

GREAT GLOBAL FINANCIAL RECESSION (2008-2013)

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Summary

The economic growth that occurred between 1994-2006 created an optimistic euphoria that led most people to believe that crises were a thing of the past. Between 2007 and 2008, this optimism faded. Humanity is now faced with the inexorable evidence that, from time to time, economic cycles of recession or growth emerge which, together with globalisation, bring about significant changes in the world economy.

Following this introduction, this chapter analyses the origin and causes of the first Great Global Financial Recession of the 21st century. The work initially focuses on the case of the United States, which is examined in detail to explain the importance of the use of a series of complex, high-risk financial products and the role played by rating agencies. The study is then extended to Europe, Latin America and Asia. The corresponding sections are devoted to these regions, in that order, in an attempt to clarify the peculiarities of the recession that took place in each of them. The chapter ends with some brief conclusions.

1. Introduction and background of the crisis

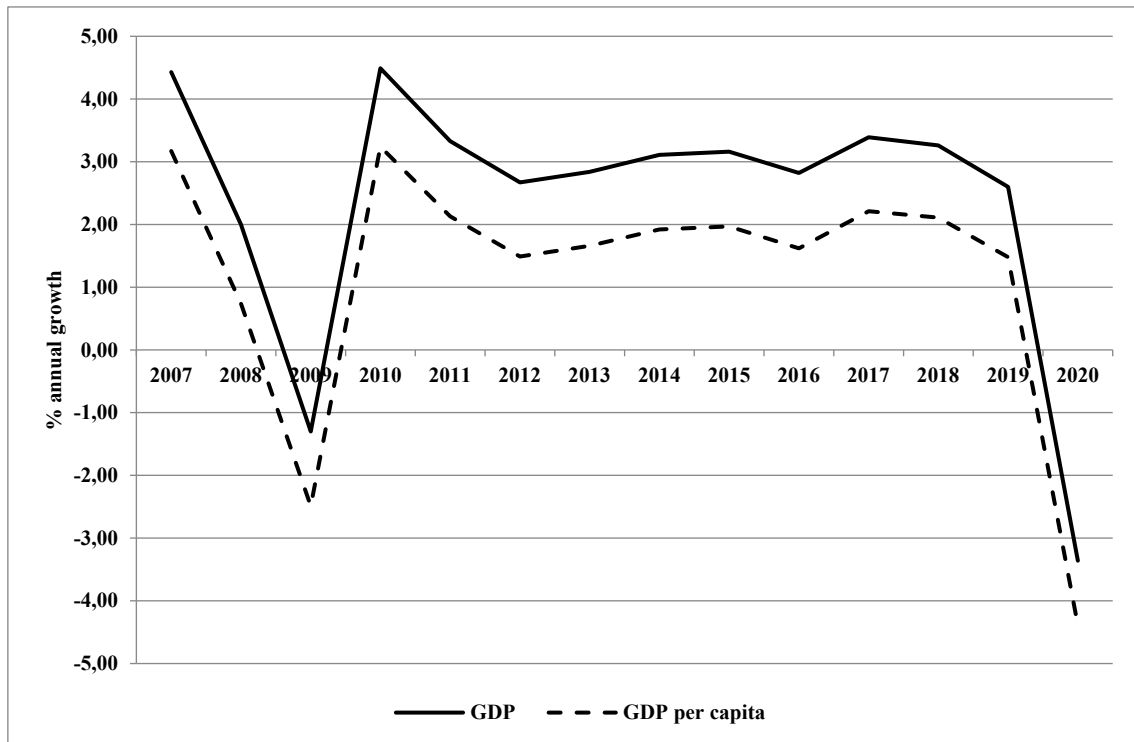
After the tremendous growth of the period 1951-1970, the various global crises of the last three decades of the 20th century weighed on economic performance. Per capita income, labour productivity and activity growth declined (Table 1 and Figure 1). Unemployment, inflation rates and external imbalances reached unprecedented levels, causing the process of real convergence to be reversed and the gap between rich and poor countries to widen again (Segura, 2010).

Table 1. World Economic Growth Indicators (annual %)

	GDP	GDP per capita
2007	4.43	3.17
2008	2.00	0.74
2009	-1.30	-2.49
2010	4.49	3.24
2011	3.33	2.13
2012	2.67	1.49
2013	2.84	1.66
2014	3.11	1.92
2015	3.16	1.97
2016	2.82	1.62
2017	3.39	2.21
2018	3.26	2.11
2019	2.60	1.48
2020	-3.36	-4.39

Source: World Bank (2022b). Prepared by author.

Figure 1. Absolute and per capita GDP in the world (2007-2020)



Source: Table 1. Prepared by author.

In the previous growth cycle (2000-2006), world GDP increased by 42%, with annual growth rates never falling below 2.5%. The progress of the world economy was particularly affected by the crisis of the technology companies (the dot-com bubble) and by the 11 September 2001 attacks on the Twin Towers in New York. The responses of the advanced economies with expansionary monetary policies partially propitiated the continuity of the bullish financial cycle, with increases in mortgage and other types of

credit, as well as in the prices of certain assets, including real estate, due to the housing bubble in the U.S. and Europe (Bank of Spain, 2017).

The answer lay in the control of inflation, which in advanced countries was contained at around 2%, with a peak of 2.4% in 2006. Globalisation and, above all, the growing integration of emerging economies into international trade contributed to this, by increasing competition and limiting the scope for price increases—margins—for goods and services in the more advanced economies.

In some emerging economies, significant levels of savings were generated, leading to a fall in nominal and real interest rates—at constant prices—which intensified capital flows to advanced countries. The most interesting consequence was that they caused misalignments in the current account balances of the more developed economies—global imbalances.

In 2008, the real estate and credit bubble that had been swelling for years burst in the USA. High-risk financial instruments were created that severely damaged the global economy. The collapse of Lehman Brothers, the investment bank that declared bankruptcy on 15 September 2008, spread to other financial institutions and marked the beginning of the subprime mortgage crisis. As Jason Lennard (2020), associate professor at the LSE, explains, almost immediately "the banking system and the hardest hit economies were bailed out to avoid a total collapse and then an ambitious programme of public debt purchases was implemented to relieve governments and stimulate growth".

In short, as Rodríguez-Canfranc (2020) points out, it was immediately clear that we were facing a Great Recession which, because it was systemic, could spread to the entire financial system. The level of indebtedness was unsustainable in the short term. Moreover, the credit quality of many assets was not well known to investors. It was inevitable that the system would collapse with the resulting systemic consequences that would be seen later. A great deal of financial mistrust was generated on a global scale as a series of imbalances built up in many economies, not only as a consequence of the real estate and financial bubble, but also because of the high level of indebtedness of private companies and households, and the excessive leverage of much of the financial system.

The economy came to a sudden halt due to the accumulation of imbalances, which precipitated the bankruptcy of many indebted companies and financial institutions, as well as the default on private mortgages. But the first phase of the Great Recession of 2008 was short-lived, at least in the United States where the Federal Reserve acted swiftly to lower interest rates from 5% to 0%.

In short, the Great Recession that began in 2008 was not an accident that could not have been foreseen. The crisis was caused by an out-of-control financial industry.

2. The gestation of the first financial crisis of the 21st century

As Pineda-Salido (2011) recalls, the period of deregulation had its origin in the Depository Institutions Deregulation and Monetary Control Act of 1980. A first step was taken by phasing out restrictions on certain interest rates. With the arrival of Alan Greenspan as Chairman of the U.S. Federal Reserve in 1987, the deregulation process intensified and Wall Street expanded its power of economic influence.

Among the most important regulations were the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 and, above all, the Gramm-Leach-Bliley Act of 1999, which was the most important expression of the extreme liberalisation advocated by Greenspan. Thanks to the latter Act, parts of the regulations contained in the Glass-Steagall Act of 1933 were repealed, and banks were authorised to offer both commercial and investment services. This facilitated the merger of Citicorp and Travelers and opened up the possibility of future large-scale mergers within the financial sector. It also allowed commercial banks to enter the investment banking business and thus take on more risk with their customers' deposits.

The problem was that deregulation and instability began to go hand in hand in the financial markets. This led to the dot-com crash at the end of the 20th century. Between 1995 and 2000, investment banks contributed to the creation of a price bubble in technology companies listed on the NASDAQ. When these companies reached the peak of their price, which was based on the speculation of the stocks themselves, it all ended in a fall of the same magnitude as the rise of the preceding years (Hayes, 2019).

Another problem arose with derivatives. These are complex financial products developed by investment banks, which accounted for almost all the demand in the market for financial products and services. Their functioning is extremely complicated because they are a financial product whose value is based on the price of another asset. In practice, they allow bankers and various intermediaries to bet on anything.

According to Hera (2010), the rise of derivatives brought with it an important debate. At first, some economists and bankers argued that derivatives make markets safer; but just the opposite happened, and markets became more unstable. This is something

that neither the political and monetary authorities nor the major investment banks took seriously. They thought that economic prosperity would be unstoppable.

According to Stout (2009), this explains why the U.S. Congress passed the *Commodity Futures Modernization Act* (CFMA) in 2000, whereby the derivatives market was no longer subject to the regulation of the futures markets and any regulation of it was prohibited, eliminating the existing minimal control. Logically, once this law had been passed there was an "open bar" to develop and position in the market a whole series of increasingly complex financial products.

The definitive push came with the new administration of Bush (Jr.), who began his first term as U.S. president in 2001. The financial sector strengthened its profitability and power by being highly concentrated. It was controlled by five investment banks (Morgan Stanley, Goldman Sachs, Lehman Brothers, Merrill Lynch and Bear Stearns), two financial conglomerates (Citigroup, JPMorgan Chase), three insurance companies (AIG, MBIA, AMBAC) and three rating agencies (Moody's, Standard & Poor's (S&P) and Fitch). All these were linked by the securitisation food chain, which, through a new system, distributed trillions of dollars in mortgages and other loans to investors around the world (Gallant, 2019).

3. Development and expansion of the recession from the U.S.

The various studies on economic crises agree that the Great Recession of 2008 and the Great Depression of 1929 are similar in the sense that they both originated in the United States, then spread to Europe and later, to a greater or lesser extent, to the rest of the world. Therefore, 2008 was not about a halt in economic growth. The recovery from the Great Recession occurred with weak economic growth and an effect on employment that persisted over time. The fundamental issue was that, in order to solve the environmental problem, according to the sustainable development forecasts of the World Bank (2021) and the UN, climate change would have to be addressed, and this is incompatible with unlimited economic growth achieved at any price, which, hypothetically, creates an increase in employment.

A series of structural variables of the economic crisis would have to be taken into account related to inequality in income distribution, uncontrolled speculative bubbles or strong international trade and financial imbalances. To these must be added a series of factors linked to U.S. deregulation and monetary policy whose aim was to benefit almost exclusively the financial system (Comín, 2011). All this meant that we were facing

possibly the worst financial crisis since the Second World War and the COVID-19 health-economic crisis of 2020-2022.

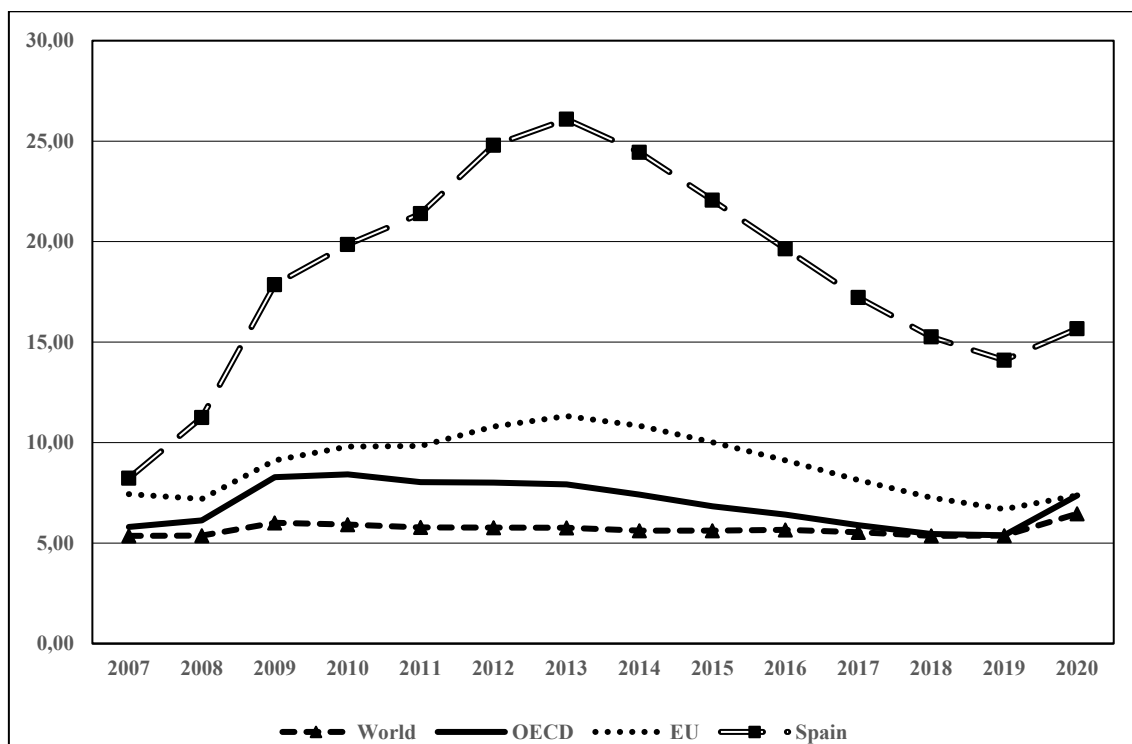
The changes in the unemployment rate as a percentage of the active population, shown in Table 2, illustrates the most pernicious effect of the crisis. By the end of 2009, some 50 million people were unemployed, 20 million of them in China. Globally, some 200 million fell into extreme poverty. This is when some of the championed economic theories were discredited: that free and efficient markets—accompanied by financial deregulation, ICT and financial engineering—are enough to ensure that depressive cycles and economic recessions will never return.

