstable, poorly remunerated

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<sup>8</sup> According to the World Report on Violence, issued by the World Health Organization.

<sup>9</sup> According to the United Nations Office on Drugs and Crime.

<sup>10</sup> ILO (January 2009), Global Employment Trends.

<sup>11</sup> USDOL, Bureau of Labor Statistics (March 6, 2009), The Employment Situation: February 2009

<sup>12</sup> Statistics Canada (February 2009), Labour Force Survey

jobs that offer no social security, and they are held by a large proportion of workers at the threshold between poverty and extreme poverty. Thus the crisis threatens to exacerbate the risks faced by this vulnerable population segment. ECLAC warns that 2008 might have marked the end of a five-year decline in poverty and extreme poverty in the region. According to the Commission's estimates, extreme poverty fell from 19.4% to 12.6% between 2002 and 2007, and remained at 12.9% in 2008.

To deal with the effects of the crisis on poverty, a variety of policies to promote jobs and social protection have been designed in the region, and it is important not to abandon them in times of crisis. This is especially true of social protection policies that target the most vulnerable families, as they have achieved notable success in many countries. This is a fundamental strategy for protecting human capital and breaking the cycle of poverty that goes from one generation to the next.

### **Energy, the environment, and sustainable development**

The crisis also threatens the sustainable use of energy, the environment and, from a broader perspective, development. There are three challenges facing energy management in the region that are amplified by the crisis: universal access to reliable energy sources; mitigation of the volatility of energy prices; and, creation of the incentives needed to shift to energy supply technologies that are more environmentally friendly.

The many challenges facing the region in the energy sector are exacerbated by the global financial crisis, which poses a serious threat to the region's energy security and has reduced the capacity of consumers to gain access to energy services. Producers and investors in the energy sector are encountering more difficult access to the credits that enable them to invest in new large-scale projects.

With regard to the sustainable management of the environment, it is important to point out that there are challenges that continue in a crisis situation. These include universal access to drinking water and the preservation of its sources, reduction of soil degradation, and mitigation of the impact of natural disasters.

Climate change is one of the major challenges facing mankind. Although there is agreement on the problem and its causes and effects, countries and the international community in general must find an effective response to them. This is why the United Nations Conference on Climate Change, to be held in Copenhagen in December of this year, is so important. We hope that this Conference will result in a new agreement endorsed by all countries, and a renewed impetus for dealing with this scourge.

### **Trade**

According to studies recently published by economists of the World Trade Organization (WTO), the volume of global trade will decrease by 9% as a result of the crisis. It is important to realize that a decline of this magnitude has not been recorded since the Second World War. World Bank

projections indicate that for 2009, global exports of goods and services will decrease by 2.1% in comparison with 2008, while imports will decline by 1.8% in that time span.

The contraction in developed countries will be particularly severe. Real exports will be reduced by 10% this year. For developing countries, which are even more dependent on international trade for growth, the volume of their exports will shrink by 2%-3% in 2009.

Moreover, in a recent study by the International Monetary Fund based on a survey of 40 banks by the Bankers Association for Finance and Trade (BAFT), financing for trade, which accounts for a large part of the \$13-\$14 trillion circulating in the world market, has been reduced to a volume of \$100 to \$300 billion as a result of the international economic crisis. This situation is confirmed by the Director General of WTO, Pascal Lamy, who believes that the depletion of funds for financing commercial transactions will be one of the factors in the reduction of trade flows, especially in developing countries.

An additional concern is that countries will adopt protectionist measures that will only aggravate the already complicated situation. In the present circumstances, a clear message of commitment, followed by concrete action to conclude the Doha Round, would make an important contribution to efforts to deal with the impact of the crisis on trade.

## VII. The need for a regionally-agreed line of action

In view of this scenario, we need a coordinated, comprehensive, and effective response with the support of the international community. The political objective of this response should be to mitigate as much as possible the effect of the crisis on the poorest sectors and dynamic production sectors, especially SMEs. The cost of the current crisis should not be borne by the vulnerable sectors. This is not a matter of ideology; it is the way to avoid a setback to democracy.

As it is clear that the solution is not going to come from the market, states should act rapidly and effectively on two fronts: investment in more effective and focused social policies; and, use of government spending as an economic stimulus. The international community must be aware that its support in these times should also be directed to strengthening governments, which in most countries of the region are fragile, with inefficient bureaucracies and low levels of “statism.”<sup>13</sup>

Responses to the crisis have, so far, been isolated, and regional coordination has been inadequate. In some cases, the response has originated in the fiscal or monetary arena, and in others, it has been seen in devaluations or protectionist measures. Aside from the relevance of these measures--some of which are more aggressive than others--the impression remains that there is still not a full comprehension of the true scope of the crisis. It is essential to allocate time and resources in order to finally understand its true dimensions and the ways to monitor it, as well as how to anticipate its possible economic, social, and political effects. An inadequate or insufficient response to the crisis could mean that the region will suffer a major setback in terms of poverty, inequality, and employment, and in the degree to which its citizens support democracy. A crisis of the magnitude and depth of the current one requires political action based on economic and social criteria. Gone is the time for purely economic responses designed for the sole purpose of balancing government accounts. If this path were once again taken, it would inevitably lead us to a new period of instability and declining democracy.

The region’s economic and social accomplishments are based on democracy, and it is on that basis and on the basis of efforts to achieve greater equality and equity that policies to counter the crisis should be constructed.

The international community must be part of this effort, by providing support that is not based solely on IMF resources. Recent agreements of the G-20 in terms of increased resources for the IMF and the World Bank and greater and better international financial regulation are in the right direction, but they will probably be inadequate. That is why the Heads of State and Government decided to meet again in September 2009 to assess the implementations of these measures.

But in addition to this action, the international community, working through regional organizations, could support countries to ensure that these resources go to the sectors that are most vulnerable to the crisis and that the competent public institutions allocate these resources in an effective and efficient manner. In line with these efforts, it would be appropriate to consider creating a temporary mechanism for coordination among multilateral agencies working in Latin America and the Caribbean. The OAS, as a multilateral political organization for the region, could provide the impetus, management, and organization for such a mechanism.

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<sup>13</sup> “Statism” is understood to refer to the capacity to exercise the powers of the state.

## VIII. Final Reflections

The democratic governments of the region are facing unexpected social and economic difficulties. The democracy constructed over the past twenty years not only has the elements to limit the negative impact of this situation, but it also has the capacity to attack more effectively the economic effects of the crisis.

**Democracy has the capacity to attack the economic effects of the crisis more effectively.**

Our key objective is to work together to maintain and enhance our democracies. Here we are facing a threat not only to our economies, but specifically to our political systems.

**For the OAS, the political consequences of the economic crisis are a key issue.**

This is reason enough to make the political effects of the crisis the central theme of the text we are presenting to this Summit. We are doing so not only to describe possible risks and warn of dangers. Our purpose is to examine and debate the ways in which the democratic system could mitigate and curb some of the most damaging effects of the crisis on political stability.

The solutions are not easy, but they are feasible if we combine the necessary political consensus with experience from previous crises, when responses triggered greater social conflict, situations of political instability, and a new role of the state to regulate and lessen the social effects of the crisis.

The responses to the crisis must be on a par with its severity; they must be based on the fiscal accounts accumulated in recent years, be planned on the basis of a revised vision of the state, and be able to count on external resources on easy terms obtained in a framework of renewed international and regional cooperation.

The main objective of these responses should be to ensure good democratic governance and to minimize the social effects of the crisis, especially on vulnerable sectors.