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Good-Bye financial crash, hello financial eclecticism: Latin American responses to the 2008–09 global financial crisis☆

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ABSTRACT

1985 saw the publication of Carlos Díaz-Alejandro's classic article, "Good-Bye Financial Repression, Hello Financial Crash" (1985). Writing in the wake of drastic financial blowups in the Southern Cone, Díaz-Alejandro nonetheless argued that "a *believable* alternative system could be designed, avoiding many of the inefficiencies of financial repression … and blending both public and private financial agents" (18). Nearly three decades after the publication of this prescient work, there are credible signs that such an arrangement is now emerging within some Latin American emerging economies (EEs). Just as Díaz-Alejandro studied how the 1982 debt shocks both exacerbated and shed light on financial sector policies and institutions in the Southern Cone countries, we use the 2008–09 global financial crisis (GFC) as a lens through which to examine the policymaking capabilities of six Latin American countries. We find that several of the countries successfully weathered the 2008–09 financial shocks and argue that this is due to: institutional modernization that facilitated policy learning and a more business-friendly climate; and, to sustainable improvements in income distribution that may have facilitated consensus-building. These factors, we suggest, gave

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policymakers both the expertise and the political space to employ more nuanced fiscal and financial policies.

1. Introduction

Our title is obviously a play on words and meant to infer how financial policy-making in Latin America has been transformed since the publication of Carlos Díaz-Alejandro's (1985) classic article, "Good-Bye Financial Repression, Hello Financial Crash." This highly influential piece noted how earlier attempts to rid various Latin American countries of financial repression—which refers to a cluster of policies (below-market interest rates, high reserve requirements, taxes on securities transactions, and regulations on cross-border capital flows) meant to channel funds away from borrowers and into government hands (Reinhart et al., 2011) – had themselves inflicted severe economic stress. Indeed, when Latin America was rocked by debt shocks and world recession in the early 1980s, recently liberalized financial systems could not withstand the strain and buckled under a mix of high debt, capital flight, and chronically mismanaged macro policies.

Given that experience, Díaz-Alejandro sagely warned against the pitfalls of doctrinaire approaches to financial liberalization and called for a more pragmatic and eclectic style of economic policy-making in Latin America. As such, he might be pleased to know that at least some Latin American countries have taken him up on this charge. While the 2008–09 global financial crisis (GFC) might have been expected to throw Latin America into yet another economic tailspin, the effects were short-lived. The region had largely rebounded by 2010, rendering this a far cry from the decade-long recession that followed the 1982 debt shocks in Latin America. The GFC, in essence, tested the depth and resilience of market-oriented, institution-building and social policy reforms that had been undertaken in this region beginning in the early 1990s, initially under the auspices of the "Washington Consensus" (WC) (and since modified in local fashion with left-leaning executives like Brazil's Luiz Ignácio Lula de Silva and Chile's Michelle Bachelet simultaneously seeking to address poverty and guarantee macroeconomic stability).

Indeed, on the eve of the GFC, measures of financial liberalization in Latin America were actually higher than in the usually more celebrated Asian countries (see Table 1). The bottom line: countries like Brazil, Mexico, and Peru, having liberalized and deeply reformed their respective financial sectors, now had the policy expertise (and, we suggest below, the political latitude) to flip the script temporarily and impose pragmatic "tax-like requirements" to discourage volatile capital inflows and certain types of unwanted international financial transactions (Díaz-Alejandro, 1985). In fact, countries such as Brazil and Chile have been identified by Frankel et al. (2013) as "recent graduates" in a larger class of emerging economies (EEs) that have successfully weathered the GFC by relying on a combination of counter-cyclical fiscal measures and macro-prudent financial policies (Nier et al., 2011; Vegh and Vuletin, 2013). While "still in school," even Mexico and Peru have implemented some counter-cyclical fiscal and financial policies and produced respectable growth rates in the wake of the GFC. At the same time, remaining outliers like Argentina and Venezuela confirm that vestiges of the past are still present; in the current lexicon, the policy recklessness displayed by both would perhaps best be categorized as macro-profligate (Wise and Lins, 2015).

Thirty years ago, Díaz-Alejandro argued that "a *believable* alternative system could be designed, avoiding many of the inefficiencies of financial repression … and blending both public and private financial agents" (1985, 18). In this essay, we consider the extent to which this has happened by exploring the diverse paths taken by six key Latin American economies (see Table 1). We focus on this group of countries (Argentina, Brazil, Chile, Mexico, Peru, and Venezuela), first, because together they represent over 80 percent of GDP for the entire Latin American region; second, because all were the site of dramatic macroeconomic instability and political conflict during earlier eras of reform; and third, because in the current environment, they run the gamut from reform laggards (Argentina and Venezuela) to earnest reformers (in varying degrees, e.g., Brazil, Chile, Mexico, and Peru).