Table 2. Unemployment trend (% of total work force)

	World	OECD	EU	Spain	USA	Latin America Caribbean	Europe-Central Asia	Eastern Asia Pacific	South Asia	China
2007	5.36	5.80	7.44	8.23	4.62	6.86	7.17	4.24	4.81	4.30
2008	5.37	6.13	7.20	11.25	5.78	6.49	7.09	4.36	4.78	4.60
2009	6.01	8.28	9.12	17.86	9.25	7.48	8.93	4.43	5.06	4.70
2010	5.92	8.42	9.80	19.86	9.63	6.94	9.01	4.19	4.93	4.50
2011	5.78	8.03	9.83	21.39	8.95	6.47	8.76	4.09	4.96	4.50
2012	5.77	8.01	10.80	24.79	8.07	6.39	8.96	4.06	5.08	4.60
2013	5.76	7.92	11.32	26.09	7.38	6.34	9.19	4.03	5.26	4.60
2014	5.62	7.41	10.84	24.44	6.17	6.16	8.94	4.00	5.09	4.60
2015	5.62	6.83	10.02	22.06	5.28	6.69	8.54	4.04	5.24	4.60
2016	5.66	6.42	9.12	19.64	4.87	7.80	8.07	3.95	5.22	4.50
2017	5.54	5.89	8.14	17.22	4.36	8.08	7.47	3.83	5.15	4.40
2018	5.36	5.45	7.26	15.26	3.90	7.95	6.88	3.73	5.10	4.30
2019	5.37	5.39	6.69	14.10	3.67	7.98	6.68	3.86	5.03	4.60
	6.46	7.37	7.37	15.67	8.31	10.28	7.40	4.34	6.62	5.00

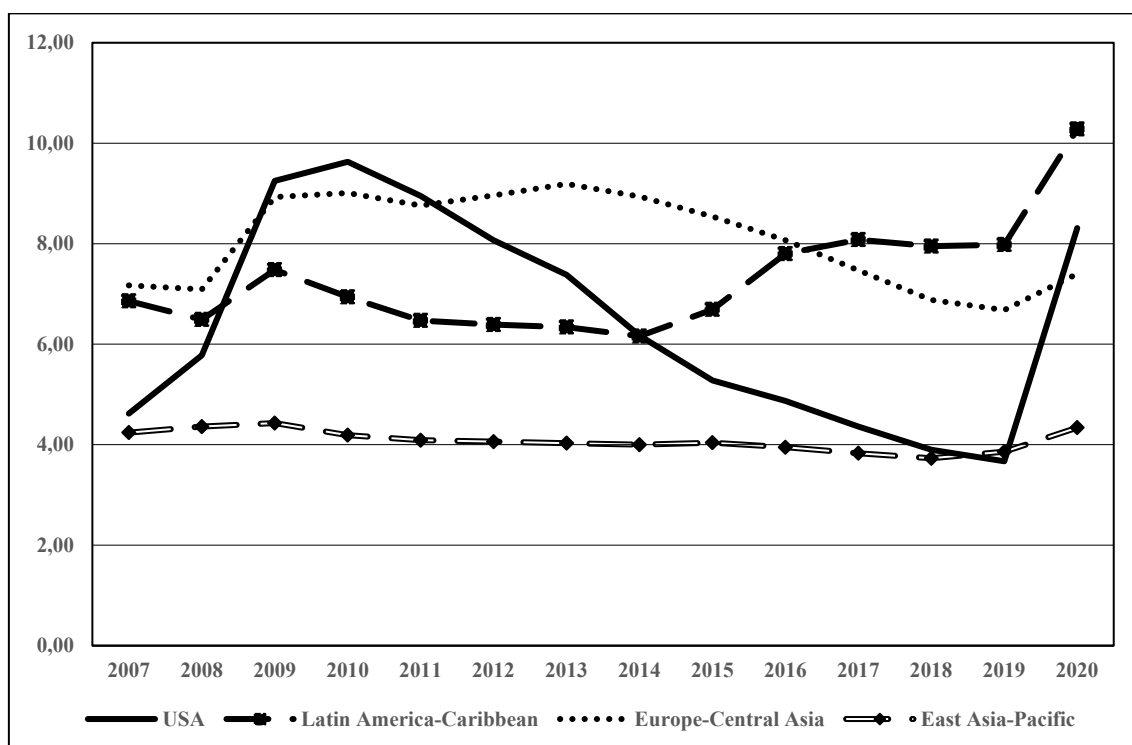
Source: World Bank. 2022a, ILO modelled estimate. Prepared by author.

Figure 2. Unemployment trends in the world, OECD, European Union and Spain (% of total active population)



Source: Table 2. Prepared by author.

Figure 3. Total unemployment trends in the U.S., Latin America-Caribbean, Europe-Central Asia, East Asia-Pacific (% of total labour force)



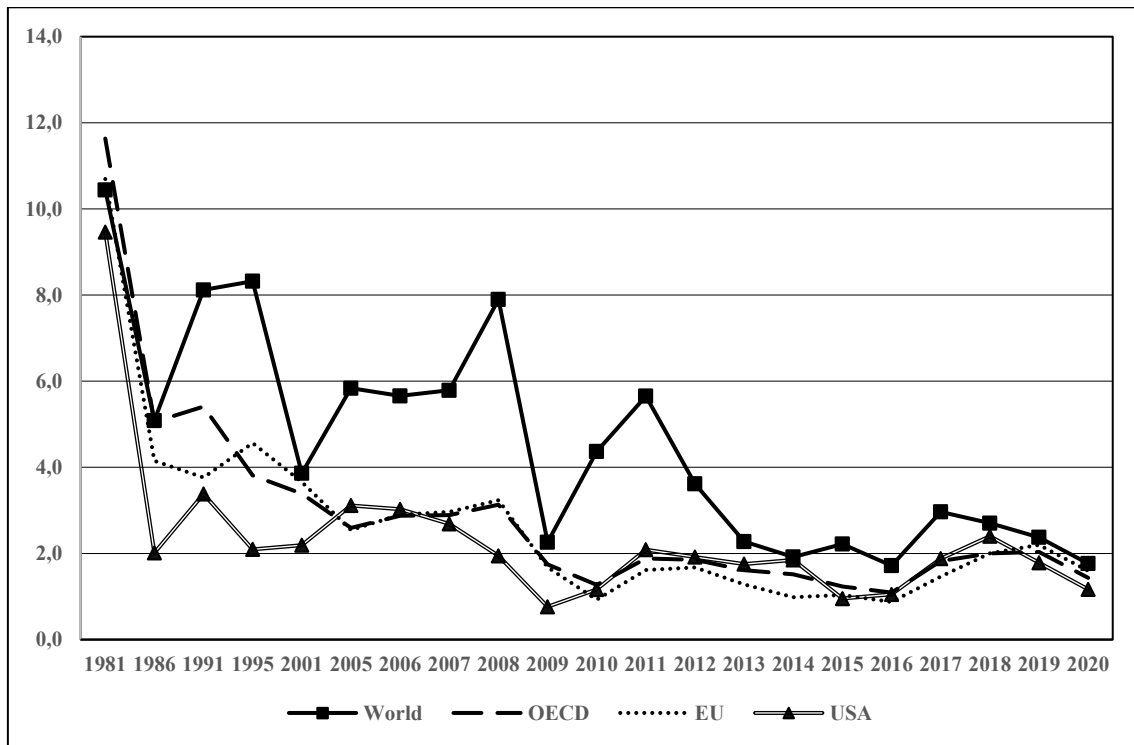
Source: Table 2. Prepared by author.

It can be seen at a glance from Figures 2 and 3 that the first phase of the Great Recession of 2008-2009 affected the OECD countries, the EU (European Union), the United States, Latin America and the Caribbean, Europe-Central Asia, East Asia and the Pacific. In contrast, Table 2 shows that its impact was less noticeable in South Asia and China. A second impact of the Great Recession is also observed in the unemployment figures; its resurgence between 2011 and 2013 only seriously affected some EU countries, including Greece, Ireland, Portugal and Cyprus. It is true that it spilled over to Spain and almost as much to Italy.

Fontana (2011; 2013) notes that, starting in 1986, the U.S. Federal Reserve, led by Paul Volcker, carried out effective regulatory work to raise interest rates to 20% nominal. The aim was to reduce inflation by making credit more expensive. It succeeded in bringing inflation down to 2% by the end of that year (Figure 4). But in the summer of 1987, President Reagan decided to introduce deregulatory measures in the U.S. economy—so-called Reaganomics—and appointed Greenspan as Chairman of the Federal Reserve.

Under Greenspan's leadership, there were two decades of uncontrolled expansion, even if they were affected by successive crises that finally led to the Great Recession of 2008.

Figure 4. Inflation, GDP deflation rate (annual %) in the world, OECD, European Union, USA



Source: World Bank (2022b). Prepared by author.

As Figure 4 shows, falling inflation rates encouraged the supply of cheap money, which inevitably fuelled a speculative bubble in mortgage prices and other loans, incurred by large international investors and small savers alike. In 2008 they collided with reality. Prices only rebounded internationally in three specific years, 1995, 2008 and 2011; but the general trend remained downward until 2020, after which inflation shot up in 2021-2022.

In fact, throughout the last quarter of the twentieth century, banking crises spread again, albeit of a local or regional nature. The preceding deregulation unleashed a wave of speculation in the economy, provoking a series of corrupt practices and scandals, such as the so-called junk bonds, which promise high yields for high-risk businesses, or hostile takeover bids, which facilitate the acquisition of companies using credit.

One of the biggest scandals in the U.S. was that of Savings and Loan Associations. These were authorised to invest their reserves in risky operations and leave traditional mortgages and other safe but less financially profitable investments on the sidelines. This led to 747 of them going bankrupt, having speculated in the purchase of junk bonds and, sometimes, in fraudulent operations.

In 1989, President Bush (Sr.) had to bail them out at a cost to the state of some 125 billion dollars. This economic policy resulted, in the medium and long term, in an increase in the public deficit and, more importantly, in public and private debt. The latter, fuelled by deregulation, encouraged families to go into debt and stop saving. This inevitably led not only to an increase in economic inequality, but also to the final burst of debt in the following years, thereby creating the ideal conditions for the 2008-2009 crisis in the US.

As Pineda-Salido (2011) points out, in 2004, Henry Paulson (Chairman of the Board of Goldman Sachs), who had previously been Secretary of the U.S. Treasury and a member of the Board of Governors of the International Monetary Fund (IMF), helped lobbyists to put pressure on the U.S. Securities and Exchange Commission (SEC) to allow the leverage limit to be raised. Indirectly, this made it easier for banks, which are theoretically supervised by the SEC itself, to increase the amount of money they borrow and take on more risk.

Until 2007, the level of leverage of U.S. banks increased considerably, with some banks having a ratio of more than 30 monetary units of debt for each unit of capital. This meant that the value of their assets was reduced to the point of insolvency.

4. The Great Recession of 2008 in the U.S.

This section explains how a long period of economic growth (World Bank, 2021) led to an underestimation of risks. Real and financial asset prices were set at very high levels, as was private sector indebtedness, both financial and non-financial. As a result, in the U.S., after a phase of strong and prolonged expansion in the housing sector, there was an adjustment beginning in early 2006. But it was not until 2007 that subprime mortgage delinquencies began to rise sharply.

4.1. Introduction

In mid-2007, the first signs of the international financial crisis became apparent. At first, however, they were limited to subprime mortgages, a modest segment of the U.S. mortgage market, which accounted for only 13% of all mortgage lending that year. But the borrowers benefiting from these mortgages had low or very low credit ratings. During the up cycle, they were mostly granted on very favourable terms, which increased their

potential risk with initial interest rates below market rates and excessive amounts relative to borrowers' income. Thus, borrowers were trapped in very long term mortgages.

Until then, as Tardi and Scott (2020) point out, mortgages were normally granted by local entities that received a monthly payment from their debtors. As the loan was repaid over the long term, these financial entities were prudent with the income they received, trying to minimise their reinvestments. Therefore, when someone requested a loan, the lender was confident that it would be repaid and accepted a return in relation to the agreed interest. But according to Conley and Brown (2019), along this chain a four-stage process developed:

a) Mortgages or other loans were granted, such as, for example, for the purchase of a vehicle, for university studies, second homes, etc.

b) Local lenders and financial institutions sold such loans to investment banks, thereby freeing themselves from the risk of default. They earned a significant accounting profit since, by selling the mortgages, they reduce their liability levels and increase their liquidity. This enabled them to make new loans, keeping the chain in constant motion.

c) Investment banks pooled thousands of mortgages and other loans to create complex derivatives called collateralised debt obligations (CDOs). These new financial products also included mortgage backed securities. CDOs are, in fact, a type of loan made with an underlying asset, so that if the borrower defaults, the holder can retain the asset.

d) Investment banks sold these CDOs to international investors. Consequently, when someone made a mortgage payment, it was not received by the local entity with which they had contracted in the first instance, but by investors anywhere in the world.

4.2. Use of CDS (Credit Default Swaps) and the fall of AIG (American International Group, Inc.)

In reality, the leverage mentioned above is not the only cause of the collapse of the financial system. The world's largest insurance company, AIG, had long traded a huge number of derivatives known as CDS (Credit Default Swaps). The way the swaps worked for investors holding CDOs is that the CDS operated as insurance against a hypothetical default of the CDO; in return, investors paid a quarterly fee to AIG.

At the end of 2006, the major investment banks, especially Goldman Sachs, decided to continue marketing toxic CDOs, while actively trading against them. At the same time, they continued to state publicly that they considered CDOs to be very safe

investments, with AAA (triple A) ratings comparable to U.S. Treasury Bills and, above all, high yields.

In turn, Goldman and other investment banks were speculating with CDS, basically betting against CDOs, predicting the collapse of real estate speculation in the short to medium term. When CDOs failed, these banks made money. What is unprecedented about this situation is that the very banks that were selling these products—composed of subprime mortgages, among others debt obligations—thought it best not to warn their clients that they no longer trusted the financial products they themselves were marketing.

