

THE FINANCIAL CRISIS AND THE HYPOTHESIS OF «DECOUPLING»

Досліджено генезис сучасної фінансової кризи та ефективність застосовуваних антикризових заходів. Дано оцінку обґрунтованості гіпотези про встановлення зв'язків в сучасній світовій економіці. Особливу увагу приділено факторам прискореного розвитку китайської економіки.

Исследованы генезис современного финансового кризиса и эффективность применяемых антикризисных мер. Дана оценка обоснованности гипотезы об установлении связей в современной мировой экономике. Особое внимание уделено факторам ускоренного развития китайской экономики.

The article studies the genesis of the present financial crisis and looks into the efficiency of anti-crisis measures employed. It also evaluates the substantiation of hypothesis about dissolving connections in global economics. Special attention is paid to the factors of accelerated development of Chinese economy.

financial crisis, anti-recessionary measures, «destruction of links» hypothesis, factors of economic progress

1. The genesis of the financial crisis and anti-crisis measures

Most of contemporary crises erupted in developing and in moderately developed countries. The crises of the nineties put pressure in those countries on speeding up changes in the practiced policy affecting both microeconomics and macroeconomic levels, and additionally enforced them to join in the overall globalisation process. This applies to the most countries in Southeast Asia and South America. Those countries engaged intensively in the global distribution and flow of goods, services and production factors. They became active participants in the process of the financial market globalisation. The outcome of those processes and relationships was an unprecedented expansion of the world economy comprising almost all its regions, especially emerging countries in Southeast Asia and South America. However, the characteristic feature of this period was an increase of the so called global-unbalance in the field of financial flows, which accompanied the boom synchronisation in the global scale. This effect was indicated by the analysis of the basic macroeconomic figures of the highly-developed (e. g., USA, Japan, Germany) and emerging countries (e. g., China, India, Brazil, Russia).

Based on the data contained in Table 1 it can be concluded that macroeconomic values of emerging countries are substantially higher if compared with the appropriate figures in highly-developed countries. The years of the present decade (until 2007) are characterised in the world economy by a high and balanced (in the geographical meaning) economic growth. However, at the same time an increasing financial unbalance takes place. Developing countries have reached 2 or even 5 times higher growth rate, the surplus in the current turnover, and as a result of the significant accumulation of foreign reserves and reduction of the foreign debt they even became net creditors.

The result of the high growth is that the emerging economies (countries) generate one third of the global GDP. Estimates based on purchasing power, indicate that this share is even around 50%¹. However, in the summer of 2007, the situation dramatically changed and the financial crisis in the United States erupted. The American crisis, also called the *subprime mortgage crisis*, in fact ignited already at the end of 2005. It is a typical scenario, in that sense that for some time each crisis remains asymptomatic, and only when the shock exceeds its ability to be absorbed the financial sector, it reaches its acute phase with all its symptoms. The American subprime mortgage crisis quickly spread and reached European countries with highly-developed real estate business sector, which are most exposed to the emergence of a recession. Fears of a potential recession induced the Federal Reserve System to radically cut interest rates and to prepare an Economic Rescue and Stabilisation Package².

Furthermore, many countries facing the increasing sizes of recession started to implement multi-billion worth packages with the intention to stabilise financial markets and stimulate consumption and investments. Individual countries use diversified instruments of their economic policy. Within the scope of initiatives stimulating investments and consumption³ they use tools of fiscal and monetary policy, and structural investments. In the United States in order to restore confidence to investments and to stimulate credit shares a dedicated public-private investment fund was established (within the framework of an overall stimulus package) and equipped with circa 1 trillion US dollars. The aim of this fund is to buy toxic assets of banks and funds. Furthermore, in order to rescue banks, the governments of the United States, Iceland, Ireland and Austria recapitalised them after assessing their condition.

In Germany, Spain, Great Britain, China and Japan in order to increase the market liquidity, guarantees for loans contracted by companies were introduced. Additionally, for companies having problems with obtaining credits, credit loans were prepared. In the UK and Germany in order to enable a broader access to credits, a dedicated program was introduced with the aim to purchase government bonds and securities on the secondary market. At the same time the automotive sector in France, Germany, Spain, Italy and the UK received multi-billion heavy financial support. In many countries taxes had been reduced, including China, Japan and the so-called Asian tiger countries. Furthermore, in order to stimulate investments and consumption those countries and the United States launched big infrastructure projects, and started reforms of their educational and health-care systems.

