POLICY RESPONSE TO THE 2008-09 GREAT RECESSION IN ARGENTINA AND BRAZIL: A COMPARATIVE ANALYSIS OF POLICY OBJECTIVES, INSTRUMENTS, AND OUTCOMES

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1. INTRODUCTION

The Argentina-Brazil relationship is both close and historical. As two major economies in Latin America, both countries implemented policy responses to counteract the impact of the 2008-09 Great Recession, but they have different economic structures and institutional patterns (Vegh & Vuletin, 2014). This paper aims to conduct a comparative analysis of their policy responses based on the Calomiris & Haber Theory, with which I proposed that though a series of policy measures can help mitigate the immediate impacts of a financial crisis, political institutions may play a more significant and enduring role in rising to the challenge of the crisis.

2. LITERATURE REVIEW

The Great Recession was a global economic crisis that had far-reaching impacts on economies around the world, which resulted from a range of factors including relaxed monetary policies, worldwide imbalances, inaccurate assessment of risks, and inadequate financial regulations (Figure 1)(Verick & Islam, 2010). I chose Argentina and Brazil for comparison due to their similarities in experiencing the impacts of the Great Recession and their subsequent policy responses. They also share certain characteristics such as being major economies in Latin America, with high levels of income inequality, structural vulnerabilities, and a history of economic instability (Pastor & Wise, 2015).

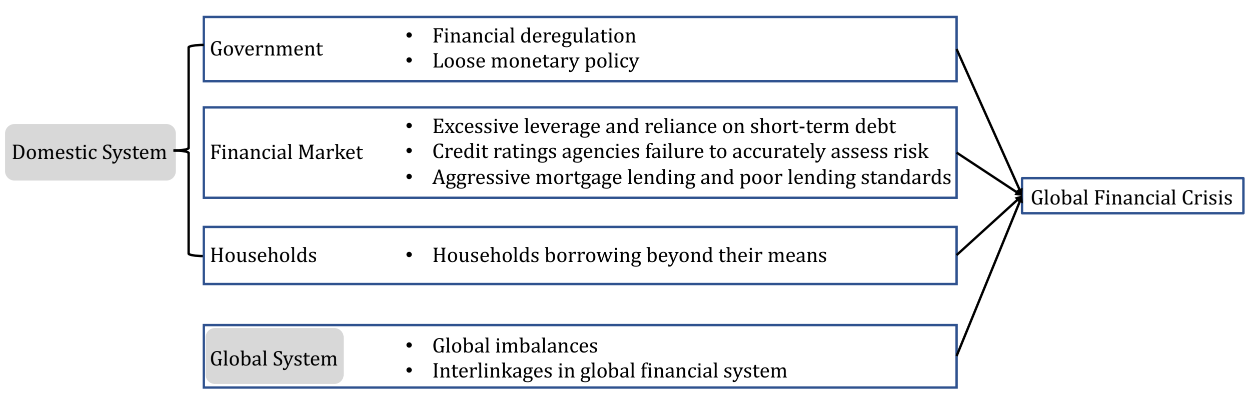


Figure 1. Key factors behind the global financial crisis (Verick & Islam, 2010)

Policymakers in Argentina and Brazil made active policy responses and adaptations to the financial crisis, where they employed a mix of fiscal, monetary, and financial sector policies to stabilize their economies, but their detailed approaches to mitigating the impacts of the Great Recession are different (Haines et al., 2020).

In Argentina, the government increased government spending, particularly in subsidies to the private sector and infrastructure expenditures, while reducing income tax for middle-income families. The private retirement system was nationalized, and benefit payments were adjusted to inflation rates. The (Central Bank of Argentina) CBA raised interest rates to control the money supply in 2008, but this approach was relaxed in 2010 with measures to expand liquidity and lower interest rates.

In contrast, Brazil implemented liquidity-enhancing measures and foreign exchange interventions by the Brazilian Central Bank (BCB) to avoid credit crunches. The state-owned banks were encouraged to expand credit operations, compensating for the deceleration in credit supply from private banks. The Ministry of Finance implemented fiscal measures such as tax reductions on certain products and an increase in the duration of unemployment insurance. The BCB eased monetary policy with a delayed lowering of the basic interest rate.

Both two countries formulated and implemented effective countercyclical macroeconomic policies in response to the crisis (Figure 2)(Ignatov, 2020) and recovered strongly in 2010. However, economic growth has been uncertain since then, due to both domestic issues and the slowdown of the world economy. Overall, the effects of countercyclical macroeconomic policies were partially efficient in cutting off the duration and intensity of the crisis (Verick & Islam, 2010; Vegh & Vuletin, 2014), but could not sustain long-term economic growth.