Instead of telling the truth, they preferred to make money by exposing their clients to risk. It is worth noting that from 2007 onwards, Goldman Sachs had only been marketing CDOs, so the more losses the client suffered, the more profit they the bank made through CDS. But Goldman Sachs was not the only entity carrying out this type of practice as an investment bank; it was common throughout the whole banking sector.

This was the case with Lehman Brothers, Morgan Stanley, JPMorgan and investment funds such as Tricadia and Magnetar, which also bet against CDOs despite the fact that they themselves had designed them to earn billions of dollars that their clients lost. The situation continued to worsen, as CDOs continued to be presented to investors as very safe investments with a top rating (Pinsent and Scott, 2020).

Unlike normal insurance, CDS could be bought from AIG by its own speculative clients to bet against CDOs they did not own. To be clear, this meant that, if one normally took out a single policy to insure things one owned, in the world of financial derivative products it was now possible for any asset insured by its owner to also be insured by someone who did not actually own it.

In the absence of regulation of the CDS market, AIG was never obliged to set aside specific amounts of money to cover losses that might arise. The insurer assumed a heavy concentration of risk in the event that a CDO failed to perform, having to return money not only to actual investors, but also to speculators.

In the preceding years of strong economic growth, AIG had encouraged its agents and independent financial intermediaries to accept high risks. All of them, spurred on, generated income and profits that earned them bonuses and salary increases. This was a risky business strategy that, in the medium term, would lead to AIG's bankruptcy. This was almost inevitable, as it had been distorting its compensation system for some time. Its incentive arrangements mainly granted large bonuses based on short-term profits, but

did not impose penalties for subsequent losses. These bonuses encouraged investment banks and insurance companies to take on risks that could decapitalise them and sink both their own companies and the entire financial system.

During the speculative bubble, AIG wrote huge amounts of CDS, most of them on CDOs collateralised by subprime mortgages. By the time the CDOs collapsed across the board, AIG found itself without enough liquidity to pay out all the insurance claims. As early as 2007, AIG's internal auditors had warned of the disastrous situation in which it found itself, but the company, in view of the profits being made and the dividend payments to its shareholders, refused to have its financial division's accounts investigated.

4.3. Role of rating agencies

Investment banks hired different rating agencies to evaluate the CDOs they offered to their clients. The problem was that, instead of conforming to reality, most CDOs received the triple-A rating, the highest possible rating and therefore the safest. Moreover, the rating agencies, which are paid by the investment banks themselves, never legally assume any responsibility for their ratings if they turn out to be wrong.

This is where one of the big problems arose. Most investors did not know what a CDO meant. They believed that the products in which they had invested their savings were very safe and offered a high return, which made them very attractive.

The main international rating agencies were, and still are, Moody's, S&P and Fitch. They earned billions of dollars by assigning seemingly safe ratings to high-risk financial products. Like investment banks, these rating agencies increased their profits during the bubble period. The rating agencies are, in fact, the actual entities in charge of overseeing the products offered by banks to their clients. If they consider the investment to be too risky, it has to be rated as high risk and, consequently, at a much higher interest rate to offset the risk that the investor may suffer (Menezes-Ferreira and Rodil-Marzábal, 2012).

This is why it was necessary to pass on the risk with a continuous restructuring and sale of assets, to a point that it was impossible for anyone to determine the real risk of the marketed products. The rating agencies have never admitted this, but it was impossible for them to do their job properly, as they were unable to check the actual risk of the products.

The real problem came to light when rating agencies gave triple-A ratings to financial products, despite the fact that they were linked to a high risk of default. The only explanation for this practice is pure greed, i.e. the profit they expected to earn. Despite being unaware of the real risk of the financial products, they chose to enter into the scheme to enrich themselves (Oliete, 2012).

As Ochoa-Mosquera and Del Palacio-Tornos (2020) explain, investment banks used rating agencies to rate their products, offering them large sums of money if the financial product obtained a triple-A rating. But the system was perverted, because if the banks did not get what they wanted, they turned to other agencies to give it to them.

The rating agencies did not alert the supervisory bodies to what was going on. They did not even consider communicating to the investment banks themselves that they should be stricter with their standards, or that they themselves did not actually know the risk of the securities they were rating. As a result, the availability of these funds continued unabated.

The irony is that the lawyers defending the rating agencies would later claim, during legal proceedings for their fraudulent actions, that the triple-A ratings were mere opinions and indications. In other words, they argued that investors did not have to follow them. None of the agents involved in the securitisation chain paid particular attention to these facts, and the indiscriminate granting of subprime mortgages to NINJA (No Income, No Job and No Assets) customers increased dramatically in the run-up to the Great Recession of 2008.

Lenders relaxed mortgage conditions, which gave them access to this type of insolvent client, while investment banks only cared about selling CDOs. The more they sold, the more profits they reaped. Instead of creating a system of derivative products with ratings more in line with their risk, they preferred subprime loans associated with higher interest rates. This made them very attractive and they were given the same ratings as other much safer financial products. This, together with an increase in official interest rates in the US, led to a huge growth in bad loans, a situation that forced debtors to renegotiate subprime loans they could not pay and to slip into a vicious circle of rising prices and interest rates.

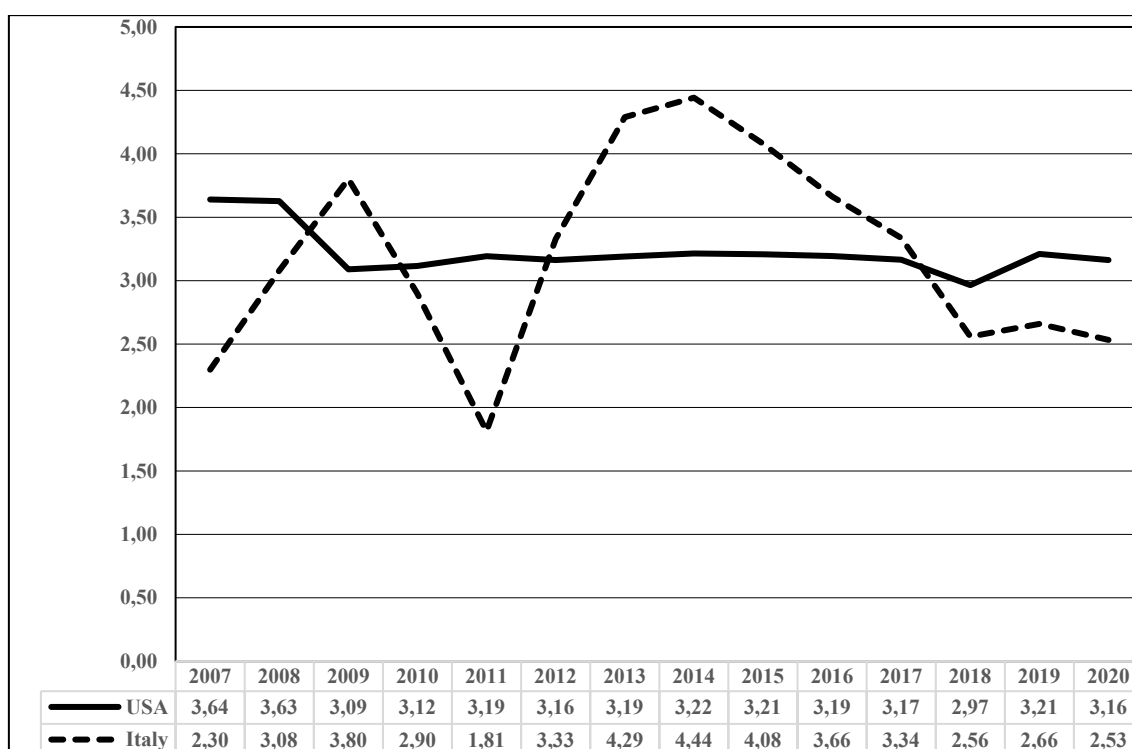
5. Contagion of the Great Recession in Europe (2010-2011)

The downturn in the European real estate sector was tied to the onset of a weakening of the expansionary economic cycle. It led to an upward adjustment of investors' perception of risk and to declines in the prices of the financial assets originally agreed upon. This affected numerous banking products. As a consequence, some of the main funding markets, including interbank markets, came to an abrupt halt.

5.1. The problem of risk premiums

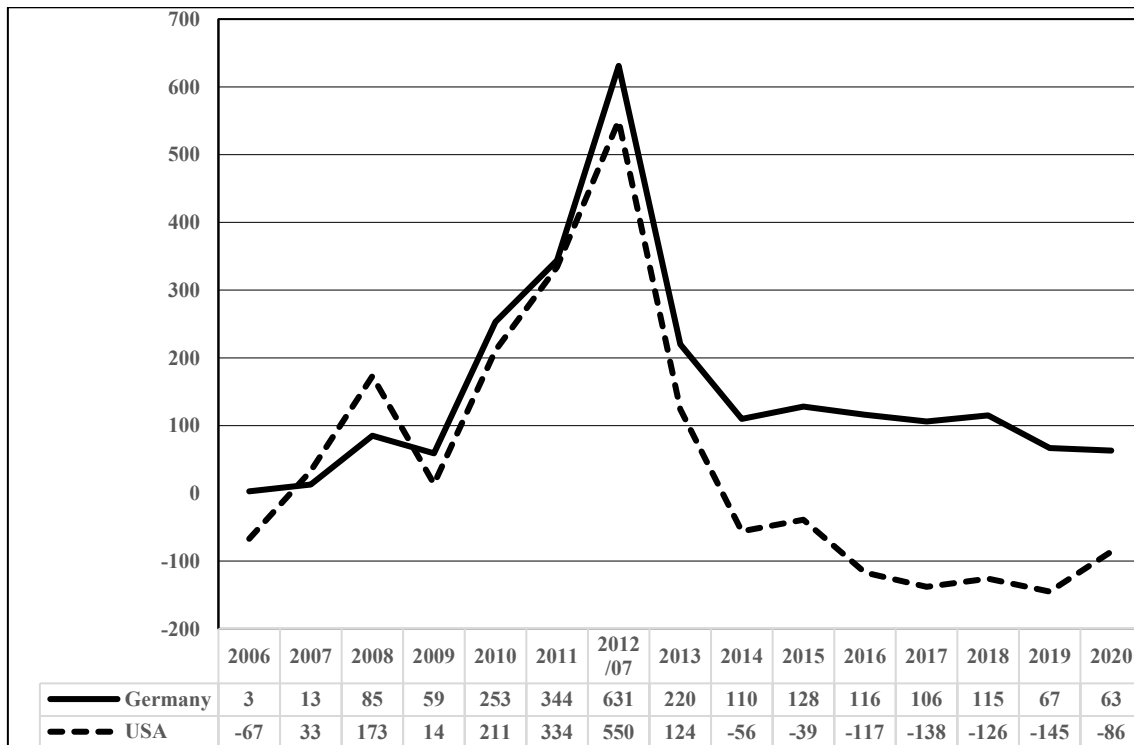
The problems in the financial markets were reflected in the spikes in risk premiums (Figure 5) and led to a tightening of private sector financing conditions in the United States, which then spread to other economies, especially the more advanced ones. Eurozone economies were affected, of course, with the Spanish case standing out for its importance (Figure 6).

Figure 5. Italian and U.S loan risk premium (prime rate minus Treasury bill rate, %)



Source: World Bank (2022b). Prepared by author.

Figure 6. Risk premium basis points (bp) of Spain versus U.S. and German risk premiums (referring to December except where indicated)



Sources: <https://datosmacro.expansion.com/prima-riesgo/espana?dr=2021-08>
(Accessed: 1 February 2022). Prepared by author.

As Carbó and Rodríguez-Fernández (2012) point out, risk premiums are not useful for predicting financial collapse. Many of the instruments and institutions that facilitated the crisis on both sides of the Atlantic had, until the eve of their bankruptcy, the highest rating from rating agencies. In a second phase, the so-called sovereign debt crisis erupted with force in some European countries from 2009-2010 onwards. Several of the peripheral economies then experienced significant downgrades in their sovereign debt ratings. These were clear signs of the deterioration and lack of confidence in the public finances and viability of some these countries' economies.

These included economies subject to bailout arrangements, such as Greece, Ireland, Portugal and Malta. A little later, other countries such as Spain, Italy and France become focal points, not only for their own economies, but also for the future of the euro. This was inevitable, given their respective sizes and strategic importance. Figures 5 and 6 for Italy and Spain show a chronological summary of their respective risk premiums, which indicate a deterioration of credit quality in both.

Between 2009 and 2012, the risk premium rose for the Spanish economy, and between 2011 and 2014 for the Italian economy. This was accompanied by instability in

Greece. Spanish debt was not the only one to suffer at that time, as the Italian risk premium also rose, which reached 420.5 basis points, with a ten-year bond yield of 5.75%.

In the case of Spain, on 29 January 2009, the S&P rating agency announced its intention to revise the AAA rating for the Kingdom of Spain, which gave it access to the most exclusive club. A few months later, on 28 May, Fitch became the second agency to withdraw the triple-A rating for Spain, and on September 30 of the same year Moody's followed suit and withdrew its triple-A rating for Spanish public debt. In March 2011, Moody's downgraded its rating to Aa2.

Moody's disrupted the markets with frenzied activity between July and August 2011 by downgrading Portugal and Ireland to junk bond status and dropping Greece's rating to the penultimate level of Ca. There was also the truly historic and traumatic event of the withdrawal of the U.S. triple-A rating by S&P's in August.

All this led the EU to accuse the rating agencies of inciting speculation and destabilising the eurozone. Germany went so far as to call for measures to limit the power of the oligopoly formed by Moody's, S&P and Fitch.

In October 2011, in addition to Italy, Fitch announced its decision to downgrade Spain's rating by two notches to AA. In its opinion, the intensification of the sovereign crisis in the eurozone particularly affected Spain because of its high level of net external indebtedness and the fragility of its economic recovery. The risks of recession and the problems of the Spanish banking system led S&P to follow suit and announce that it was downgrading its rating to double A with a negative outlook. Finally, Moody's downgraded its rating by two notches, from Aa2 to A1 (Carbó and Rodríguez-Fernández, 2012).