Started anti-crisis measures have been planned for several years and what is worth to notice is the fact they are not focused to boost only one business sector. However, attempts to create a new economic order on the international level (the G-20 Summit in London) could not appease essentially the financial markets. Those attempts targeted among others the establishment of institutions which would be responsible for regulating and supervising financial markets, the increase of funds of the International Monetary Fund by 500 up to 750 mld USD, the dissolving of the so-called «tax paradises» in the near future, and the generation of funds supporting international trade. One will have to wait a couple of years to register the impact of such attempts on the global economy and the condition of the individual economies.

Until now, there are no positive signals coming from the highly-developed countries. The attempts to stimulate the economy by lowering the interest rates failed. In many countries, their level moves around zero and has no effect on the stimulation

¹BIS (2007), 77th Annual Report, Bank for International Settlements, Basel, June 24.

²their value in the USA together with the Paulson's plan is about 1,5 bln USD

³After the reduction interest rates reached a record low level: in Japan – 0,1%, in USA – 0,25%, in GB, Switzerland and Canada – 0,5%, in ECB – 1,25%. Fiscal packages reach in Germany 1,5% GDP, in France 1,9% GDP, in Spain 3% GDP, in Singapur, Taiwan, South Korea 3 GDP. Till February 2009 the governments of G8 countries launched rescue packages totaling more than 3 bln USD.

Table 1

Macroeconomic values of the world largest countries (year 2007)

	USA	China	Russia	Japan	Germany	India	Brazil	World
Basic:								
– population	301 mln (III/4,6 %)	1321 mln (I/20 %)	141 mln (VIII/2,1%)	127 mln (X/1,9%)	82 mln (XIV, 1,2%)	1129 mln (II/17,1%)	186 mln (V/2,8%)	6602 mln (100%)
– territory	9,8 mln (III/1,9%)	9,5 mln (IV/1,9%)	17 mln (I/3,3 %)	0,37 mln (LXI/0,1%)	0,35 mln (LXII/0,1%)	3,2 mln (VII/0,6%)	8,5 mln (V/1,7%)	510 mln (100%)
Economy:								
– GDP	13,2 bln (I/28,3%)	2,5 bln (IV/5,4%)	0,76 bln (XV/1,6%)	4,9 bln (II/10,5%)	2,8 bln (III/6,2%)	0,79 bln (XIII/1,7%)	1,3 bln (IX/2,3%)	46,6 bln (100%)
– GDP by PPP	12,9 bln (I/19,9%)	10 bln (II/15,3%)	1,7 bln (IX/2,6%)	4,2 bln (III/6,4%)	2,5 bln (V/3,9%)	4 bln (IV/6,2%)	1,8 bln (VIII/2,8%)	65 bln (100%)
– GDP growth	3,4%	10,5%	6,6%	2,8%	2,2%	8,5%	5,4%	5,1%
– GDP per capita	43,45 tys.	7,6 tys.	12,1 tys.	33,1 tys.	31,4 tys.	3,7 tys.	9,5 tys.	10 tys.
Foreign trade								
– export	2,8 bln (I/11,7 %)	1,7 bln (III/7,1%)	0,49 bln (XVI/1,9%)	1,1 bln (IV/4,5%)	2 bln (II/8,3%)	0,3 bln (XVIII/1,2%)	0,3 bln (XVII/1,2%)	24,5 bln (100%)
– import	1 bln (II/8,2 %)	0,97 bln (III/7,8%)	0,32 bln (XIII/2,6%)	0,59 bln (V/4,7%)	1,1 bln (I/9,1%)	0,11 bln (XXIX/0,9%)	0,16 bln (XXIV/1,3%)	12,4 bln (100%)
– share trading GDP	21,2%	68%	67,1%	22,4%	71,4%	37,9%	23,1%	52,5%
foreign exchange reserves	69,1 mld (XV)	1034 mld (I)	314,5 mld (III)	864,7 mld (II)	48,7 mld (XXII)	165 mld (VI)	190 mld (V)	

Source: G. Wroński, Percepcja mocarstwowego statusu Chin w świetle głównych paradygmatów stosunków międzynarodowych. «Stosunki Międzynarodowe» 2008, nr 1–2, s. 70–71.