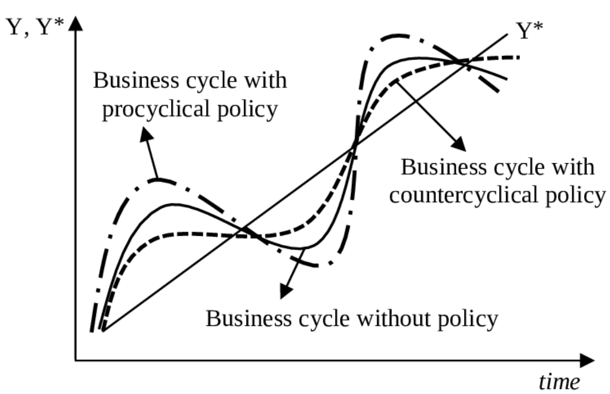


Figure 2. Procyclical versus countercyclical policy response (Ignatov, 2020)

Previous studies (Pastor & Wise, 2015) argued that Brazil's policy response generally outperformed Argentina's during the Great Recession. Researchers highlighted that institutional modernization and policy learning from previous crises, and the development of social policies that alleviated distributional tensions are two key factors that lead to Brazil's successful response to the crisis. These determinants contributed to a more business-friendly and less socially conflict environment, where a series of financial policies were viewed as critical responses to the crisis. In comparison, Argentina didn't seem to be capable of rising to this occasion, partially due to their desire to quickly fix to address distributional pressures, which resulted in their divergence from best practices.

Therefore, political institutions seem to play a critical role in rising to the challenge of the financial crisis. A study on federalism (Soares & Machado, 2020) argued that both Argentina and Brazil have centralized federal systems, but there are significant variations in the distribution of competencies and resources among the different levels of government. In Brazil, there is a combination of jurisdictional centralization and fiscal federalism that includes centralized and stable rules for revenue sharing and social expenditure. This structure provides more favorable conditions for universal and egalitarian social policies. In contrast, Argentina has lower jurisdictional centralization and fiscal federalism with more latitude for bargaining between federated entities to divide revenue and define expenditure, which may have posed challenges for coordinating a cohesive national response. The incongruence between the distribution of resources and competencies attributed to the government in social policies - vertical imbalance - is one of the principal fiscal problems in Argentina. In contrast, Brazilian fiscal federalism seems to have clearer and more stable distributive rules among governmental entities, but it also has much space for further improvement when compared to the G7 countries (Table 1).

	Liberalization	Depth	Domestic performance
	Financial policy openness index (0 = statist; 1 = open)	Financial assets/GDP	Credit to private sector/GDP
Argentina	0.32	1.02	0.13
Brazil	0.54	2.53	0.43
G7 mean	0.69	4.40	1.33

Table 1. Financial liberalization, depth, and domestic performance during Great Recession (Pastor & Wise, 2015)

Overall, the Great Recession had significant global impacts that resulted from various factors. Policymakers in Argentina and Brazil responded to the crisis with different approaches, while fiscal problems related to redistributive capacity, economic instability, and public debt further complicated the situation. Therefore, understanding the association between policy responses, political institutions, and fiscal federalism is essential in addressing economic crises effectively.

3. THEORETICAL FRAMEWORK

> *"The country that experienced the most crises was Argentina, a nation so badly governed for so long that its political history is practically a synonym for mismanagement. ..."*
>
> (Calomiris & Haber, 2015)

The Calomiris & Haber theory, which explains how a country's institutional framework affects its economic development, will be incorporated as the theoretical framework in this paper to evaluate why Brazil may have been more successful than Argentina in achieving its policy objectives. According to the Calomiris and Haber theory, a country's political institutions play a critical role in determining the effectiveness of its economic institutions.

Therefore, financial crises are more likely to occur in countries where the political system is characterized by a high degree of fragmentation, where power is dispersed among many different interest groups. In these countries, the banking system is more likely to be subject to regulatory capture by special interest groups, which can result in lax regulation and risky lending practices. In contrast, countries with a more centralized political system, where power is concentrated in the hands of a few, are more likely to have stable banking systems, as a centralized political system can better enforce effective banking regulations and prevent special interests from exerting too much influence.

In the case of Argentina and Brazil, applying the Calomiris and Haber theory will help us better understand their divergent outcomes in achieving policy objectives. With a centralized political system, Brazil has been able to enforce effective banking regulations and maintain a stable banking system. On the other hand, Argentina's higher degree of political fragmentation has made it more susceptible to financial crises.