In this environment of uncertainty, in July 2012 the premium ended up reaching 550 bp against the U.S. and 631 bp against Germany (Figure 6). This placed Spanish public debt in the "speculative" category.

From 2008 onwards, wholesale funding markets were effectively closed. This forced financial institutions to deleverage in a disorderly fashion and liquidate their assets. They had to take further losses, which spread to other institutions not *a priori* exposed.

Hedge funds, which had based their high returns on credit-financed investments, were forced to make major divestments. The situation continued to deteriorate, while tensions in the international financial markets increased. More and more institutions were affected. Some of them were subject to government interventions, such as Bear Stearns, Fannie Mae and Freddy Mac in the U.S. and Northern Rock in the United Kingdom.

As is well known, in September 2008, the bankruptcy of the Lehman Brothers investment bank, followed by the nationalisation of AIG by the U.S. government, was a quantum leap in investor distrust. In the days following the bank's collapse, premiums quadrupled in the interbank market for three-month transactions, rising from less than one nominal percentage point to more than 3.5. The S&P 500 stock index also fell by 28% and its volatility tripled.

The U.S. financial system was on the verge of collapse, as reflected in rapidly rising risk premiums in international markets, falling stock prices and accelerating volatility.

What was happening in Europe and elsewhere in the world was that, in a globalised economy with high integration and complex interconnections between financial institutions, instability was spreading to all assets, markets and economies, generating an enormous global financial crisis. Financing conditions worsened and the credit crunch meant that many companies had to adjust their workforces. This was compounded by a negative wealth effect due to falling real and financial asset prices and heightened uncertainty and distrust, which this led to a significant drop in spending by agents and a recession in advanced economies, later transmitted to some emerging economies.

In 2009, international trade flows contracted by 10.5% and global GDP fell by 0.1%, which in the case of advanced economies was 3.4%. This is considered to be the largest decline since World War II.

5.2. Crisis in the euro area

Summarising the analysis carried out by the Bank of Spain (2017), international monetary authorities had been facing tensions by increasing their liquidity supply since 2007, coordinating, although not always, their actions. A good example is that they established currency swaps between the main central banks with the aim of facilitating access to foreign currency by financial institutions.

Starting in 2008, three main types of measures were adopted: a) monetary policy, b) support for the most affected financial sectors, and c) fiscal policy:

a) From September 2008, central banks lowered interest rates and coordinated with one another to introduce a series of measures that made the provision of liquidity to financial institutions more flexible, thereby increasing the number of institutions that had

access to central bank financing. The assets accepted as collateral for monetary policy operations were expanded and maturities were lengthened to provide more liquidity to the market. In addition, some central banks made use of non-conventional instruments.

In the case of the EMU (Economic and Monetary Union), the ECB (European Central Bank) changed its policy and lowered the reference rate by 50 bp in October 2008, reaching 3.75%, and in successive steps to 1% in May 2009. The Eurosystem fully met the demand for funds in all open market operations; the maturity of all new eligible collateral was extended; new 12-month maturity operations were implemented and a covered bond purchase programme was developed, including Spanish covered bonds.

b) Governments took further measures to support the banking sector in order to finance and recapitalise it. Deposit guarantees were extended, the state guaranteed bank issues, and public funds were provided through loans and/or the purchase of high quality assets.

The deteriorating solvency of banks was resolved in many eurozone countries by injections of public capital, including the nationalisation of some institutions, and, in other cases, through the acquisition of impaired assets or the introduction of asset value protection programs for banks. As in the U.S., in extreme cases, systemically important banks in Europe were rescued, at a cost of US\$ 1.5 trillion in 2010. Finally, the G20 agreed to undertake a reform of the global financial system.

c) Governments adopted policies to stimulate the economy, including both the expansion of public spending and tax cuts, as well as other assistance to the groups and sectors most affected by the crisis. All these policies had their real effect from 2009 onwards and, on average for the G20 countries, contributed 2% of GDP per year in 2009-2010.

In the EU, the so-called European Economic Recovery Plan provided a fiscal stimulus of 1.5% of GDP. These programmes were mainly based on measures on the expenditure side through transfers and public investments.

Global GDP began to recover smoothly in 2009, with positive growth in the second half of the year, reaching a rate of 5.4% in real terms in 2010. Financial markets stabilised, volatility and risk aversion were significantly reduced, asset prices recovered and some segments of the capital markets gradually reopened. The recovery was relatively uneven across geographical regions: more consistent in emerging economies, where real GDP grew by around 7% in 2010, especially in Asia, and more subdued in

advanced economies. Only the US, at 2.5%, and Japan, at 4.2%, recovered with some energy, while the eurozone remained at 2%.

In the EMU, disparities by country were also observed: GDP growth was highest in Germany at 3.9%, and in Finland at 3%; in Spain there was stagnation at 0%, in Ireland at 0.4%, while Greece saw a fall of -5.5%. This was nothing other than the announcement of the arrival of the EMU crisis in the second phase of the Great Recession.

5.3. Sovereign debt and crisis.

At the beginning of 2010, the process of economic normalisation in Europe was disrupted when the first symptoms of the sovereign debt crisis appeared in the eurozone. The cause was directly related to the mistrust raised in the final months of 2009 with regard to Greece's public finances. But it was not only Greece; other European countries had also accumulated macroeconomic and financial imbalances during the previous expansionary cycle in relation to their public finances, private indebtedness, the real estate sector, the exposure of the financial system to both and the loss of competitiveness of their economies.

The EMU's administrative and institutional apparatus was far from sufficiently developed. It lacked the flexibility to anticipate such problems, either by preventing them outright or by establishing clear and transparent rules of procedure in the face of potential crisis scenarios. These latter aspects aggravated the tensions being generated and even transferred them to some member countries that were affected, even though they had not deviated from the recommended stability guidelines.

The tensions arose as a result of the Greek fiscal crisis, but initially spilled over to the sovereign debt of economies facing high fiscal and financial vulnerabilities or poor economic growth prospects. The strong interaction of sovereign, banking and macroeconomic risks led to a sharp rise in risk premiums in the affected countries.

These problems also spread to the stock and foreign exchange markets, and spilled over to wholesale bank financing. Serious liquidity problems eventually emerged in some institutions and affected the stability of the eurozone's financial system. An intense debate began on the assistance provided by European institutions to the Greek authorities, which was finally approved in May 2010. It consisted of a package of financial support from EMU countries and the IMF, in exchange for Greece implementing a programme of economic adjustment and fiscal consolidation. The European Financial Stability Facility

(EFSF) was also created, which was in place until 2013. This fund was intended to guarantee financial assistance to other countries in similar cases.

If we add to all this the publication in July 2010 of the results of stress tests on European banks, it is easy to understand why market tensions began to ease. However, Irish banks soon faced fresh difficulties, with implications for that country's fiscal position. In autumn 2010, this led to renewed market pressure, with the result that the Irish authorities had to request a new financial support package totalling up to 40% of Irish GDP.

However, during 2011, tensions in EMU financial markets continued to intensify. This led to the preparation of a financial assistance package for Portugal, also in coordination with the IMF, which amounted to up to 42% of Portuguese GDP.

In view of the Greek macroeconomic deterioration in 2012, the 2010 bailout was reviewed and a second aid package was implemented, given the lack of confidence in the country's ability to finance itself in the markets. The first two aid packages for Greece represented more than 100% of GDP. Investor pessimism then began to affect other eurozone countries. Contributing to this was the political problem of approving the aid, the poor macroeconomic and fiscal situation in many countries and doubts about whether or not to include private sector debt in the restructuring of the new financial aid programme for Greece.

The breakdown in confidence caused sovereign risk premiums to rise again in the summer of 2011, affecting countries such as Belgium and France, whose economies had been less involved in the crisis until then. Ten-year sovereign spreads vis-à-vis Germany reach a peak in November 2011, in which they reach levels of 189 bp in France, 560 in Italy, 485 in Spain and 360 in Belgium.

While banks held large sovereign debt portfolios, the erosion of these assets in the economically weaker EMU countries complicated the financing of eurozone banks. This increased the risk to the financial stability and economic performance of the most affected countries. It triggered tensions in exchange rates, the stock market and the interbank market.

In this second phase, the Belgian, French, Italian and Spanish securities market supervisory authorities, in coordination with ESMA (European Securities and Markets Authority), jointly decided to introduce temporary restrictions on short sales of shares by financial institutions. Their objective was quite clear: to impose an orderly functioning of the capital markets and thereby achieve financial stability.

5.4. Anti-crisis economic policy

Globally, the performance of economic policies in 2010 and 2011 was very mixed. U.S. monetary policy relied on unconventional stimulus measures, allowing the Federal Reserve to expand its balance sheet with the Quantitative Easing 2 (QE2) programme of staggered purchases of securities and increasing the total disbursed since 2008 to 2.35 trillion dollars, representing 15% of U.S. GDP. In terms of fiscal policy, fiscal stimulus plans were adopted.

With regard to EMU monetary policy, there was a preference for slightly reducing its expansionary capacity in the first half of 2011. Fiscal policy turned contractionary from 2010 onwards, in line with the complex situation in sovereign debt markets, and the European institutional framework was reformed. The ECB continued to expand liquidity during 2010, although in May of that year it launched the Securities Market Program, through which it purchased government bonds from countries in order to control and organise the functioning of the monetary policy transmission mechanism.

Thus, in the first few months of 2011, tensions eased. The outlook for economic recovery in the area appeared to be strengthening, although inflation rates rose to levels approaching 3%, against a backdrop of rising energy and food prices.

Between April and July, the ECB raised its main benchmark interest rate by 25 basis points. This did little good, as, in the face of the worsening sovereign debt crisis in the summer of 2011, EMU monetary policy changed course again through the adoption of expansionary measures, including cuts in official interest rates by the ECB.

In December 2011, new auctions of three-year long-term loans to credit institutions were held, which were repeated in February 2012. Mandatory reserve requirements were also reduced and the assets eligible as collateral in monetary policy operations were expanded (Banco de España, 2017).

In short, given the tensions in sovereign debt markets, fiscal policy in the eurozone was contractionary in nature. It was not limited to the countries receiving financial aid, but was also applied to the other economies in the area. At the G20 meeting in Toronto in mid-2010, countries agreed to make a considerable effort to reduce their respective public deficits by 2013. In the case of Spain, fiscal consolidation was brought forward to 2010, although in the rest of the eurozone economies it was implemented the following

year. The public deficit for the eurozone as a whole, after discounting the effects of the economic cycle, was reduced from 4.3% to 2.1% between 2010 and 2012.

Starting in 2010, the EMU undertook a reform of its institutional-administrative design. The sovereign debt crisis revealed the limits of this structure in several respects. First and foremost, it became clear that supervision had been neglected. The EMU had no systematised means to identify and prevent an excessive build up of macroeconomic imbalances: the prolonged loss of competitiveness, an oversized financial sector with excessive concentration of risk in the real estate sector, heavy private indebtedness and fiscal imbalances.

From 2011 onwards, governance and oversight guidelines were strengthened with various legislative initiatives (Six-Pack, Two-Pack, Fiscal Compact). These initiatives bolstered the Stability and Growth Pact and national fiscal systems.

New frameworks were created for the prevention and correction of macroeconomic imbalances, with an emphasis on current account imbalances, indebtedness and the competitiveness of countries. Finally, a series of macroprudential supervision measures by a European Systemic Risk Board were put into operation.

As the EMU had no crisis management and resolution mechanisms in place, in 2010 it temporarily created the EFSF. The aim was to avoid the same situation that occurred with the first Greek bailout plan, which was financed, in an improvised way, with bilateral loans from the member states. Faced with this reality, the ESM (European Stability Mechanism) was established in 2013 as a new permanent body.

In the EMU, the need for banking integration was not considered. Consequently, regulatory and supervisory reform was undertaken to implement new prudential regulation and a new European oversight mechanism, the so-called European System of Financial Supervision.

New international economic regulation

The collapse of Lehman Brothers in September 2008 prompted international authorities to react by adopting a series of initiatives, including a reform of financial regulation and supervision (Banco de España, 2017). To this end, a first summit of G20 leaders, including heads of state and government, was convened in November 2008 in Washington, D.C., at which it was agreed to implement urgent and exceptional measures to stabilise financial markets and reform the international financial system. The following

summit in London in April 2009 set out the broad outlines of this reform, which can be summarised in three key elements: a) changes to prudential banking regulation—macroprudential, including a series of measures on the regime for systemically important entities; b) other regulatory reforms; and c) provisions for possible bailouts of financial systems.

Beginning in 2008, reforms were developed based on a new institutional framework for the international coordination of financial regulation and supervision. These included the activation of the G20 as a forum for discussion and oversight with the summits of leaders and regular meetings of finance ministers and central bank governors; and the creation in 2009 of the FSB (Financial Stability Board), in which the range of participation was broadened to include new countries, including Spain, in addition to the members of the FSF (Financial Stability Forum), its predecessor.

Importantly, FSB member countries made a number of commitments, including the obligation to make public their degree of adherence to agreed international financial standards—such as the Framework for Strengthening Adherence to International Standards of January 2010—to undergo an assessment under the FSAP (Financial Sector Assessment Programme) of the IMF-World Bank every five years, and to submit to the FSB's periodic peer reviews.

The FSB became the main forum for international coordination in the financial sphere. Ministries of Finance, national supervisors, international organisations such as the IMF, OECD, WB (World Bank) and BIS (Bank for International Settlements), as well as other international bodies responsible for setting international standards and norms SSB (Standard Setting Bodies), including the BCBS (Basel Committee on Banking Supervision) or the IASB (International Accounting Standards Board), began to participate in the FSB.