Roman figures included in the table indicate country's position in the world ranking and associated percentage values indicate the percentage share of the same scale.

of consumption and production. However, the reduction of interest rates to nearly zero severely limits the manoeuvre space for monetary policy in the future. The Federal Reserve System and the European Central Bank may use other instruments, but this in turn is associated with the additional money emission and higher inflation in the future. Detractors of support packages also highlight the inefficiency of the tax relieves, indicating the Paulson Plan, which stimulated the production and the gross domestic product (GDP), but only within a short period, after lowering the interest rates.

Expansionary fiscal and monetary policy leads to an increase of budget deficit and public debt. The budget deficit in many European Union countries predicted for the year 2010 will reach a level that significantly exceeds 3% of GDP, and this in turn violates the convergence criteria. The highest deficit is planned for the following countries: Lithuania – 9,2%, Spain – 10,1%, Greece – 12,2%, Latvia – 12,3%, United Kingdom – 12,9%, Ireland – 14,7%⁴. As a result the following increase of the public debt in 2010–2011 can be awaited: Greece 112,6% and 135% of GDP, in Italy 116,7% and 117,6% of GDP, in Portugal – 84,6% and 91,1% of GDP, in Spain – 66,3% and 74% of GDP, in Ireland – 82,9% and 96,2% GDP. In the United States the budget draft envisages the budget deficit of 12% of GDP and the public debt of about 50% of GDP.

Such a high level of debt implies not only radical expenditure cuts, but also enforces tax raise in the near future, and this in turn generates the risk of insolvency. At the moment the following countries have already troubles to obtain financial resources to support their economies: Iceland, Ireland, Portugal, Spain, the Baltic countries, and especially Greece. As a result, the financial crisis has already caused reduction of international trade financing, reductions in world merchandise trade, and slowed down the pace of the economic increase. In contrast to the crises of the 90s, which affected the countries of low and medium development level, the financial problems of the year 2007 appeared not in the peripheries, but in the centre of the world economy. The strongest perturbations on the financial markets began to adversely affect the sphere of the real economy, especially in the developed countries.

For the full diagnosis of the outcome of initiated anti-crises measures and of reasons of current financial disturbances we will probably have to wait a couple of years. Nevertheless, can we already now indicate some differences in the evolution of the collapse process in the developed and developing countries? The answer seems to be yes, because regardless of the serious financial crises in the world economy, new aspects and relationships appeared, which require essential adjustments on the micro, macro, and global economic levels. They are as follows:

– Integration of the emerging countries into the globalisation processes, especially Brazil, China, and India;

– Emerging countries, especially those in the Southeast Asia and South America, due to their greater integration into the global market, gain broader access to finance opportunities, become new possibilities of risk diversification, and all this is in turn crucial for the stabilisation of development processes. However, what needs to be noticed, the global environment of the financial market complicates the conduct of a fully independent monetary policy within those countries. Central banks can not effectively defend the exchange rate and independently use its basic tools, especially the interest rate. That is why they represent a sceptical approach to liquidate the exchange rate and actively intervene on the currency market⁵.

– Appreciation of national currencies in South American countries, which level was much higher than in Asian countries. This undoubtedly was the result of capital

⁴Problemy z finansami w Unii Europejskiej, Komisji Europejska, Bruksela 2010.

⁵See. Cowen D and others (2006), Financial Integration In Asia-Recent Developments and Next Steps, JMF Working Paper, No 196; Knight M.D. (2007), The Globalization of Financial Markets and Financial Regulations: Implications for Latin America, «BIS Papers»

inflows, and it allowed much more space to control the inflation (e.g. the rate of appreciation of the Brazilian Real in the first half of 2007 amounted more than 5%);

– Strong growth of energy and raw material prices, and changes in the terms of trade;

– Relative increase of savings especially in China and in oil-exporting countries and their deficiency in the United States;

– Dynamic development of information and communications technologies;

– Tightened tax competition and simultaneously the increase of the budget deficit and public debt in many countries.

2. The hypothesis of «decoupling» of the emerging economies

In the context of serious slumps on financial markets and the differentiated progress of the above mentioned events and processes in the developed and developing countries, a hypothesis of «decoupling» arose. Around this hypothesis indicating a relative independency of the emerging economies from the economic cycle in the highly-developed countries (particularly in the United States), a discussion began, which provoked the researches to focus on the following aspects:

– Economic cycle and its synchronisation, i.e. approximately the same evolution scheme in a more or less numerous group of countries⁶;

– Effects of shock penetration and spreading on international level and also penetration of the cyclical effects between different business sectors, primarily the transfer of the events from the financial sphere to the real sphere⁷ on a national level;

– Tendency of the causal dependency of cyclical fluctuations and to which extent the synchronisation of the cyclical fluctuations in the Southeast Asian and South American countries depend on alliances with North America and Europe.

