**MACROECONOMIC  REFORMS IN DEVELOPING COUNTRIES: WHAT HAS BEEN GAINED?**

 This year global economy is projected to grow by 4.8 percent but the main driver of the growth would be the emerging market economies.US at 2.6%,Eurozone 1.7% and Japan 2,8% are still struggling to recover but China, India, Brazil, Indonesia are leading the way, Unemployment in the US continues to remain a worry and the  anxiety about the future course of the economy has kept investment in fixed assets subdued.

    Why is that only after a brief spell of a few quarters’ decline the EDEs in general have performed  so well, unemployment has been contained and the stimulus package although quite modest in comparison to the western economies have done the trick?

    The events of 2007-2009 show that the hypothesis of decoupling between the EDEs and DCs has not proved  valid, financial contagion is very much alive and the transmission of shocks from the financial sector disturbances to real economy occurs across the borders quite swiftly.Having said that, it is also true that the resilience shown by tthe EDEs in recovering from this crisis is also remarkable leading some analysts to surmise that the balance of economic power has shifted from the DCs to the EDEs. Of course, there is significant variation among this group but the trajectory is moving upwards.History suggests that the recovery from financial crises is normally weak but in the EDEs the recovery has been quite strong.

    Let us first recognize that even before the recent crisis the shaare of the EDEs in the global economy had almost doubled from 17%  in 1990 to 31% in 2007.Their contribution to GDP growth had risen from 50% to 65% in the same period. Structural reforms carried out in the last decade, sound macroeconomic management, favorable demographics and ever expanding production frontier due to innovation yet to be fully absorbed led to this robust growth.  External debt ratios were low.  Fiscal and monetary policy stimulus in response to the crisis did not play such an important role in recovery as these fundamental factors did.None of these factors has, in fact, been adversely affected by the subsequent events. Half of the world’s poorest people live in Brazil, China and India and the high growth rates in these countries were able to insulate them from the hardships of the global crisis.But it is also true that as many as twenty out off the twenty five middle income countries experienced decline during the fourth quarter of 2008 and twenty six during the 1st quarter of 2009.The recovery in the subsequent quarters proved more robust and widespread particularly in Asia.East European economies and Latin American economies linked clsoely to the EU and the US suffered relatively more compared to other countries.

    Second, the Banking system was the dominant part of the financial system in the EDEs funded through deposits rather than capital markets. Household debt was only 3-4 percent of GDP. Mortgage penetration in a country as large as India was 6% of GDP--- one tenth of the level of developed countries (US 75%). Financial system and banking sector reforms were successfully carried out in most EDEs well before the crisis. China had stripped its major banks of the NPLs and transferred  them to Asset management companies. Profits of Chineese banking system had recorded a 17 fold increase and used for recapitalization and strengthening of capital adequacy ratios.

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 Indian banking system also underwent similar cleaning of the balance sheets and consequently their NPLs to total advances ratio fell to 5-6 percent.

 It is true that countries with high degree of financial integration, dependence on certain market segments, free capital account convertibility and ownership of domestic banks by global banks did suffer relatively more damage. Credit contraction in East European economies and slow down in exports and remittances in several Latin American countries do corroborate this finding.

 Third, most of the leading EDEs followed a path of cautious liberalization all along. The liberal case for the free movement of capital was never accepted in large Asian countries. Restrictions on some trades, quotas on others, price controls, tightened registration requirements were the norm. Partial capital controls and lack of full capital convertibility in China, India, Pakistan and Bangladesh didn’t allow large exposure to foreign currency denominated assets. There was a constructive ambiguity about capital controls. Inflationary pressures were contained by independent Central banks pursuing Inflation targeting. Most of the EDEs had given up the fixed exchange rate policies and pursued flexible but managed exchange rate. They maintained the balance between competitiveness of their exports and inflationary pressures arising from unhindered flow of foreign capital.

 Fourth, the role of systemic regulators in the EDEs was much stronger and effective. As commercial banks formed the bulk of financial intermediation the regulation and supervision was well focused. The regulators were quite aware of the significant interactions and risks among Financial institutions (FIs) and engaged in taking prompt remedial action against those FIs that exposed the Financial system to systemic risk. They designed and implemented regulations such as higher and counter-cyclical capital requirements for systemically important institutions. I do not wish to give them too much credit but in hindsight they did much better job than their counterparts in the West.

 Fifth, various kinds of social safety nets were in place that protected the poor, small and medium businesses and farms. India had a Credit Guarantee Fund for Micro, Small and Medium Enterprises; an Export rate subsidy that provided bank loans at below the market lending rates and a National Rural Employment Guarantee Scheme. In Brazil, Bolsa Familia was able to lift 12 million people out of poverty while its coverage was 55 million of the poor population. Between 2000–2008 China had quadrupled GDP, raised exports five times and created tens of millions of jobs that moved people from rural to urban areas. Conditional cash transfers so common in many EDEs cushioned the impact on the most vulnerable citizens. Workers remittances in Asian countries held up strongly and provided stability of earnings to poor families.

 For Asia, the discussions held at an ADB conference came to the following conclusions:

(a) There was no mass unemployment or mass poverty due to the impact of the crisis.

(b) Mainly the $2 per day poor have been affected and not $1,25 per day poor.

(c) Affected most were the urban educated growth, women in export sector, migrants and

 children

(d) The picture was diverse depending on country and social groups.

    Sixth, the foreign exchange reserves accumulated by the EDEs during the post Asian crisis proved to be a powerful safeguard against the onslaught by the speculators.ff much of the banks’ debts were in foreign currency and the reserves were limited the countries would have been at the mercy of flighty foreign finance. This did not happen in 2008=09 because the countries were well equipped and prepared. the corporate sector that suffered enormously during the Asian crisis had restructured itself and the currency mismatches were quite limited. The liquidity problems in a few countries such as Hong Kong, Singapore, Korea aand Taiwan were tackled quite competently and timely by the Central banks injecting funds for liquidity support, guarantees of deposits and other liabilities, intervening in foreign exchange  and stock markets and making swap arrangements. Regulatory forbearance or easing prudential requirements was not the norm and was exercised in only a few countries  such as Indonesia, Korea and the Philippines. In my opinion, these six factors, among others, can satisfactorily explain the resilience of Asian countries in early and robust recovery while the advanced countries are still struggling.