The European Commission entrusted the review of the institutional framework for European supervisory regulation to a group of independent experts chaired by Jacques de Larosière. Its *Report of the High-Level Group on Financial Supervision in the EU* of 25 February 2009, known as the "Larosière Report", led to the creation of the ESFS (European System of Financial Supervision). It established new European supervisory authorities in charge of microprudential tasks for the banking sector: EBA (European Banking Authority); the securities sector: ESMA (European Securities and Markets Authority); and the insurance sector: EIOPA (European Insurance and Occupational Pensions Authority). All of them replaced, with the rank of "authority", the former

European committees in these same areas. A new institution for macroprudential oversight—the ESRB (European Systemic Risk Board)—was established. The ESFS became operational in January 2011, as did the other new bodies linked to it, although their respective implementing regulations were published in December 2010.

6. Mild impact of the Great Recession in Latin America

One can agree with Ocampo (2009a; 2009b) when he notes that, in the case of Latin America, the difference between an economic "recession" and an economic "depression" is never entirely clear. The region had gone through a markedly favourable cycle in 2003-2007, based on a rare combination of a financial boom, high commodity prices and the arrival of large remittances from migrant workers. But this all came to an end in the course of 2008.

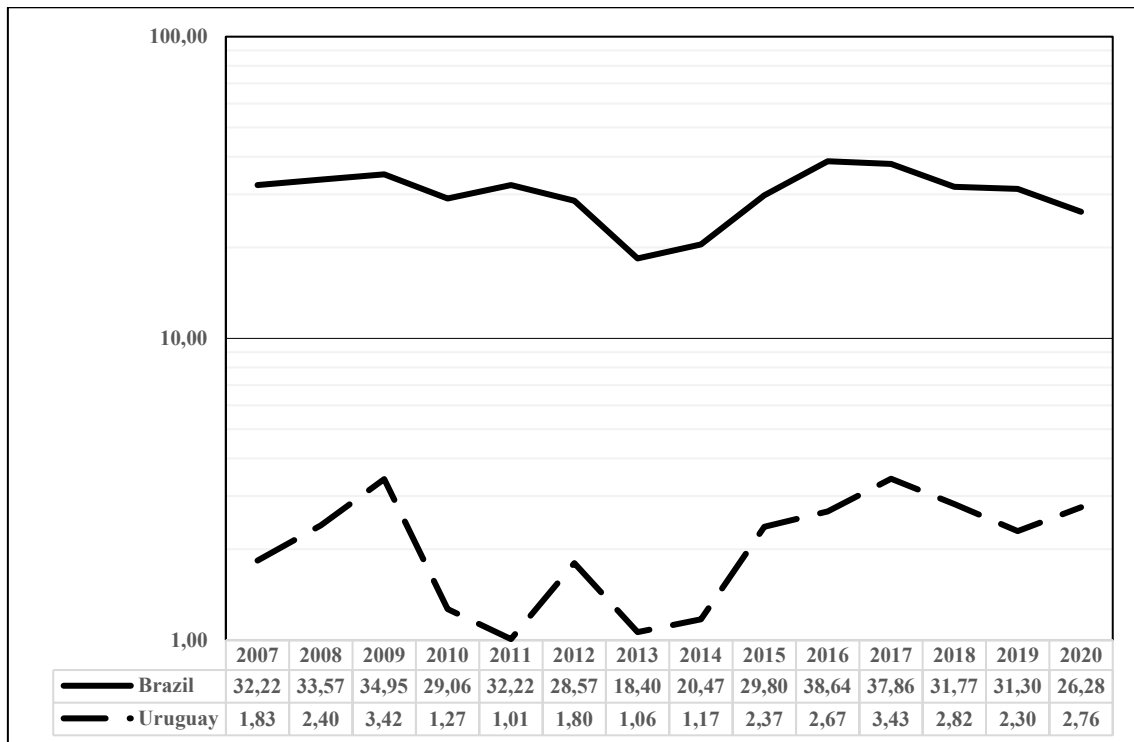
6.1. Crisis in Latin America and the Caribbean (2008-2009)

Several economies in the region began to experience a major slowdown, including Colombia, Mexico, Venezuela and almost all the smaller economies in Central America and the Caribbean. Financing capacity had been shrinking since the third quarter of 2007, coinciding with the U.S. financial crisis.

In mid-2008, commodity prices began to fall, although it was not until the global financial meltdown of mid-September 2008 that the most significant problems were unleashed. It began with a credit crunch and a widening of risk spreads (Figure 7). Commodity prices then plummeted and some of the demand for these products was lost. Undoubtedly, the latter can be directly linked to the Great Recession in the advanced economies that were supplied with these commodities. Even those Latin American economies that managed to maintain growth until the third quarter of 2008, such as Brazil and Uruguay, eventually ran into difficulties.

The peculiarity of the Latin American emerging economies lay in their ability to insulate themselves in the early stages of the crisis, thanks to a renewed rise in commodity prices, as well as a certain degree of security from foreign direct investment in view of the high level of international reserves and persistent demand from the major Asian emerging economies.

Figure 7. Risk premium per loan in Brazil and Uruguay (prime rate minus treasury bond rate, %. Logarithmic scale)



Source: World Bank (2022b). Prepared by author.

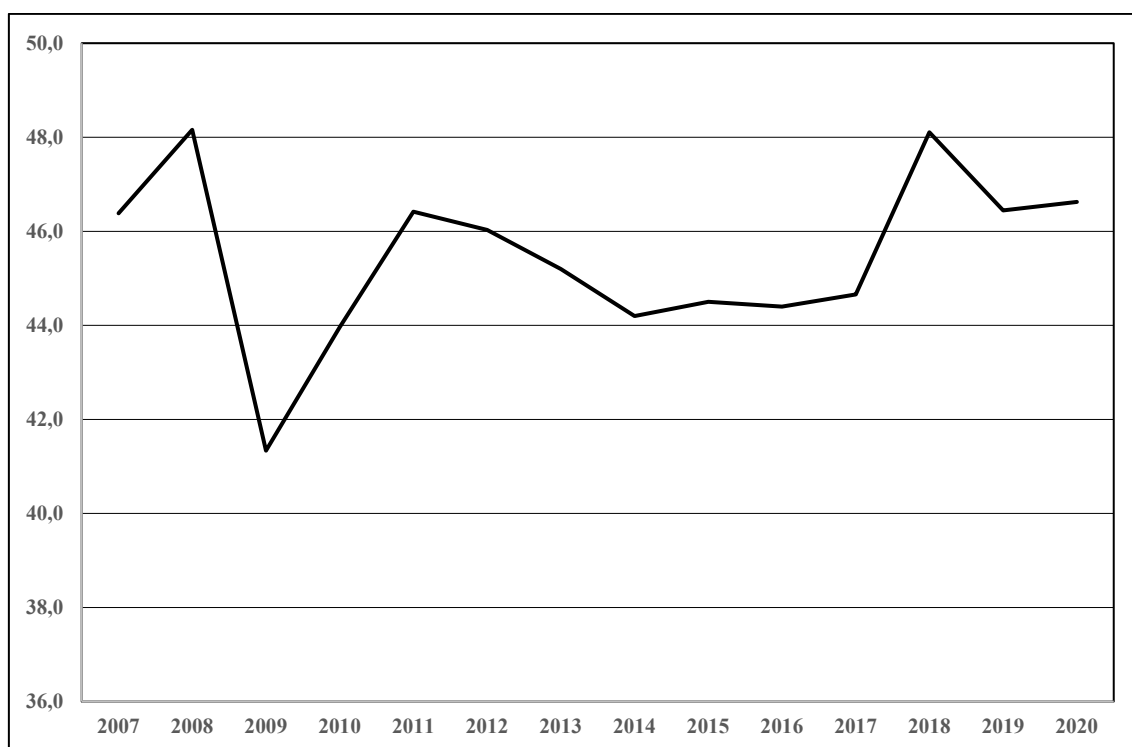
Another interesting point is that the IMF's predictions that emerging economies of the developing world would "decouple" from the negative economic trends of the advanced economies failed to come true. This is because, to use the terminology employed by Calvo (2008), in Latin America, this apparent "Indian summer" was followed by a "storm" triggered by the global financial crisis of September 2008.

The contagion channels of the crisis in Latin America were based, firstly, on the decline of migrant remittances (Ocampo, 2009a; 2009b). According to Latin American balance of payments statistics, their period of accelerated growth ended in 2006. In the following two years, they increased at an average of less than 3%, with a moderate contraction in 2008 for Mexico. In that case, the slowdown in U.S. construction was the main channel of transmission linking the crisis to remittances. A high proportion of workers in the construction sector were Mexican migrants (13.8%), almost triple the average proportion of Mexicans in the U.S. labour market, which stood at 5.1% (JPMorgan, 2008). A similar effect occurred for other Latin American countries due to the construction crisis in Spain, which was an important destination for Colombian and Ecuadorian migrants.

Secondly, there was the deterioration of international trade. During the boom years from 2003 to 2006, there was a 9.3% annual increase in the volume of world trade. However, the growth rate of this indicator proved to be very sensitive to the economic cycle and, consequently, highly volatile. As a result, international trade amplifies not only boom phases, but also downturns in productive activity.

Between 2008 and 2009, growth in Latin America and the Caribbean fell by almost 7% in relation to GDP (Figure 8). In the region as a whole, the decline in the volume of trade became an effective mechanism for propagating the crisis, but it particularly affected Mexico, Central America and the Caribbean, whose exports are in manufactured goods and services.

Figure 8. Trade in Latin America and the Caribbean (% of GDP)

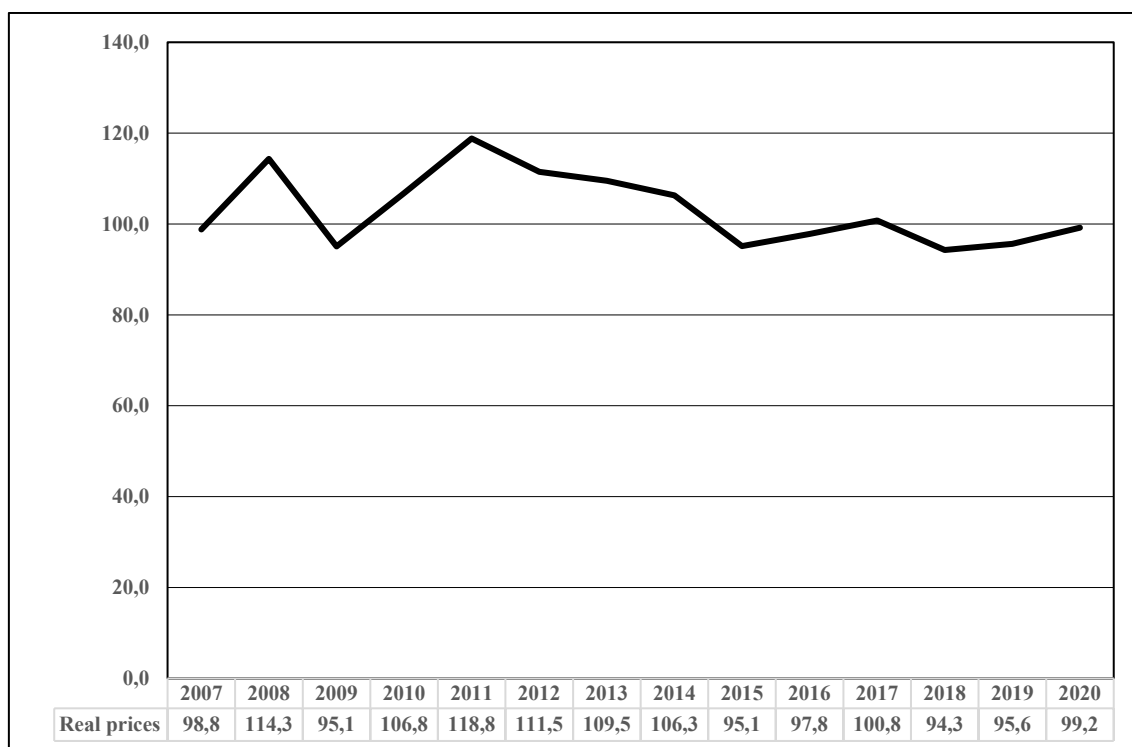


Source: World Bank (2022b). Prepared by author.

At the same time, the fluctuation of world food commodity prices was the main variable determining the behaviour of South American exports (Figure 9). The problem was that, as reflected in the ratio of total natural resource revenue to GDP in Latin America and the Caribbean, as shown in Figure 10, the prices of mining products, including energy products, performed better than agricultural products. The real price of minerals far exceeded that of the 1970s, although the price of energy products was higher

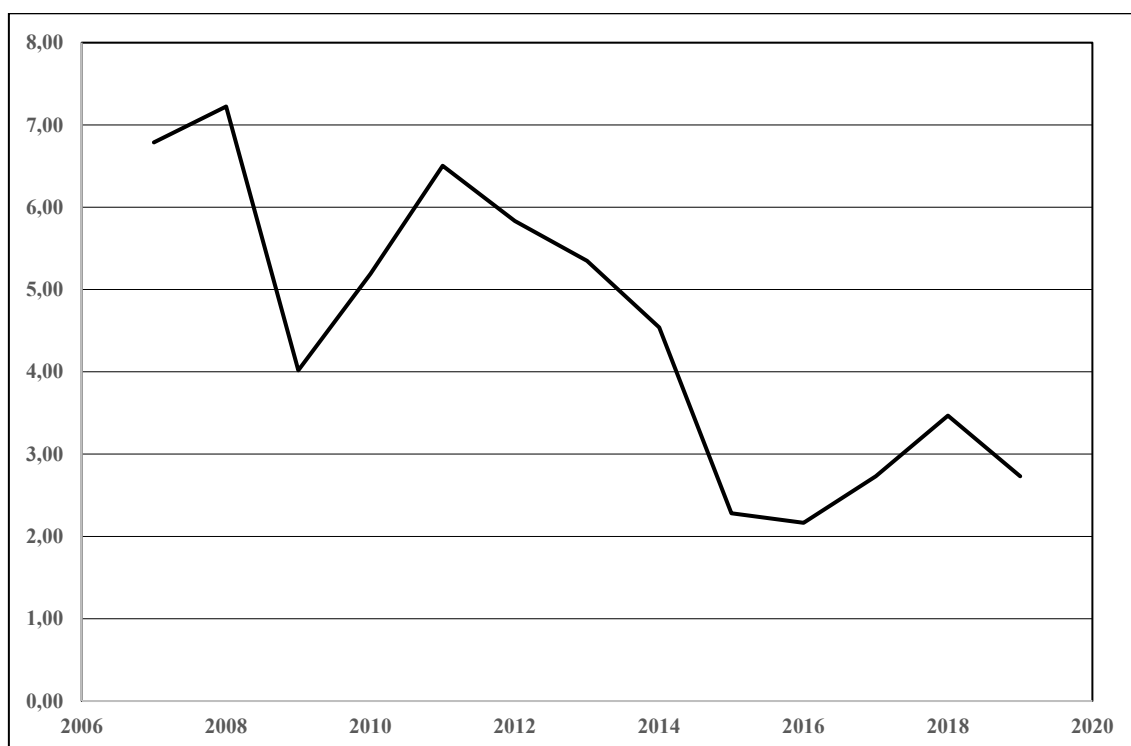
than that of metals. On the other hand, agricultural products barely reached the levels of those years.