The problems mentioned above were objects of numerous discussions and analyses. Among others, the research work in this field was conducted by the International Monetary Fund⁸, Dees S., Vansteenkiste⁹ and Kay J.¹⁰, and others. The goal of these analyses was the determination of the relationships between the amplitude of the cyclical fluctuations and the changes in the level of their synchronisation, and also the identification of the feed-back strength in the context of mutual relations between individual countries and the groups of countries.

The intention of the author of this article is to present only an outline of the question regarding fluctuation synchronisation and impulse penetration in the global scale, and the «decoupling» possibilities of countries remaining at a lower development level. Taking into account the characteristics and dynamics of the development trends in emerging countries, especially in China, India and Brazil one can agree with the viewpoints of numerous economists that the process of «decoupling» of those countries is already in progress for several years. It should be emphasised that on the one hand under the influence of the globalisation processes the relations and mutual dependencies between different world regions are getting tightened and on the other hand the desire to reduce the development gap by the emerging countries intensifies the mechanism of competition. This in turn results in a high pace of economic growth

⁶Lubiński M., Kąsek L. (2006), Wahania koniunkturalne a perturbacje finansowe, w: Barczyk R., Kąsek L., Lubiński M., Małczewski K., Nowe oblicza cyklu koniunkturalnego, PWE, Warszawa s. 99.

⁷Ibidem, s. 101.

⁸JMF (2007), Spillovers and Cycles In the Global Economy, w: World Economic Outlook, April.

⁹Dees S., Vansteenkiste I. (2007), The Transmission of US Cyclical Developments to the Rest of the World, European Central Bank Working Paper, No 798, August

¹⁰Kay J., (2007), emerging Economies Have Not Become «Decoupled», 'Financial Times», November 21

of emerging countries in comparison to the highly-developed ones experiencing the recession phase.

Thus, if the spectacular success of the emerging economies of countries such as China, India or Brazil in the second half of the decade of the XXI century, are the result of internal changes and processes that took place under the influence of reforms? The dynamic entry of these countries into the global economy, led the global market to become even more global. These countries, developing at a rate of 6–10% of GDP in recent years (2005–2008) contribute to the increase of the global demand (through the increase in import) and to the increase of the global supply (through increase in export). Furthermore, they act more actively on the financial markets and integrate with the global economy. However, in addition to common features, these countries are characterized by several distinguishing features from other emerging countries.

3. The determinants of development of the chinese economy

On the one hand the economy of China fascinates, but on the other hand it worries. The pace of economic development and the magnitude of economic change arouses admiration. Disquieting is the fact, how much depends on the global economic trend in this country. The average annual GDP growth, since the start of economic reforms maintained at 9,4%. It is the fastest and longest-lasting economic growth in the world. The economic growth in China is much higher than the growth of other rapidly developing Asian economies and the average rate of growth of developing countries¹¹. Undoubtedly, many external and internal factors affected the dynamics of development. However, two very important determinants that distinguish China from other emerging countries, have to be pointed out, namely:

- a shift towards a market economy is not preceded (as in the countries of Central and Eastern Europe) by any major changes in the political system,
- during the period of peak changes, China has not experienced any major economic crises (such as the Asian crisis)¹².

Based on the data presented in Table 2 in the years 2006–2008 a very high rate of economic development in China occurred. The high GDP growth rate has its source in both internal and external demand impulses. Among the internal factors the most important influence on the economic activity had the demand increase, in both

Table 2

Basic macroeconomic values for China in the years 2006–2008

Specification	2006	2007	2008
GDP	11,1	11,4	9,0
GDP per capita (in USD)	2109,5	2456,0	2677,0
Central budget deficit	1,3	0,8	1,1
Inflation (PI – consumer price index) %	1,5	4,8	5,9
Unemployment rate %	4,2	4,0	4,1
Current account balance (% GDP)	8,3	8,5	7,5
Growth rate of export %	23,8	25,7	22,0
Growth rate of import %	20,0	20,8	19,5

Source: based on the data from the National Statistical Office ChRL and Central Bank

¹¹B. Ślusarczyk, K. Puchalska, *Gospodarka Chin a kryzys w końcu I dekady XXI wieku* (2009) w: Bednarczyk J.L, Bukowski S. J., Misala J.(red.), *Wpółczesny kryzys gospodarczy, przyczyny-przebieg-skutki*, wyd. CeDuWu. PL, Warszawa, s. 255–256.

