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“The United States in its Latin American Days”

The American financial crisis of 2008 should seem familiar to Latin Americans, for it is very similar to the debt crises that have plagued Latin American countries for decades. The government led the way, borrowing heavily from foreigners to finance large deficits. The private sector followed, using foreign funds to expand consumption, especially in the housing market. The five trillion dollars that the United States borrowed abroad after 2000 allowed the country to live beyond its means for a decade. It consumed more than it produced, invested more than it saved, and the government spent more than it took in. The foreign debt financed a major economic expansion, then a boom, then a bubble, especially in finance and real estate. The bubble has now burst, and the economy is spiraling downward.

The inevitable fallout of a financial crisis is also well known to Latin Americans: stabilization, adjustment, and reform. We are now in the stabilization phase, whose principal task is to limit the immediate damage and keep the economy from further collapse. This phase highlights one great difference between the current American debt crisis and previous Latin American ones: the American crisis has not led to a sudden cessation in the willingness of foreigners to lend to the U. S. government. This means that the government can use aggressive deficit spending to try to stimulate the economy and lessen the blow of the crisis. This is very good news, both for Americans and for the world. If the U. S. government were unable to borrow, the recession would undoubtedly be much deeper, and its impact on the rest of the world would undoubtedly be much more serious. Nonetheless, it is almost certain that there will be a very severe recession in the United States, and it will probably be at least two years before the U. S. economy begins to grow again.

Even after economic growth is restored, however, the United States will confront the challenges of medium-term adjustment. For the country’s economic position has been unsustainable for years. Every year since 2001, the United States has borrowed between half a trillion and a trillion dollars from abroad. This money has gone to finance the government’s massive deficits, and the country’s enormous trade and current account deficit to the rest of the world. This cannot go on much longer. Once the immediate crisis fades, the government will have to reduce its budget deficit, and the country will have to start consuming less
and saving more, importing less and exporting more. Again, this should sound familiar to Latin Americans, who have lived through such experiences. They are never pleasant. In the United States, the process will require pushing taxes up and government spending down, forcing wages down to increase exports, and driving interest rates up to encourage saving. In all, the result will be a dramatic reduction in the real living standard of many Americans. But the adjustment is necessary to restore macroeconomic balance.

Macroeconomic adjustment will not be the end of the aftermath of this crisis, for the country’s economic institutions are in need of more fundamental reform. First and foremost is the demand for more comprehensive and effective regulation of financial markets. Before the crisis is fully over, American taxpayers may have to pay out two or three trillion dollars to bail out the country’s financial system. Americans are adamant that this experience cannot be allowed to happen again, and that an absence of regulatory oversight was largely responsible for the disaster. So Congress, the President, and the regulators will need to work out a new regulatory structure – probably in concert with governments in other nations – to confront the new financial realities.

None of these three stages will be easy. Together, they amount to a dramatic turn away from the policies of the Bush years. There will be more government involvement in the economy, and more public oversight of financial markets. There will also be higher taxes and lower spending, as the fiscal nightmare of the past eight years is gradually unwound.

While the economic challenges facing the United States are serious, the political challenges may be even more daunting. For the crisis is certain to inflame powerful political passions. Already before the crisis, there was great resentment over the increasing gap between rich and poor in the United States. For most of the benefits of the economic expansion of the past ten years went to the wealthiest ten percent of the population, while the conditions of average Americans did not improve very much.

Now Americans are being asked to sacrifice in order to make up for the excesses of the country’s financial system. Rich Americans were the principal beneficiaries of recent economic policies. Once the policies failed, it was middle class and poor Americans who were asked to bail out the economy, and to support those who drove the country into its current crisis.
Whether this point of view is fully justified or not, the fact is that many Americans share it. Americans are angry, and the new administration will have to address the anger of the American middle class, even as it works to restore the confidence of domestic and foreign investors in the United States. This will be an extraordinarily difficult undertaking. The new administration is faced with the task of putting the American economy, and the American political system, on a healthy path to recovery. President-elect Obama has a great reserve of good will, at home and abroad, upon which he can draw; he will need it all as he and his administration work to renew the American political economy.