Figure 9. World food commodity prices (deflated according to food price index 2014-2016 = 100)



Source: FAO Food Price Index. Prepared by author.

Figure 10. Total natural resource revenues in Latin America and the Caribbean (% of GDP)



Source: World Bank (2022b). Prepared by author.

Table 3 shows how in Latin America the terms of trade favoured the Andean countries, from Venezuela to Chile, which are important exporters of mining products. It should be noted that even in Colombia, two fifths of its exports consisted of energy products (oil and coal) and metals (nickel and gold). On the other hand, Argentina, Brazil and Paraguay, which depend on their exports of agricultural products, had only slight improvements in their terms of trade.

In all Central American countries plus Uruguay, which are clearly reliant on oil imports, the terms of trade deteriorated, while in Mexico they improved. There, the predominant export of manufactured goods was combined with its foreign sales of oil. As Von Braun (2007) points out, the difference between mining and agricultural products indicates that the decisive factors in the formation of their prices were very different. In the case of energy and mining products, a key issue was the low rate of investment due to low prices from the mid-1980s until the beginning of the 21st century.

Strong demand was linked to rapid growth in emerging economies, most notably for metals in China, leading to a recovery in prices. In the face of business expectations, investment revived; but in all mining projects there is a relative lag between spending and investment decisions and production increases. In contrast, in the case of agriculture, the

imbalance between supply and demand is much smaller. However, there is the impact of high energy prices, which translates into inflation for agricultural products that replace those used as feedstock to produce biofuels.

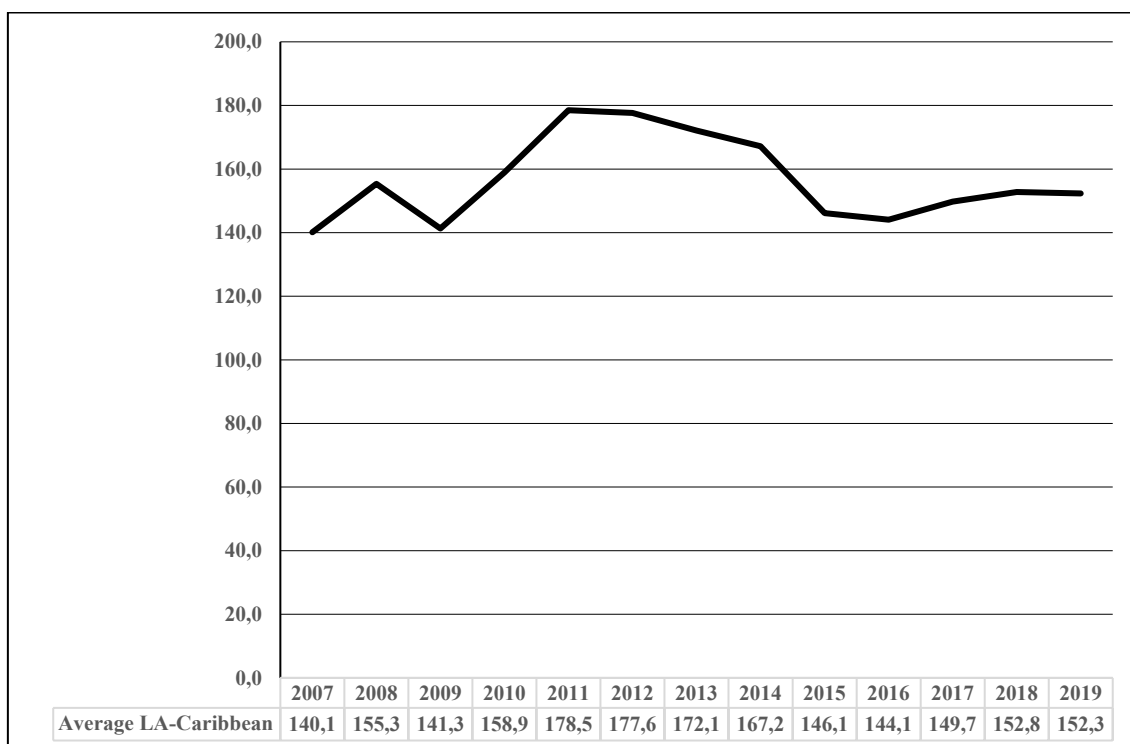
Table 3. Net terms of trade index. Latin American (LA) and Caribbean Countries (2000 = 100)

Years	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Argentina	124.4	139.5	140.6	145.5	160.6	167.1	156.5	153.3	146.3	155.2	150.7	152.6	151.2
Brazil	106.2	110.1	107.3	124.5	134.2	126.4	123.8	119.6	106.4	109.7	116.1	113.6	114.4
Chile	198.4	169.6	176.2	214.4	217.8	202.8	196.4	192.5	187.1	194.1	214.4	209.0	207.4
Colombia	138.0	146.1	138.0	160.3	183.9	173.8	161.3	146.8	110.5	109.2	127.8	139.7	137.8
Mexico	114.5	116.0	103.0	110.9	118.4	114.1	114.0	108.2	93.6	87.9	91.8	94.0	94.9
Peru	181.5	160.0	155.8	188.4	203.3	197.4	185.7	175.7	163.6	163.1	175.4	174.7	171.7
Paraguay	91.5	94.5	915	99.0	113.2	101.5	112.2	125.1	127.3	127.7	126.1	123.4	119.1
Uruguay	89.3	96.4	103.1	102.5	104.9	108.9	110.8	115.1	117.3	120.6	120.1	114.2	118.3
Venezuela	293.7	446.6	272.9	364.4	447.0	455.6	458.6	399.0	218.9	185.5	205.0	217.1	199.9
Average LA-Caribbean	140.1	155.3	141.3	158.9	178.5	177.6	172.1	167.2	146.1	144.1	149.7	152.8	152.3

Source: World Bank (2022b). Prepared by author.

The contraction of international trade was perhaps the most significant transmission mechanisms of the Great Recession of 2008 in Latin America. It could not be otherwise, considering the greater degree of openness that characterised Latin American economies, as seen in the average of the countries included in the Latin American and Caribbean group, depicted in Figure 11. However, historical experience teaches that, in order to take advantage of this—as proposed by ECLAC (United Nations Economic Commission for Latin America and the Caribbean) as early as 2008—more proactive productive development policies must be put in place.

Figure 11. Average net terms of trade in Latin America and the Caribbean



Source: Table 3. Prepared by author.

Thirdly, there were capital flows. These, in line with Jara and Tovar (2008) or Ocampo and Tovar (2008), show two notable changes in the balance of payments of the seven largest economies selected by them—Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela. One was the increase in assets, especially international reserves, but also in direct and portfolio investments abroad, which in all cases exceeded GDP growth in current dollars between 2003 and 2007.

The second change was the variation in the composition of liabilities, characterised by a reduction in indebtedness and the presence of liabilities such as treasury shares. The latter included investments in the countries of the region by international investment funds, which also participate in local bond markets. The improvement in the balance of payments was undoubtedly an important asset for the region to cope with the new unfavourable international conditions.

Indeed, in six of the seven largest countries in the region, except Venezuela, the balance of payments surplus in the last quarter of 2006 and the first half of 2007 approached US\$ 113 billion, of which close to US\$ 100 billion was in the capital account, although approximately two thirds of this went to Brazil and the rest to the other five economies (Ocampo, 2007).

Monthly Latin American bond issuances in international markets confirm that financing reached its highest level between mid-2006 and mid-2007. Issuances were growing but volatile, and private companies predominated, accounting for about 70%. Corporate issues generally have a higher cost and a shorter average repayment term than government bonds. They also require a faster turnover of debt and are more vulnerable to fluctuations in capital availability.

Thus, when the international financial crisis hit, it spread in a complex way over time and had different effects in the various countries in the region. During the third quarter of 2007, the initial impact consisted of a sharp fall in capital flows and bond issuance, a moderate increase in financing costs and a mild decline in stock markets.

Spreads were volatile between July and September 2007, but their effects differed from country to country. They were manifested in an element that can be termed "political risk". The widening and volatility of spreads were greater in Argentina and Venezuela. In Brazil and Colombia, on the other hand, the exchange rate was more sensitive to short-term movements in spreads. Mexico exhibited a strong correlation between both variables, but with much lower levels of volatility. In contrast, Chile and Peru were among the least affected economies.

Further market turbulence occurred in June 2008, a precursor to the subsequent financial meltdown in September. It coincided with the fall in commodity prices. The explanation lies in the fact that many of Latin America's emerging multinationals are suppliers of industrial commodities like steel and cement. Bond issuances plummeted in June and July and disappeared from the market from August onwards. Refinancing costs rose by 0.5%, even before the collapse in September 2008.

Spread volatility was not much different. The separation of Argentina and Venezuela from the remaining larger countries was accentuated and, once again, in Brazil and Colombia the exchange rate became more unstable. Stock markets fell sharply. The collapse of mid-September 2008 increased these trends in Latin American economies (Bustillo and Velloso, 2009).

Credit of all types came to a standstill, capital outflows occurred and all Latin American currencies depreciated. Exchange rate movements led to losses in the futures markets in the millions, especially in Brazil and Mexico. In addition, accumulated reserves fell in most Latin American countries. Financing costs rose sharply and stock markets experienced losses far in excess of those in advanced economies. Spreads became highly volatile and all countries increased their correlation with exchange rate

movements. Brazil, Chile and Mexico were the countries with the greatest exchange rate instability. In contrast, Colombia was more stable than in previous economic difficulties.

All these problems, as well as the uncertainties linked to the financial crisis in advanced economies, meant that the weakness of private external financing would continue in the short and medium term. In Latin America, however, the balance of payments crisis was less acute as a result of better initial conditions in terms of external indebtedness and the level of reserves. In addition, a favourable side effect of the new context was the easing of pressures for currency revaluation in several countries in the region.

Possible reasons for the lesser impact of the Great Recession in Latin America

According to Quenan (2013), the global economic crisis in Latin America can be seen as interrupting a growth cycle between 2003 and 2007. Baduel, Ordoñez and Quenan (2010) argue that the Great Recession hit Latin America hard, although the effect was relatively short-lived.

The recovery began in the second quarter of 2009, and almost no country faced a prolonged external financing squeeze. It is true that between September 2008 and March 2009, risk premiums on sovereign debt rose across the board, followed by a recovery in March 2009 thanks to a decrease in risk aversion and abundant global liquidity. By then, capital flows were returning to the region and most Latin American countries had easier access to international credit markets.

Between late 2008 and early 2009, the currencies of the countries in the region depreciated sharply, followed by a generalised revaluation from March-April 2009 onwards. In turn, following the slump in local stock markets at the end of 2008, most Latin American financial centres saw a rapid recovery in their operations beginning in March 2009.

It is striking—in contrast to the U.S. and Europe—how Latin America avoided being severely shaken by the economic and financial collapse and managed to overcome the worst effects of the Great Recession of 2008.

What happened in Latin America overturned the region's own history, traditionally much more sensitive to crises in advanced economies. In fact, it was the part of the developing world that was most adversely affected by the downturn in

industrialised countries after the attacks on the Twin Towers in New York on 11 September 2001 (Lissardy, 2018).

According to Porzecanski (2018), 2008 was possibly the first time since the independence of Latin American countries that a major economic contraction and financial disaster in the most industrialised economies did not spark a debt, currency or banking crisis in the region. Part of the explanation lies in the consumption stimulus measures undertaken to cope with the global crisis in Latin America. The differences between the region's economic recovery and that of developed countries after the collapse of Lehman Brothers are striking.

According to data from the World Bank (2022b), while Latin American GDP growth went from -1.9% in 2009 to 5.8% in 2010, OECD countries saw a fall of -3.5% and a rebound of only 2.9% . Latin America's unemployment rate fell to 7.3% in 2010, while in the USA and the EU it exceeded 9.0% . While two of the hardest hit countries in the immediate aftermath of the crisis were Argentina and Mexico, with GDP contractions in 2009 of -5.9% and -5.3% , respectively, both countries recovered the following year, with Argentina's economy growing by 10.1% and Mexico's by 5.1% . Mexico's recovery was hampered by its strong links to the US economy, which was facing its own difficulties.

The crisis in Latin America "did not have the kind of consequences that eventually occurred in Europe, where countries that had never turned to the International Monetary Fund had to ask for its help," (Porzecanski, 2018). Another explanation for the lesser impact of the Great Recession lies in Latin America's commodity exports during the previous years, which provided enough foreign exchange to withstand the 2008 recession.

Nor were banks bailed out, as was the case in the U.S. and Europe. The explanation in the case of Latin America lies in the fact that: (a) improvements in banking oversight and some flexibility in exchange rate regimes were encouraged; (b) new bond and equity markets emerged, which financed companies and governments during the global upheaval; and (c) finally, but most importantly, the foreign exchange reserves of Latin American Central Banks had increased considerably and countries had managed to reduce their fiscal deficits thanks to commodity price increases, which help to increase export revenues (Porzecanski, 2018).

