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# Book reviews on global economy and geopolitical readings

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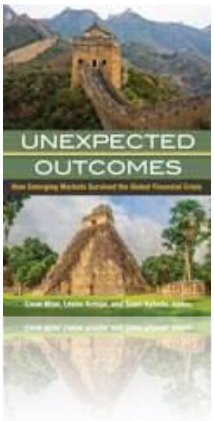
# Unexpected Outcomes: How Emerging Economies Survived the Global Financial Crisis




**Wise, C., Armijo, L.E., Katada, S.N. (2015), Brookings Institution Press, Washington DC.**

*"The combination of prior market reforms and fortuitous countervailing factors provided unprecedented policy leeway, especially in the Latin American cases, to pragmatically tackle the challenge of the global financial crisis in more flexible, nondoctrinaire ways."*

## Summary

The extraordinary resilience of emerging economies in East Asia and Latin America during the 2008-09 global financial crisis surprised most economists and political analysts. Their economic performance and rapid recovery marked a starting point that was completely different from previous recoveries, which had been both slower and weaker. The debt crisis of 1982, for example, pushed Latin America into a deep and decade-long recession. In Asia, the financial crisis of the late 90s caused a dramatic decline in emerging economies. However, in the latest crisis, emerging nations in both regions showed great strength, and their economic revival resulted in a landscape in which in 2010 more than half of global GDP growth came from these nations.

Why was it different this time? To answer this question, the authors of *Unexpected Outcomes: How Emerging Economies Survived the Global Financial Crisis* studied outcomes in China, South Korea, India, Brazil, Argentina, and Mexico during and after the global financial crisis. One clear lesson is that the old labels of 'neoliberal' versus 'developmentalist' do not accurately capture the strategic fundamentals of recovery. The good results were the result of a combination of previously enacted macroeconomic, financial, and commercial reforms that enabled the economies to creatively combine market- and policy-based solutions, and respond with greater flexibility and effectiveness to the crisis. Moreover, the authors also emphasise throughout the book that while most avoided the "when America sneezes, emerging economies catch pneumonia" syndrome, it would be an error for these nations to become complacent, given that past performance cannot guarantee similar results in the future.

## The authors

**Carol Wise** is an associate professor of international relations at the University of Southern California. She is co-editor (with Isabel Studer) of *Requiem or Revival: The Promise of North American Integration* (Brookings, 2007). **Leslie Elliott Armijo** is a visiting professor at Portland State University and non-resident professor at the Center for Latin American and Latino Studies at the American University. **Saori N. Katada** is an associate professor of international relations at the University of Southern California.

## Key ideas and opinion

**Both Asia and Latin America have experienced great difficulties recovering from past economic shocks.** The most recent memories are the **debt crisis of 1982** in Latin America and the huge decline in Asian economies after the **financial crisis of the late 90s.** In both cases, there were major political debates about what went wrong and what could be done to restore stability and growth. Explanations of the crisis differed with respect to the weight given to national/institutional variables against international/systemic variables in causing the crisis. **The first variable (national/institutional) placed the blame on sovereign borrowers in failing** to channel the funds provided by foreign commercial banks to the macro-stabilisation projects and micro-economic restructuring for which the loans were agreed. **The international/systemic explanation blames international financial institutions** for imposing on borrowers almost all the costs caused by their own poor lending decisions.

The resulting policy recommendations naturally differ depending on the preferred explanation. These policies also reflected the **classic division between neoliberals, who advocated economic openness and market solutions to the crisis, and developmentalists, who called for public policies and strategic state interventions**. When the need for massive rescue packages from the International Monetary Fund (IMF) in both regions became apparent, it was **the calls for market liberalisation that prevailed**. Most countries had to adopt austerity measures to adjust their balance of payments. The authors of *Unexpected Outcomes* explain how these measures gradually evolved into what we know today as the "**Washington Consensus"**, a package of measures based on liberalisation, privatisation, and deregulation that by the late 1990s had already been implemented to varying degrees in developing and post-communist nations.

**Both ideological positions seem to be claiming victory in recent discussions on the good performance of emerging countries during and after the 2008-09 crisis. The market-oriented analysts point to the success of previously executed neoliberal reforms** in helping to protect the financial sectors in emerging economies from contagions, as happened in Mexico when the peso collapsed in 1994. The fact that the most recent contagion came from the US, and then Europe, made the macroeconomic stability and growth of these countries even more impressive. And even though the global financial crisis revealed major market failures in the OECD bloc, pro-marketers were still quick to claim as their own victory the rapid recovery of emerging nations. However, **those with a more heterodox position argue that the economic performance of the emerging countries is due to innovative and strategic public policy interventions. The approach taken by Wise and her two co-authors is halfway between these two positions.** The responses of individual countries defy easy categorisation, but **the general trend has been to adopt pragmatic and flexible policies, rather than rely on the rigid dogmas that previously prevailed.** In this book, the authors focus on analysing the regional leaders, as well as the major emerging economies in Asia and Latin America.