4. DISCUSSION

I conducted the comparative analysis to examine the findings in the literature review regarding their policy responses to the 2008-09 Great Recession in Argentina and Brazil. Specifically, I explored the differences in policy objectives, instruments, and outcomes between the two countries, as well as the institutional factors that contributed to Brazil's relatively more successful response compared to Argentina, where I summarized these in a table of comparison below (Table 2):

Dimensions		**Argentina**	**Brazil**
Policy Objectives		To stimulate domestic demand and stabilize the economy	To ensure credit availability and support economic activity
Policy Instruments	Fiscal Policies	Increased government spending, subsidies, and infrastructure investments	Implemented tax reductions and higher extension of unemployment insurance
	Monetary Policies	Initially raised interest rates, and later expanded liquidity and lowered rates	Implemented liquidity-enhancing measures and foreign exchange interventions
	Other Financial Sector Policies	Developed nationalized private retirement system, and adjusted benefit payments	Encouraged state-owned banks to expand credit operations
Policy Outcomes	Short-term Recovery	Both achieved robust recovery in 2010	
	Long-term Economic Growth	Both considered as uncertain due to domestic issues and global economic slowdown	
Political Institutions		Fragmented and decentralized political systems	More centralized systems and modernized institutional reforms

Table 2. Comparison of policy responses to the Great Recession in Argentina and Brazil

4.1 Policy Objectives & Instruments

Both Argentina and Brazil had the common goal of stabilizing their economies and minimizing the effects of the Great Recession through proactive policy measures. For example, Argentina prioritized the augmentation of government expenditure, specifically in areas like subsidies and infrastructure investments. They also undertook actions such as nationalizing the private retirement system and adjusting benefit payouts. On the other side, Brazil utilized strategies to enhance liquidity and intervene in foreign exchange markets through the BCB. Additionally, they implemented fiscal measures like tax cuts and an extension of the duration of unemployment insurance.

Their distinct policy objectives demonstrate how Argentina and Brazil responded to the crisis based on their specific challenges and priorities. Argentina's approach, which was centered around government spending and reducing income taxes, sought to stimulate domestic demand and alleviate the economic downturn, while Brazil's strategy of implementing liquidity-enhancing measures and fiscal policies aimed to ensure credit availability and support economic activity. These policy objectives were shaped by their unique economic structures and conditions, which played a significant role in influencing their respective policy responses.

Overall, these policy objectives and instruments also align with the Calomiris and Haber framework that a stable and efficient financial system will contribute to economic growth and social welfare.

4.2 Policy Outcomes (Quantitative Evaluation)

After implementing countercyclical macroeconomic policies in response to the Great Recession, both Argentina and Brazil witnessed a robust recovery in 2010. They mitigated the impacts of the crisis on key indicators such as the unemployment rate and bank deposits as a result of liquidity-enhancing measures (Figure 3).

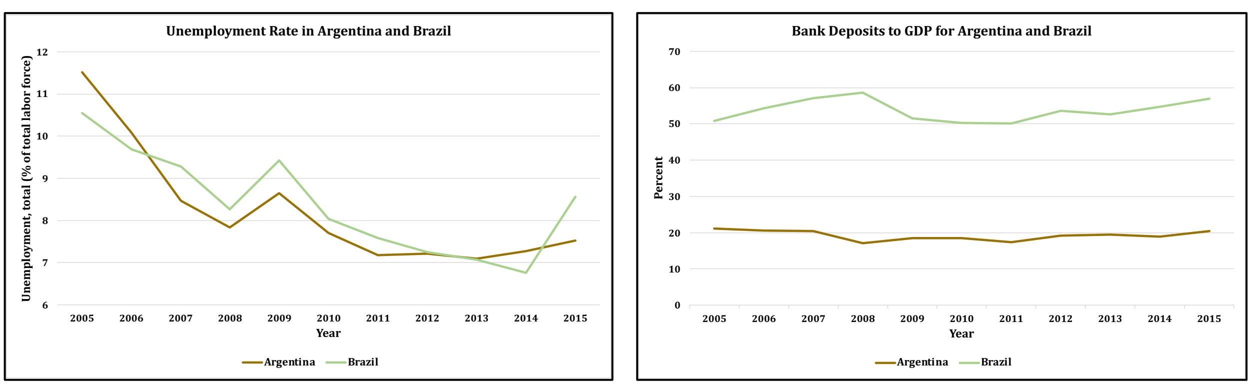
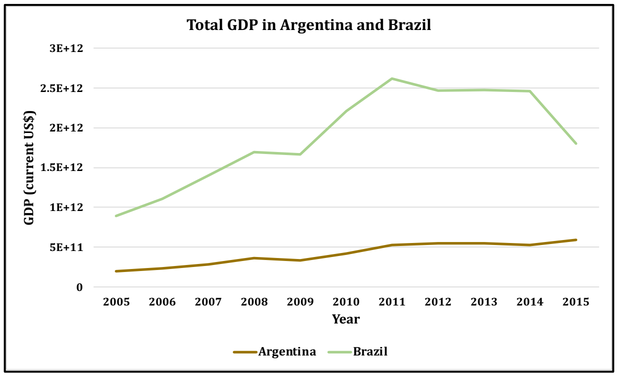


Figure 3. Policy outcome indicators in Argentina and Brazil

Source: International Labour Organization, Federal Reserve Economic Data

Nevertheless, the subsequent economic growth in both countries has been volatile due to some internal challenges and the global economic deceleration after 2010 (Figure 4). Therefore, despite the effectiveness of countercyclical macroeconomic policies in reducing the duration and severity of the crisis, they were unable to secure enduring long-term economic growth.