Most governments were able to react to the crisis with countercyclical economic policies. This allowed them, as never before, to invest more heavily in infrastructure, stimulate consumption and transfer income to those most in need. In addition, there was

relative political stability, as in several Latin American countries the electorate re-elected presidents or political forces in power, while in the USA and Europe there was greater destabilisation as the crisis led to several changes of government.

The emergence of local capital markets provided Latin America with an alternative source of financing. In the United States, on the other hand, the debate has been raging for some time as to whether it would have been better not to have pushed through so many countercyclical measures in the wake of the 2008 crisis. In the words of the 2001 Nobel laureate in economics, Stiglitz (quoted by Lissardy, 2018) "The Obama administration made a crucial mistake in 2009 in not pursuing a larger, longer, better-structured and more flexible fiscal stimulus. Had it done so, the US economy's rebound would have been stronger." But that view was quickly countered by a former Obama economic advisor, Lawrence Summers (2018): "I cannot see the basis for the argument that a substantially larger fiscal stimulus was feasible. And the effort to seek a much larger one certainly would have meant more delay at a time when economy was collapsing—and could have led to the defeat of fiscal expansion."

Some economists point to Latin America as a good example of what can be avoided with strict banking regulations. Former IMF Director for Latin America, Claudio Loser (2018), stated that "European countries and the U.S. were totally exposed because the financial system was overextended and without sufficient protection. So the crisis hit there very hard. Ultimately, macroeconomic policy in Latin America was better than in Europe."

But the global landscape changed over the following two years and long before the COVID-19 crisis emerged. Commodity prices fell, the complex economic recovery of the U.S. and its trade war with China emerged, as did new crises in Venezuela and Argentina. It should be noted that the latter country was forced to turn to the IMF to prop up its currency (Loser, 2018). Nevertheless, the region as a whole may be prepared for the possibility of new cyclical crises, but it is not advisable to fall into the risk of "complacency". Latin American and Caribbean countries should never assume that because they have successfully weathered one terms-of-trade shock, they are immune to further recessions in the future.

7. Great Asian Recession

The crisis reached practically every corner of the planet. In the case of Asia, given China's role as a global economic dynamo since the final decades of the 20th century, the contraction of its exports at the end of 2008 and the relative stagnation of its economy in the last quarter of the same year show that the global crisis also reached them. The question is to what extent.

7.1. Lower impact on China

For some individual countries, particularly those in regions that drive global growth and trade, the 2008-2009 global economic crisis had a different impact. Such was the case for the East Asian economies. China, for example, was at one extreme of the crisis (López-Villafañé, 2011). Financially, it was little affected, but because of its strong links to international trade, on which a significant percentage of its economy depends, it could not help but suffer from the fall in demand for its exports. After all, exports represented more than 30% of GDP at the time. A significant proportion of its manufacturing companies depend on foreign trade. They are responsible for employing large numbers of people, especially migrant labour from rural areas that flock to China's large coastal cities.

The recession in China undermined trade, mainly with the U.S., Europe and Japan, which accounted for 50% of the total. As an alternative, the Chinese government supported the expansion of its domestic market, given the loss of a portion of the foreign market, and implemented an economic stimulus plan of US\$ 590 billion (Song, 2009). This did not prevent a 6.1% decline in GDP in the first four months of 2009. This meant a loss of more than 10 million jobs among migrant workers, and some six million new graduates found it difficult to enter the labour market. China's real economic and social problem was related to employment, as it faced an annual surge of around 15 million new job seekers.

For every percentage point drop in GDP, labour pressure increases, and China cannot afford unemployment if it wants to maintain social stability. This, along with other policy reasons, explains the implementation of anti-crisis measures.

It should be borne in mind that, in addition to the global Great Recession, China experienced a series of calamities in those years, such as the first half of 2008, with heavy snowfalls in January, the uprising in Tibet in March and the Sichuan earthquake in May.

The need to maintain high employment rates meant that China's anti-crisis plan prioritised the export sector. This was the only way to absorb the large amount of available labour, as has always been the case in China's economy in the past. This is why new tax breaks were granted for foreign trade and, most importantly, the exchange rate of its currency unit—the renminbi issued by the People's Bank of China, whose basic unit is the yuan—was supported at a very competitive value against the dollar, even though this exacerbated the trade conflict with the US.

The U.S. authorities have always called for an appreciation of the yuan to make its exchange rate against the dollar more realistic. In fact, the data refute this argument, since between mid-2005 and 2008 the value of the yuan increased by 21% against the dollar. Despite this, the U.S. trade deficit with respect to China not only did not decrease, but increased from US\$ 202 billion to US\$ 268 billion.

The weakness of the U.S. government's arguments that a more competitive dollar against the yuan automatically leads to an increase in its exports were evident (Ikenson, 2010). Just before the summer of 2008, the Chinese authorities allowed their currency to revalue, but when the severity of the crisis became apparent, they decided to make a competitive devaluation to secure a favourable exchange rate for their export trade.

Another important element in China's trade relations with the U.S. was seen in the latter's financing through the purchase of its treasury bonds. By 2010, China was holding \$800 billion of U.S. debt in financial assets in U.S. capital markets (Ikenson, 2010).

Asian financing capabilities underpinned the trade relations that the U.S. maintained with these countries through large quantities of annual imports; this was the basis of its trade imbalance. According to Song (2009), using official Chinese statistics, the real figure was closer to US\$ 1 trillion worth of U.S. assets. In other words, the U.S. depended on these types of resources to help fund the enormous bailout and economic stimulus programs that would enable it to recover its economy. In view of the crisis in the U.S. economy, it made them more dependent on Asian financing and, therefore, became a very powerful instrument in the economic relationship between the Asian powers and the U.S.

It should be noted that the purchase of U.S. government Treasury bonds was not the only form of financing, as other procedures were also used. One was the so-called yen carry trade, which, with near-zero rates in Japan, became a high-risk but high-return investment. It has been estimated that US\$1 trillion of this trade was used for subprime loans in the U.S. (Song, 2009) and for other investments in emerging markets.

Financial dependence on the dollar is an issue that the Great Recession brought back to the fore, especially in the context of China, which would prefer to diversify its financial reserves to reduce the weight of the dollar and trade its goods exclusively in its own currency. Bilateral trade programmes were being offered for this purpose, using this type of model.

On the other hand, to solve the problem of dollar dependence in 2009, the governor of the People's Bank of China proposed the transformation of the IMF's special drawing rights into a supranational currency that would solve the credibility of a global reserve currency in the short to medium term (Yiping, 2010).

7.2. Asian model for exiting the recession

Asia recovered much faster than other regions, with the exception of Japan, although that country still maintained a powerful industrial and financial footprint. By 2009, the aggregate reserves of China, Japan, Singapore, India and Hong Kong totalled \$4 trillion, giving Asia three of the world's four largest economies: China, India and Japan.

China's immense domestic financial power, with total deposits of US\$ 7.6 trillion, gave it great resilience. Between January and April 2009, its financial institutions extended credit to industrial enterprises worth some US\$ 760 billion. In addition, aid for low-income residents in urban and rural areas was increased by 48% and 13%, respectively. In addition to this, other forms of support were also provided, such as subsidies for farmers and loans for the purchase of vehicles.

China's credit flow persisted in 2010, with credit growing by 17% to US\$ 1.1 trillion (Song, 2009; Information, 2010; *Xinhua Net*, 21 January 2010). Priority was given to employment growth, wage hikes and improved productivity.

The Great Recession put pressure on other powerful Asian economies, such as South Korea, India, Singapore and Thailand, forcing them to devalue their currencies. In this way, they were able to increase their exports and provide a quicker solution to their domestic economic recessions (Choong-Lyol, 2009).

The Japanese economy saw its GDP fall by -6.2% in 2009. The Japanese government launched a series of stimulus packages to revive its economy, amounting to US\$ 270 billion. It should be noted that, despite Japan's long deflation, it still had formidable financial power, as its domestic savings deposits were worth US\$ 15 trillion.

Therefore, without this factor associated with Chinese savings, it is not possible to explain the reasons for the linkage with the U.S. economy, whose disruptions affected them indirectly.

7.3. China's economic policy in the face of the crisis

To cope with the crisis and in order to "guarantee 8%" GDP growth" (Villesca-Becerra, 2015), the Chinese government revised its macroeconomic objectives for 2009. In November 2008, a series of fiscal stimulus measures were announced and implemented in 2009 and 2010. They amounted to 4 trillion yuan (about US\$ 586 billion). The objective was to reactivate the economy by stimulating domestic demand, both private and state-owned (Yue, 2009). Forty percent of these incentives were invested in infrastructure. Local governments also introduced their own incentive packages amounting to 18 billion yuan.

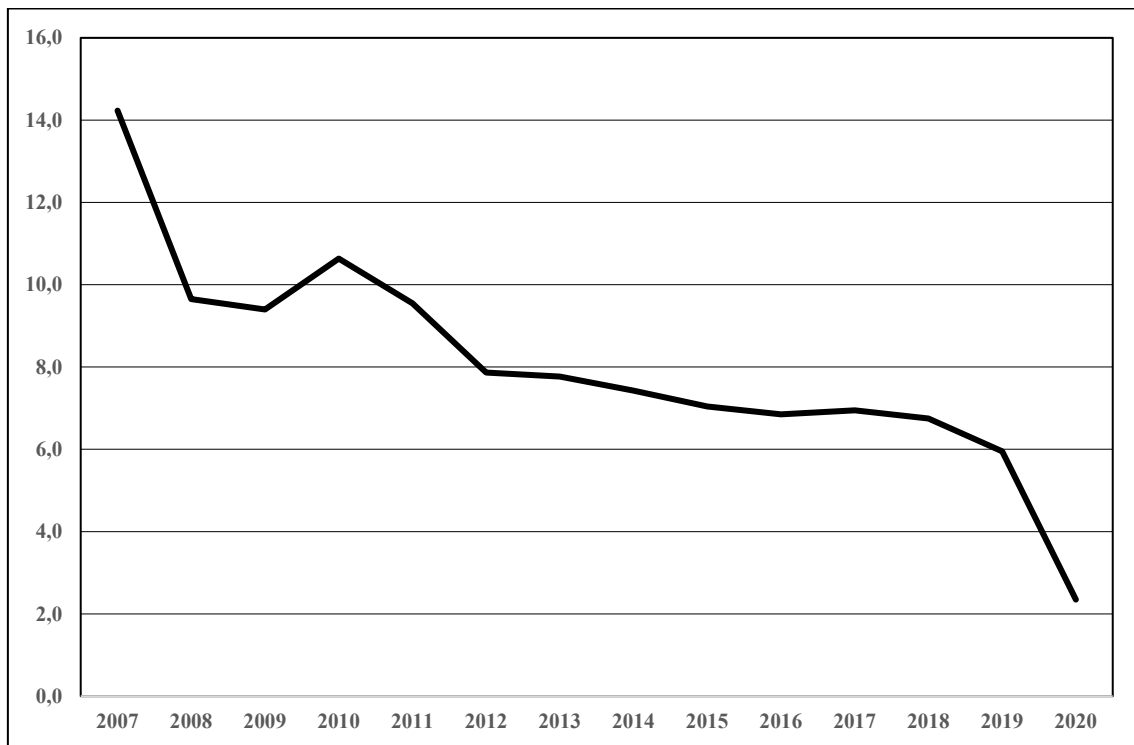
The implementation of these fiscal policy measures was spent mainly on highways and railroads, agriculture, science and technology, environmental protection, education and health. Investment in railway infrastructure increased by 67.5%, roads by 40.1%, education by 37.2% and health and social welfare by 58.5% (WTO, 2010).

This policy of real rescue was accompanied by monetary expansion adopted by the People's Bank of China to support fiscal policy. The result was the recovery of GDP growth during the third and fourth quarters of 2009 to 8.9% and 10.7%, respectively, which translated into an annual growth rate of 8.7%, that is, 0.7% higher than the planned target.

The Chinese communist government employed "Keynesian" economic policy measures to sustain the financing of labour-intensive public works. The fall in exports caused by the decline in global demand, especially in the European and North American markets, was countered by boosting domestic demand supported by fiscal spending (Han, 2012).

Figure 12 shows the evolution of China's GDP since 2007. It is possible to appreciate the marked contrast in 2008 and 2009 due to the effect of the Great Recession; however, compared to what was experienced by the world's most important economies discussed above, it shows that the reduction in economic activity was slight, and even much less than that occurring in the second phase of the crisis during 2012 and 2013.

Figure 12. China. GDP growth rate (annual %)



Source: World Bank (2022b). Prepared by author.

It is true that it is eventually linked to the COVID-19 crisis, which is of Chinese origin, as can be seen in the 2020 data. However, in 2009, as indicated by the IMF (2011), while China's GDP grew by 9.4%, world output declined by 0.7%. In 2010, GDP increased by 10.6%, while world output remained at 4.5%. This growth was sustained, despite the global financial crisis, because at the end of 2009 China was still producing 2.7 billion tonnes of coal, 51.3 billion metres of garments, 60.5 million tonnes of potassium fertiliser, 518 million tonnes of crude steel, 174 million personal computers and 93 million colour televisions. And, if that were not enough, China accounted for two thirds of the world's production of photocopiers, microwave ovens and footwear, 60% of cell phones and 75% of toys (NBS, 2010).

China mainly exported personal computers, cell phones, clothing and footwear, and imported iron, steel, petroleum and fuel minerals, machinery and equipment, plastics, optical and medical equipment, as well as organic chemicals. Its main trading partners were the EU, the US, Japan, Hong Kong and South Korea (China Balance of Trade, 2010).