¹²Prasad E., Rajan R.G. (2006), *Modernizing China's Growth Paradigm*, JMF Policy Discussion Paper, No 3.

consumption and investment. The key role in the growth of total demand played a fast-growing demand for durables, which was the result of the dynamic development of housing.

Also investments in the analyzed period could be characterized by high growth. However, despite the massive scale of new investments, imbalances in the production and the level of development of individual regions could not be neutralized. China has still a large backlog in generating a modern socio – economic infrastructure, especially in transport, communications, environment protection and efficient use of energy, materials, etc.

An important factor in the high GDP growth in China is a large inflow of capital in the form of foreign direct investment. Their growth rate is high and the average annual value increases continuously since many years.

Table 3

China's share in the world inflow and outflow of foreign direct investments and the FDI ratio to the gross domestic product in the years 1980–2008 (%)

Years		1980	1985	1990	1995	2000	2005	2008
Word share (%)	inflow	0,11	3,5	1,68	11,0	2,95	7,44	6,38
	outflow	bd	1,01	0,35	0,55	0,08	1,39	2,81
Share in the GDP (%)	inflow	0,02	0,63	0,86	4,96	3,41	3,14	2,49
	outflow	bd	0,20	0,21	0,26	0,08	0,53	1,2

Source: <http://stats.unctad.org/FDI/TableViewer/tableView.aspx>

Parallel with the opening of the Chinese economy to the foreign capital, the number of enterprises with foreign capital increased. Furthermore special economic zones, which play an important role in attracting foreign direct investments to China appeared. They operate along the coast of the country as modern industry centers, where investors can obtain various types of privileges, such as tax exemptions¹³.

It is worth noting, that the persistent wave of capital inflow to China, increases the lending by the banking system. It contributes to the inflationary expectations and the expectations of an increase in interest rates, which attracts even more capital. Increase linkages with the world economy indicated the growing importance of China in the international arena. The most significant indicator that indicates the growing importance of China in international trade is the ratio of the value of foreign trade to GDP. The value of this index for China in 2007 was about 68% and was higher than the average for the world (52.6%), Japan (22.4%) and USA (21.2%). Furthermore, the specificity of China's foreign trade is that the trade balance with the most Asian countries is negative, while with the European Union and the USA countries positive. Those trade relations indicate the growing importance of China in the Asian region. Due to the increased propensity to import China begins to play a «regional locomotive role» of economic growth of these countries. It is expected that in the near future the geographic structure of international trade will change. The main actors involved in the global trade will be the Asian countries, led by China. This country is ahead (taking into account the share of world exports) the United States and Germany. Since 2009 China occupies a leadership position. The spreading since 2007 financial crisis also reached the Chinese economy. Its symptoms were already visible in the fourth quarter of 2008. It had undoubtedly an impact on reducing the level of the basic macroeconomic values (see table 2).

Export drastically reduced (decreased by 26%), inflation increased to 5,9% and the GDP growth fell from 11,4% to 9% in 2008 and to 5,8% in 2009 and in 2010

¹³Nawrot K.A. (2008), Determinanty rozwoju gospodarczego państw ASEAN, Wydawnictwo Naukowe SCHOLAR Warszawa, s. 157.

to 6,5%. The economic slowdown caused by the decline of export turnover forced changes in the economic policy of China. It is estimated, in fact, that in the years 2009 – 2010 the share of consumption in the creation of GDP growth will be greater than the investments. Can therefore the specific of the economic development be regarded as a positive decoupling process?

4. Conclusion

The answer to this question could be affirmative, provided that the changes resulting from policy reforms in macro- and micro-economy, not only in China but also India and Brazil and other developing countries, favour of both maintaining a stable path of growth and reducing global imbalances on the financial markets. Primarily the point is that economic growth in these countries should be a result of internal mechanisms and institutions that shape the structure of growth, where the endogenous factors in demand play a dominant role. At the same time, these countries implementing the policy of openness and being active participants in the regional integration and globalization, will have much greater contribution to maintaining the world economy and to accelerating the long term multi-polar system. These issues, however, require a broader study, research and evaluation from the long distance perspective.

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