Latin Lessons

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There will be a total solar eclipse next month which, at six minutes and 39 seconds, will last longer than any other this century. Will the current global financial crisis be Latin America's and the rest of the world's darkest economic period this century?

Back in October 2008 (Politics and Perceptions – Issue 190), I finished my column with a positive report on the state of health of the economy in Chile and I quoted its finance minister, Andrés Velasco, who expressed the belief that you would "be hard pressed to find any country in the world with better public finances". Several months later, I am reminded of his remarks as I watch the developments following the G-20 meeting held in London on the second and third of April at which the leaders of the world's 20 most important economies were all present. Perhaps the second of April was thought to be a better day to start the meeting than the day before which happened to be April Fool's Day – although whatever the day and whatever the month, feeling foolish for some members of the G-20 must surely have been a given.

Many assumptions this year have been knocked on the head; more people understand that (with few qualifications), it matters not where the professional is located, but that he is truly professional (and competent). Whether or not he uses a laptop in Lapland, it is not the address, but the advice, that is key. As I highlighted last month (Colombia: A Developing Story – Issue 196), a country's high level of sophistication or development is no guarantee of either probity or investor security and now, as we know, this includes its economic health. Many financial commentators have picked up on this in regards to emerging markets (I will return to Chile's economy) and see some of today's developed countries experiencing a role reversal.

As Chairman of the Panama-British Business Association, I witness the frequent expressions of surprise from visiting foreign businessmen and government officials coming to Panama for the first time. They are especially impressed with the banking industry which is strong and where orthodox lending practices prevail in line with the thinking of Walter Bagehot, the British nineteenth century author and banker:

> *"The business of banking ought to be simple; if it is hard it is wrong. The only securities which a banker, using money that he may be asked at short notice to repay, ought to touch, are those which are easily saleable and easily intelligible".*

Mortgages and derivatives are not mentioned in the same breath by bankers in Panama.

During the last decade, both the United Kingdom and the United States of America are two clear cases which reveal how increasing current account deficits, together with strong domestic investment (particularly in housing), but weak domestic saving, can be the road to ruin. As government budget discipline became more lax and credit became easier to obtain, the valuation of assets began to become distorted and unrealistic. In America alone the McKinsey Global Institute believes that between 2003 and the third quarter of 2008, households borrowed USD2,300 billion of home equity. It was the British prime minister, Sir Robert Walpole, who introduced the funding system in England during the early eighteenth century which revealed that it was possible to perpetuate government debt. What was needed was a reliable source of revenue which could be used to pay the annual interest as well as the principal of maturing bonds. Every redeemed bond was then replaced by selling a new one. We know that this system was eagerly taken up by the US also and we know its results.

One of the outcomes of the G-20 meeting in April was to place all of the no-tax and low-tax jurisdictions in the spotlight in relation to bank secrecy. At the time of the meeting, two Latin American countries had been unwilling to co-operate with the Organisation for Economic Co-operation and Development on the question of sharing bank information for tax purposes. One was Costa Rica, which is a tourist, not a banking, destination and the other was Uruguay, a country with a successful private banking industry. Uruguay was featured in my March column (The Land of Oxo – Issue 194) and if as I described it, it is the Land of Oxo, then surely in 2009 the US, being the ground zero of the world's stock and property market meltdown, has to be the Land of the Oxymoron.

It was the American comedian, Groucho Marx, who said that military intelligence is a contradiction in terms, I can think of other examples in 2009: "safe as houses", "good as money in the bank", they both ring hollow in 2009 as does coupling a AAA grade investment with the words "maximum safety" when pronounced by one or more of the leading credit rating agencies following their bungling of derivative valuations. Back in 2002, Warren Buffett had warned that derivatives were "toxic" and "potential time bombs". His business partner and very close friend, Charlie Munger, also added: "To say derivative accounting in America is a sewer is an insult to sewage". It would seem that the rating agencies lost their sense of smell during the last few years. When will they get it back? Meanwhile, how should we rate their ratings? These agencies, after all, had the same mesmerising effect on unsuspecting and vulnerable investors (widows and orphans come to mind) as the Pied Piper of Hamelin had, in Robert Browning's poem of the same title, who played his three hypnotic notes that entranced a town's children and also delivered a powerful moral message.

Some play hypnotic notes whilst others read from them. I recall past remarks made by the former Chairman of the Board of Governors of the Federal Reserve System in the US, Alan Greenspan, who stated: "Derivatives have permitted the unbundling of financial risks" and who felt that the use of a growing array of derivatives "and the related application of more sophisticated approaches to measuring and managing risk are key factors underpinning the greater resilience of our largest financial institutions". Mr Greenspan said this in May 2005, and in his book, *The Age of Turbulence,* he refers to lots of small, local bubbles that "never grew to a scale that could threaten the health of the overall economy". But he also admitted in 2007 (the year financial woes started and his book was published), that as Federal Chairman his use of the word "froth" in respect of a few problem areas in the US economy, when others were seeing a bubble, really had amounted to the same thing.

Five days before the April G-20 meeting in London, both the US vice president and the British prime minister, including other leaders from Europe and South America, travelled to Chile. On the agenda was a round table discussion about the world's financial crisis and the venue was appropriate because Chile is a country that many foreign politicians can learn lessons from. It is almost 20 years since the Pinochet dictatorship (an aberration in a country with a long democratic tradition) came to an end, and about 40% of the population still lived in abject poverty, whereas today, the proportion is around 13%. Since 1990, the country has experienced a succession of stable centre-left governments during which time economic growth has averaged five per cent per year; from having 20% of the country's public spending go on servicing debt, Chile today enjoys budget surpluses. It has one of the world's most open economies with a privatised pensions system and its elderly are guaranteed a minimum income. Chile's finances have benefited from a blend of "right-wing" economic policies and social values readily identified with the left.

It should be remembered that long before the meeting in Chile both the US and Europe were lecturing Latin American countries about fiscal recklessness, unregulated banks and opaque financial markets. So at the meeting in Viña del Mar in Chile some South American leaders were harsh in their comments; the Brazilian president blamed foreign bankers, and in particular the US, UK and Spain, for bringing five years of economic growth in Latin America to a halt.

Perhaps Messrs. Brown and Biden – not to mention others – should think about including Chile's 2006 Fiscal Responsibility law as part of their bedtime reading.

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ISSN 0954-0628 US PS 002-273.

Printed by Pensord Press Limited, Pontllanfraith, Blackwood, Wales, UK. *Offshore Investment* has tried to ensure that all information contained within this publication is accurate, however, the publisher would emphasise that he cannot accept responsibility for any mistakes or omissions. No legal or investment instruction is intended. The opinions expressed are strictly those of the authors. *Offshore Investment* **USPS 002-273** is published monthly except July and December by Offshore Investment, Lombard House, 10-20 Lombard Street, Belfast, BT1 1BW, United Kingdom. The 2008 US annual subscription price is USD790. Airfreight and mailing in the USA by Agent named Air Business, C/O Worldnet Shipping USA Inc., 149-35 177th Street, Jamaica, New York, NY11434. Periodicals postage paid at Jamaica NY11431.

US POSTMASTER: Send address changes to Offshore Investment, c/o Worldnet Shipping USA Inc., 149-35 177th Street, Jamaica, New York, NY11434. Subscription records are maintained at Offshore Investment, Lombard House, 10-20 Lombard Street, Belfast, BT1 1BW, United Kingdom. Air Business Ltd is acting as our mailing agent.

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