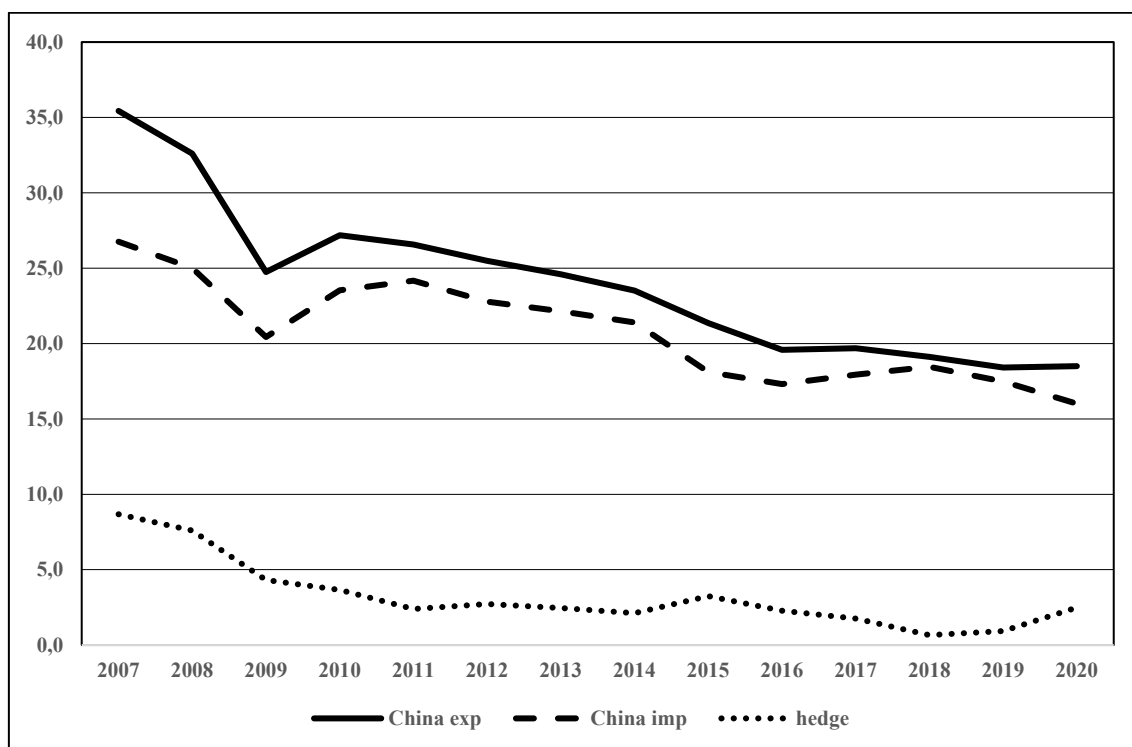
However, since China joined the WTO (World Trade Organisation) in 2001, the value of its exports and imports had never fallen as much as in 2009, reaching only 45.2% of GDP, a drop of 12.4% from 2008. Chinese exports were the hardest hit, with a decrease

of 16%, while imports fell by 11% (WTO, 2011). According to data from the World Bank (2022b), the volume of total world trade decreased in 2009 to 52.4% of GDP, a loss of 8.6 points compared to 2008, and did not return to growth until 2010, at 57%. For its part, China, despite rising by 5.5 points, still accounted for 50.7% of GDP.

This was one of the main consequences of the weakening of the dollar and a reduction in consumer spending in the U.S. economy which, in turn, had a strong impact on China's exports from the second half of 2008, leading to a relative decline in its international trade. As China's trade was mainly based on low value-added manufacturing, the reduction in exports brought with it a significant decline in imports.

Figure 13 shows the behaviour of exports and imports between 2007 and 2020. It shows that they not only stopped growing, but also experienced a clear downward trend during the period in question. Only a slight recovery appeared in 2017, which could barely be sustained in 2018 for imports, but which did not prevent the hedge rate from continuing its downward trend at least until 2019-2020, when a modest recovery began.

Figure 13. China's exports and imports of goods and services (% of GDP)



Source. World Bank (2022b). Prepared by author.

China's share of world trade, according to the WTO (2011), allowed it in the first half of 2009 to marginally overtake Germany for the first time in the value of its exports

(US\$ 521.7 billion for China compared to US\$ 521.6 billion for Germany). It thus became the world's largest exporter and, in global terms, the world's second largest importer.

But by far the key driver of Chinese growth was FDI (Foreign Direct Investment) (Yao and Kailei, 2007). The huge fiscal stimulus packages launched by the Chinese government in 2009 demonstrate the importance of the fall in FDI due to the crisis experienced by the most advanced economies (Yue, 2009). China managed to ensure that FDI not only did not decline symmetrically with the rest of the countries, but even turned out to be positive. The total world FDI flow between 2007 and 2009 fell by an average of 41.2% for both inflows and outflows, by 33.8% in the EU and 53.1% in the USA, while in China it increased by 18.2% (Table 4).

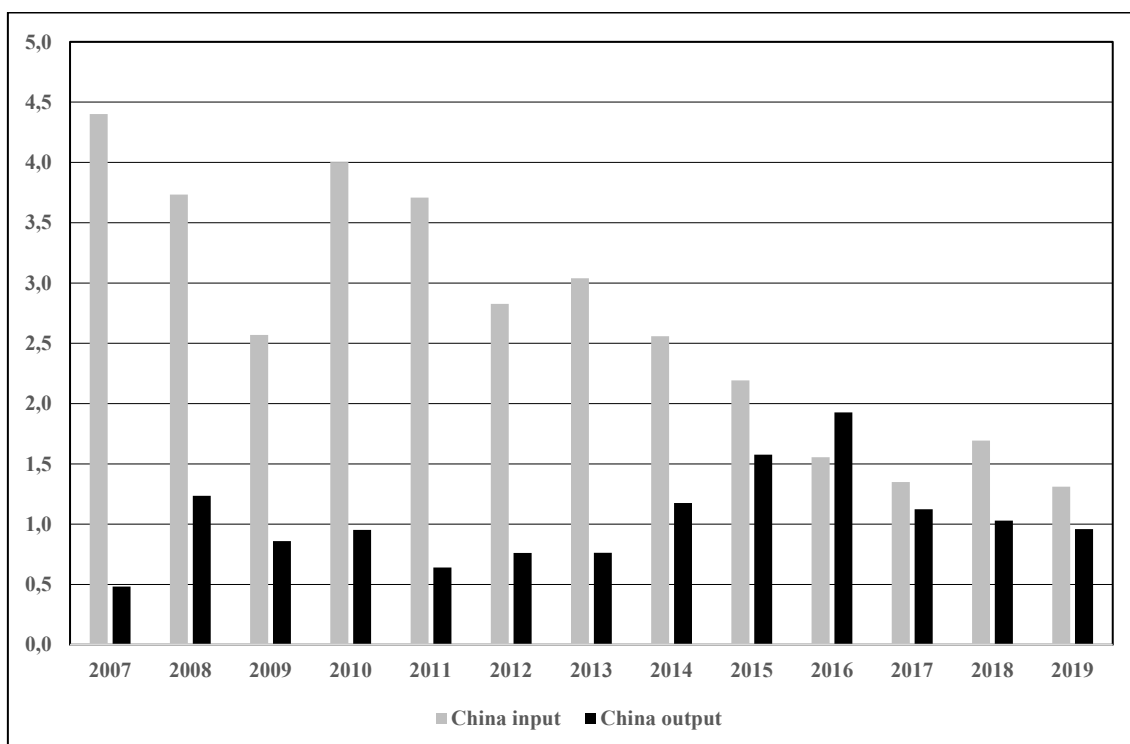
Table 4. FDI, net capital inflows and outflows (% of GDP)

	World		EU		USA		China	
	Input	Output	Input	Output	Input	Output	Input	Output
2007	5.0	5.4	10.0	11.1	2.4	3.6	4.4	0.5
2008	3.5	4.0	5.1	7.3	2.3	2.3	3.7	1.2
2009	2.1	2.2	3.3	3.9	1.1	2.2	2.6	0.9
2010	2.6	2.6	3.7	4.4	1.8	2.3	4.0	1.0
2011	2.8	2.9	5.6	5.9	1.7	2.8	3.7	0.6
2012	2.7	2.2	4.0	4.0	1.5	2.3	2.8	0.8
2013	2.7	2.5	4.0	4.7	1.7	2.3	3.0	0.8
2014	2.4	2.2	2.8	3.6	1.4	2.2	2.6	1.2
2015	3.6	2.9	5.7	6.8	2.8	1.7	2.2	1.6
2016	3.5	2.8	5.3	5.8	2.5	1.6	1.6	1.9
2017	2.7	2.6	3.7	4.3	1.9	2.1	1.3	1.1
2018	1.2	0.8	-0.3	0.8	1.0	-0.6	1.7	1.0
2019	1.7	1.2	0.8	0.8	1.4	0.6	1.3	1.0

Source: UNCTAD (United Nations Conference on Trade and Development) (2012a). World Bank (2022b). Prepared by author.

As shown in Figure 14, with the exception of 2016, in all years of the series, FDI inflows as a proportion of GDP were higher than outflows. This is evidence of the strength of the Chinese economy and its resilience to the Great Recession that affected all economies globally.

Figure 14. FDI in China, net capital inflows and outflows (% of GDP)



Source: Table 4. Prepared by author.

In contrast to China, in the case of the EU, all years exhibit a deficit in the flow of FDI inflows and outflows, except 2012, when they were equal. With respect to the U.S. with the exception of 2008, when they were equal, in all years between 2007 and 2014 outflows exceeded inflows, although from 2015 onwards the trend changes and FDI inflows outstripped outflows, with the exception of 2017, which saw a slight increase of just 0.2% relative to GDP.

In China, a major downward effect on its economy was avoided, as the Chinese central government managed to open up new sectors to FDI, putting in place new laws and regulations, as well as a series of accompanying administrative reforms (Yue, 2009). China remained the main destination of foreign capital, which came from more than 190 countries around the world and, at least since the final decade of the 20th century, has been increasing steadily, with the sole exception of a US\$ 13.3 billion drop between 2008 and 2009 (Table 5).

Table 5. China. FDI Flow

	Billions of US dollars
2007	83.5
2008	108.3
2009	95.0
2010	114.7

Sources: NBS (2010). UNCTAD (2012b). Prepared by author.

To explain this situation, there were a number of important features at work in the successful management of the Chinese economy. Banks were very cautious about investing in financial derivatives, thereby managing to limit their risk exposure in the trading of U.S. mortgage-backed securities and mortgage-backed debt obligations. In this way, they maintained robust growth with sound finances in a very volatile international economic environment. In fact, in 2008, behind the Industry and Commercial Bank of China, three other major Chinese state-owned banks ranked among the top five most profitable banks in the world.

China's central government injected US\$ 19 billion at the end of 2008 in order to reduce overdrawn and under-performing loans in its banking system, and in 2009 it decided to accelerate the reform of the most troubled state-owned bank, the Agricultural Bank of China.

The deft economic management of previous years, the high trade surplus and the progressive flow of FDI helped China to accumulate large foreign exchange reserves, allowing it to tackle the crisis with considerable flexibility and a very expansive fiscal policy.

Finally, China's political model, dominated by the communist party, facilitated the ability to react smoothly and quickly to rebuild its economy (Xie, 2007). In this way, it demonstrated to the rest of the world its power to ensure economic success.

The Chinese example of emerging from the international economic crisis can be explained by a growth strategy based on two essential aspects: international trade and investment. To this can be added the momentum of its high-tech industrial sectors (Xiaolan and Balasubramanyam, 2005).

Macroeconomic factors, the capacity of its financial system and the interventionist policy of the Chinese central government to stimulate the economy favoured not only recovery, but also a high growth rate. The state's involvement in the economy is fundamental and partly explains the reasons for the success of the Chinese method to save itself during the crisis.

The application of massive incentives to stimulate the economy proved feasible thanks to the strength of a fiscal position supported by the huge trade surpluses accumulated over many years. This was particularly true for 2008, when the stimulus package used was much larger compared to advanced economies in the West.

The reforms carried out for the modernisation of the Chinese economy led to a significant improvement in the banking system, especially in relation to the maturity of the securities portfolio. The system has one of the largest foreign exchange reserves in the world, amounting to US\$ 2.4 trillion at the end of 2009.

Falling commodity and food prices during 2009 helped boost China's imports. Falling oil prices allowed them to increase their reserves, while the global shortage of financial resources reinforced their foreign investment strategy. Moreover, as the Chinese financial system was not too closely connected to the international market, its economy did not experience the most damaging effects of the global financial crisis. But state intervention was crucial for the management of the financial market in terms of maintaining a very cautious position in deciding where and in what to invest.

Conclusions

The Great Recession of 2008-2009 had different economic impacts. It was triggered in the U.S. economy by the unrecovered debts of the so-called *subprime* mortgages. These spread first throughout its financial system and then around the world through credit networks. Ultimately, it affected demand in the U.S. with the consequent loss of employment and investment. The result was a severe economic recession that spread not only through financial channels, but also through trade with other countries.

One of the main challenges for the U.S. was that it had to rebuild its capacity to grow and create jobs. Likewise, it had to control its borrowing capacity as well as its fiscal deficit. The latter represented the main difference with previous U.S. recessions, in terms of the burden of indebtedness on subsequent growth.

All economies, both in Latin America and Asia, placed the concept of trade policy as a strategic focus rather than subordinating it to a development policy. In Latin America, the fall in the terms of trade was well managed, and China was able to confront the Great Recession thanks to its enormous financial power.

But it is also true that, although the economies of Latin America and China fared well in the critical juncture of the global crisis, they face structural problems that cannot

be avoided in the future. The most important of these is inequality between urban and rural areas, where per capita income in cities is much higher than in rural areas. Another problem is the unsustainable exploitation of their natural resources. Last but not least, there is the dilemma of corruption and the democratic deficit in the political-institutional sphere.

From a historical perspective—and before the COVID-19 crisis—the years 2008 and 2009 turned out to be among the most difficult years that economic globalisation had faced in a long time. Almost none of the most advanced European economies escaped sharp declines in economic growth. However, the EU's economic model and the appropriate direction of its economic policy avoided the worst consequences of the first phase of the Great Recession and enabled a recovery in the second phase from 2012-2013, defusing the most negative consequences of the crisis that began in 2008.

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