## Southeast Asia

The analysis of the Southeast Asian bloc begins with **China**, the top destination for foreign direct investment among emerging markets. In just a decade, China has gone from being one of the least significant high-tech exporters to world leader. Not surprisingly, the authors emphasise that **China has been instrumental in the recovery of the global economy since the 2008-09 crisis.** The fiscal stimulus in China was implemented alongside stimulus packages in the United States, Japan, and Germany. **When the global crisis hit Chinese trade, the country's rulers became fearful of the social instability** that could be caused by an economic slowdown and the resulting increase in unemployment, leading them to rapidly implement a vast stimulus package. This, according to the authors, **was only possible because the Chinese had previously made credible macroeconomic reforms**. Moreover, previous reforms in the financial and banking system enabled the stimulus to be launched through state banks and other government-controlled financial mechanisms. Thus, since 2010, the focus of Chinese economic policy has moved away from monetary tightening and towards expansion and mini-stimuli.

Ironically, while **Chinese countercyclical policies did not follow neoliberal prescriptions, the strategy worked, and was even praised by international financial institutions.** The strategy also served as an impetus for other emerging economies in Asia and Latin America. However, Wise et al. argue that **it remains to be seen if Chinese leaders can effectively control the long-term consequences of the global financial crisis. Two fundamental challenges** must be tackled to ensure political and social stability, as well as economic growth. Firstly, the organisation of local finances seems, according to the authors, dysfunctional and unsustainable. **Local governments' emphasis on selling land-use rights to increase income is a recipe for price bubbles, corruption, and popular protest in the long term.** Secondly, although access to healthcare and social services has improved, many citizens feel very uncertain that they will have access to healthcare when they need it. Some 500 million people are at risk of falling into absolute poverty if they, or a family member, need medical attention or fall ill. **Until China guarantees the provision of basic social services, millions of people (especially in rural areas) will continue to choose saving over other options.** The authors emphasise that whatever reforms are undertaken by China, it seems unlikely that a neoliberal path will be chosen given the country's history.

In **South Korea**, financial and macroeconomic reforms implemented after the crisis of the late 90s are, according to the authors, the best example of policy learning. The almost complete financial liberalisation of South Korea left the country vulnerable to capital outflows when the crisis erupted in 2008-09. However, a **bank restructuring plan that had been implemented after the Asian financial crisis crucially enabled the financial system to maintain a strong capitalisation and very low delinquency rates, and it was left holding very few toxic assets**. The previous policy of monetary tightening also gave the nation the ability to lower interest rates during the most difficult moments of the crisis. **In addition, no bank needed rescuing. Quite the contrary: banks helped implement countercyclical measures and prevent financial shock**. For trade, South Korea relied on China, which became its biggest partner, and this helped offset falling demand from Europe and America. **The Korean case shows, for the authors, that a liberalised and well-managed economy can successfully weather an international financial crisis.** Moreover, while government controls are not necessary, their actions from the sidelines can be useful, as evidenced by Korea.

During the first decade of this century the **Indian** coalition government resisted liberalisation and the deep reforms needed by the banking and financial system. From a positive perspective, the **fact that Indian banks and financial institutions had little to no exposure to mortgage securities and other toxic assets from Wall Street enabled the country to resist the impact of the financial crisis.** From a negative perspective, **the severe credit crunch in Europe and America made it difficult for Indian companies to obtain credit**. Wise and her co-authors emphasise that national elections coincided with the start of the financial crisis. In anticipation of the elections, the government had already adopted **expansionary economic policies**, which remained in place when the crisis hit. This monetary expansion, however, generated a growing **deficit**, persistent **inflation**, a major **depreciation** of the rupee, and huge **outflows of portfolio investments**. To counteract these effects, the Reserve Bank of India (RBI) **raised interest rate ceilings on foreign currency deposits** and lifted restrictions on external commercial borrowings. According to Wise et al., **the political responses were far from perfect, but they still helped the country to overcome the crisis.** The recovery was furthermore boosted by an unorthodox (but very fortuitous) policy mix that combined modest liberalisation reforms, state bank lending, prior commercial policies that reoriented trade towards Asia, debt cancellations because of elections, and public employment projects. India also fought the crisis **by combining market- and policy-based solutions**. The authors of *Unexpected Outcomes* report that as a whole, these policies created sufficient room for macroeconomic manoeuvring.