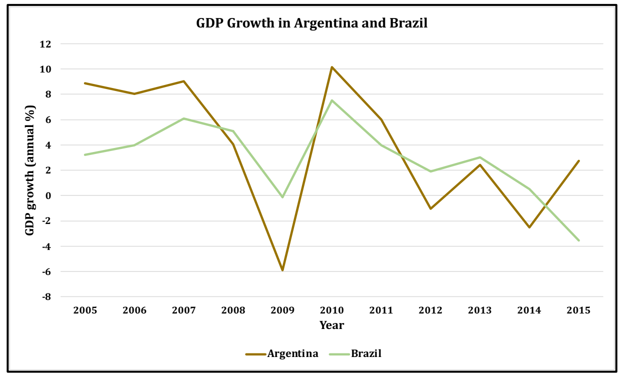


Figure 4. Total GDP and GDP growth in Argentina and Brazil

Source: World Bank National Accounts Data, OECD National Accounts Data

In this case, addressing the immediate impacts of a financial crisis does not guarantee long-term economic stability and growth. The challenges faced by Argentina and Brazil following the initial recovery highlighted the importance of further tackling structural challenges, improving institutional frameworks, and implementing comprehensive reforms to sustain economic growth.

Considering the Calomiris and Haber framework, the policy outcomes in Argentina and Brazil could be partially attributed to the differences in their political institutions and the way they interacted with economic institutions. However, such a disparity didn't seem to be salient when quantitatively evaluating their economic outcomes. Therefore, I consider it necessary to qualitatively evaluate some implicit factors that may lead to effective policy responses.

4.3 Factors for Effective Policy Responses (Qualitative Evaluation)

Centralization of Political Power

Brazil has a relatively more centralized political system compared to Argentina, which may have played a role in facilitating effective policy responses. A centralized political system allows for greater coordination and enforcement of policies, enabling the government to implement measures more efficiently. This centralization of power can help prevent regulatory capture by special interest groups and ensure the stability of banking systems, where the government would have more control over regulatory enforcement.

Social Policies and Distributional Capacity

Brazil's successful policy response during the Great Recession can be partially attributed to the development of social policies that addressed distributional tensions. By prioritizing social policies and alleviating distributional pressures, Brazil created a more favorable and less socially conflictual environment. This facilitated a more cohesive national response and allowed for the effective implementations of financial policies. In contrast, Argentina's desire to quickly address distributional pressures may have impacted the effectiveness of their policy responses, which might instead "fuel populism rather than counter-cyclical and macro-prudential approaches" (Pastor & Wise, 2015).

Fiscal Federalism and Coordination

The distribution of competencies and resources among different levels of government posed challenges for Argentina's cohesive national response. With lower jurisdictional centralization and fiscal federalism, Argentina had more latitude for bargaining between federated entities. This decentralized structure may have hindered effective coordination and the implementation of cohesive policies. In contrast, Brazil's combination of jurisdictional centralization and fiscal federalism, with centralized and stable rules for revenue sharing and social expenditure, provided more favorable conditions for the implementation of universal and egalitarian social policies.

4.4 Policy Implications

While countercyclical macroeconomic policies can help mitigate the immediate impacts of a crisis, addressing structural issues and implementing comprehensive reforms are crucial for long-term economic stability and growth. Therefore, political institutions play a significant role in rising to the challenge of the financial crisis. A more centralized political system, as observed in Brazil, may provide advantages in terms of policy coordination and enforcement. Strengthening political institutions and governance frameworks can enhance the effectiveness of economic institutions and contribute to more successful policy responses during times of crisis.

5. CONCLUSION

The comparative analysis of policy responses to the 2008-09 Great Recession in Argentina and Brazil demonstrates the importance of considering unique economic circumstances, tailoring policy instruments to specific objectives, and addressing underlying structural issues. Brazil's relatively more successful policy responses can be attributed to factors such as institutional modernization, policy learning, and the development of social policies. The theoretical framework provided by Calomiris and Haber underscores the critical role of political institutions in shaping the effectiveness of economic institutions. I believe that by recognizing the significance of political institutions and tailoring policy responses to the specific institutional patterns of a country, policymakers can better navigate future financial crises and work towards long-term economic stability and growth.

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