## Latin America

Despite the diversity of Latin American nations, **the bloc as a whole differs from Asia in at least two important respects.** Firstly, it has shown **greater affinity with the type of reforms advocated by the Washington Consensus since the 1990s** (policies to reduce public debt, eliminate trade barriers, deregulate commercial banks, and encourage expansion of stock markets). A second difference is that, generally speaking, **Latin America has benefited from the commodity boom that began in 2003.**

Yet not all Latin American nations have shared the same fate during the crisis. **Brazil, Chile, Colombia, and Peru enjoyed better results than Argentina or Venezuela.** Before the financial crisis, the first group had carried out macroeconomic reforms, significantly modernised their financial sectors, and achieved some diversification in trade (including stronger ties with China). Focusing on **Brazil**, Wise et al. explain that **the nation had achieved a gradual economic liberalisation and structural reform since the 1990s.** It had reformed its banking and financial system, adopted macroprudential measures to control inflation, revised the tax system, and floated the exchange rate. Brazil did not lose sight of these objectives during the 2008-09 crisis. A tight monetary policy was used to combat inflation, and steps were taken to prevent speculative capital inflows. In addition, the Brazilian Development Bank added liquidity to the economy through the public banks. **That is, Brazil implemented a pragmatic combination of policy-based solutions and market-based solutions. However, the authors point out that the "success" of these policies is fading due to the current reform paralysis**. As an example, the authors state that if Brazil does not encourage higher rates of savings and investment, as well as reduce the vast amount of red tape, then the nation risks sliding into a period of slow economic growth.

**Argentina and Venezuela, meanwhile, carried on with the populist strategies and expansionist policies that they have been activating at intervals over the last two decades.** This approach helped them to reduce the effects of the crisis, but its application was disjointed and did little to ensure sustainable growth. Focusing on **Argentina**, the authors point out that the country **implemented rapid market reforms in the early 90s,** in line with the Washington Consensus. However, they note that **fixing the exchange rate** from 1991 to 2001 **distracted the nation from the fiscal, social, and general macro prudential reforms** that were needed. **A fortunate commodity boom** helped the country to balance its budget, and be able to respond with a large fiscal stimulus when the crisis hit. Wise et al. emphasise, however, that **instead of trying to regain macro stability, the government in power since 2003 chose the populist path**

and so buried any type of legacy that may have arisen from the macroeconomic and financial reforms the country achieved in the 1990s. **Argentina returned to a traditional financial repression, including negative interest rates, double-digit inflation, multiple exchange rates, and controls on the entry and exit of capital.**

Finally, the authors highlight the **group of nations in the region with much stronger links to the United States**, and which therefore experienced much slower recoveries, as is mostly the case of Mexico and Central America. Specifically, the authors focus on **Mexico**, the most affected country, and **emphasise not so much the reforms undertaken by the country in the 2000s, but the favourable factors that enabled Mexico to accumulate foreign exchange reserves and strengthen its balance of payments**, namely: strong economic growth in the United States, rising oil prices, and high remittances from Mexicans working abroad. The structural reforms undertaken in previous decades were especially neoliberal and facilitated the relatively rapid recovery of Mexico after the financial crisis. In particular, **the framework of macroeconomic stability** (low inflation, flexible exchange rates, low public debt, and low fiscal and current account deficits), **along with the trade liberalisation policies of the mid-80s and early 90s, were fundamental in encouraging an export-led recovery**. This does not mean, however, that the Mexican economy is in a privileged position. For the authors, the country remains very vulnerable to external shocks, especially those from the United States. Moreover, **the economic framework does not have the tools necessary to respond effectively to a crisis**. This is mostly due to zero-fiscal deficit legislation and a strict anti-inflation mechanism that prevents implementing monetary and fiscal countercyclical policies to mitigate the effects of a crisis. For that reason, Wise and her co-authors **recommend that the nation continues with reforms, diversifies its trading partners, and modifies its institutional framework for macroeconomic policies**.

## Conclusion

From their analysis of this set of countries, the authors of *Unexpected Outcomes* draw the following general conclusions:

1. **Macroeconomic reforms** prior to the global financial crisis, which ensured low inflation and reasonable levels of public and external debt, were crucial for surviving the immediate effects of the crisis, both in Asia and Latin America.

2. **Reforms implemented prior to the crisis in the banking and financial sector** helped prevent financial crises. However, there is no evidence that more liberalized national or international regulations were better than policies that accumulate foreign exchange reserves (to prevent attacks on the national currency) or rely on publicly-owned banks providing liquidity to the private sector.

3. **Policies of trade liberalisation** implemented before the crisis encouraged growth and trade diversification. However, it is difficult to establish a direct link between these reforms and the ability of a nation to survive an acute financial crisis.

4. **International factors,** especially the commodity boom and low interest rates in major economies, have tended to favour the major emerging economies.

5. **Institutional innovations and lessons learnt during past crises** have enabled emerging economies to better respond to the global crisis of 2008-09.

6. **Labels such as "neoliberal" and "developmentalist"** are becoming less relevant. Since 2000, politicians from various nations in these two blocs have stepped out of their comfort zone to adopt a combination of approaches based on market- and policy-based solutions.

7. Finally, the general trend that emerges is one of **greater flexibility when crossing conceptual barriers and political approaches**.