

**U. S. Monetary Policy as a Hegemonic Tool in Emerging Markets**

By

William Duncan Martin

\*\*\*\*\*

Submitted in partial fulfillment

of the requirements for

Honors in the Departments of Economics and Political Science

Union College

March 2022

## **ABSTRACT**

Martin, William D. U.S. Monetary Policy as a Hegemonic Tool in Emerging Markets.  
Department of Economics and Political Science, March 2022.

ADVISORS: Ercan Karadas and Guillermina Seri

This paper analyzes how the U.S. The Federal Reserve impacted the economic conditions of eight countries considered as emerging market economies from 2000 to 2020. Equally important, this thesis uses country-specific macroeconomic and political variables to examine how developing countries alter their short-term targets to avoid volatile spillover from Washington. Moreover, I use each country's sovereign nominal credit spread to proxy its economic conditions as this benchmark's perceived risk premium or the cost of borrowing. The countries used in my thesis are Argentina, Brazil, Colombia, Mexico, Russia, Korea, Qatar, and Turkey. Using a two-way fixed effect model, my thesis finds that U.S. short-term rate hikes and heightened volatility in the S&P 500 increases the nation's cost of borrowing. Poor country-specific underlying macroeconomic conditions drive up the nation's risk premium, seen through a more extensive sovereign credit spread. Correspondingly, elevated domestic social and political vulnerability levels positively impact each nation's perceived risk alluded to decaying economic conditions. Complementing my econometric empirical results, my thesis provides four country case studies of Argentina, Brazil, Russia, and Turkey, highlighting historical macro management changes in policy targets to hedge against U.S. spillover. Understanding the role of the U.S. political-military hegemony in the context of the global credit cycle is vital, as the landscape of international finance is collapsing due to the shortsighted prerogative of many Washington technocrats.

## ACKNOWLEDGEMENT

I want to thank Professor Karadas and Professor Seri for the effort and time they dedicated to helping me complete my Senior Thesis. Over the past two terms, both worked tirelessly to answer my questions while also making time for additional meetings and responding to my emails within a minute's notice. Their excitement about my project helped me find the determination to succeed even when I felt the most discouraged. Equally important, Professor Karadas and Seri motivated me to become more excited about the overlap between economics and political science. I could not have asked for two better Senior Thesis advisors. Once again, thank you, Professor Karadas and Seri. Thank you to Professor Bradley Lewis and Professor Robert Hislope for their insight during my oral examinations.

Finally, I would like to thank Professor Therese McCarty and Clifford Brown for their continued support throughout my academic career at Union College. Through each long and stressful term, Professor McCarty always made the time to address any of my concerns or to speak. Likewise, Professor Brown's insight outside and inside the classroom pushed me to become a more engaged student and enthusiastic to learn more. So, for all of this, Professor McCarty and Brown, I am very thankful.

## TABLE OF CONTENTS

<b>1. Introduction</b>	5
1.1 U.S. Financial Hegemony	6
1.2 Concentrated Negligent Global Spillover	12
1.3 U.S. Influence on Emerging Market Credit Cycles	17
<b>2. Methodology and Data</b>	24
2.1 Model	25
2.2 Data	25
2.3 Descriptive Statistics	33
<b>3. Empirical Analysis</b>	35
3.1 Collective Emerging Market Fixed Effect Regression	37
3.2 Eastern Hemisphere Fixed Effect Results	41
3.3 Latin America Fixed Effect Results	44
<b>4. Latin America Case Study: Brazil and Argentina</b>	46
4.1 Brazil	49
4.1.1 Brazilian Economic Scaffolding	50
4.1.2 Lula's Excellent Macro-Management	57
4.1.3 Brazil, A New Economic Miracle? In the Context of a Fixed Effect Model	62
4.2 Argentina	66
4.2.1 Argentina: Economic Zigzag	66
4.2.2 Post-Global Financial Crisis: El Gil Coming to Fruition	74
4.2.3 Argentina Fixed Effect Model	79
<b>5. Eastern Hemisphere Case Study: Russia and Turkey</b>	82
5.1 Russia	85
5.1.1 Salvaging A House in Flames	85
5.1.2 Moscow's Economic Muscle Pounding U.S. Economic "Egoism"	99
5.1.3 Erratic Policy & Sound Macroeconomic Conditions: Russia Regression	105
5.2 Turkey	110
5.2.1 Turkish Monetary Policy: Ever-Changing Structural Reforms	111
5.2.2 The Turkish Smoking Gun: Successful Structural Changes Post-2001	117
5.2.3 Turkish Idiosyncratic Risk: Fixed Effect Regression 2000 to 2020	121
<b>6. Issues For Evaluation: Shortsighted FED Policy</b>	124
6.1 In a globalizing world, no country is an island	125
6.2 U.S Federal Reserve Short-Sightedness	129
6.3 Spillover Back onto the U.S.	139
6.4 Evaluating Processes of U.S. FED Policy-Making	142
<b>7. Conclusion</b>	145
<b>Appendix</b>	150
Table 13: Mexico Fixed Effect Regression	150
Table 14: Colombia Fixed Effect Regression	151
Table 15: South Korea Fixed Effect Regression	152

Table 16: Qatar Fixed Effect Regression	153
<b>Bibliography</b>	154

# 1. Introduction

Like most countries, Argentina has a lexicon of colloquialisms that are not common in the remaining Spanish-speaking world. Arguably the most emblematic phrase is *el Gil*. In its harshest form, it means *the idiot*, whereas in its kindest regard it is the *naive fool*. Regardless of *who* or *how* it's expressed, it's something no one in contemporary Argentine culture wants to be, let alone a title for any sovereign country in today's globalized economy that attempts to adjust its own conditions to the international market. Similarly, verbalizing *el Gil*, Reich (2015, 2018), and Wendy Brown (2015), argue that, when faced with volatile markets, technocrats in Washington solely push their agenda during the legislative process, with the intent to protect their seat in office and the health of the U.S. economy. In that, Stiglitz (2010) highlights that during domestic recessionary periods, the U.S. drives amplification in the global economy. During this time, Washington officials often exercise countercyclical policy that yields the most considerable returns on investment. The two further extend the claim that U.S. policymakers and their respective bureaucratic institutions fail to properly remedy global market conditions, as they myopically address the domestic needs of the U.S. economy without considering its potential spillover. My thesis interrogates the U.S. political-military hegemony, in the context of the U.S. Federal Reserve and how its negligible nearsighted policy moves limit the economic austerity of countries considered emerging market economies. Correspondingly, in the context of U.S. hegemony my thesis adds further to the claim that a globalized *free-market* economy is a pejorative term due to the capitalistic tendencies of Washington policymakers that curb autonomous legislation in international finance.

## 1.1 U.S. Financial Hegemony

Over the past few decades, through increased globalization of the global economy, emerging market economies have become more dependent on the conditions of the U.S. financial system. Washington's repressive influence is established following Bretton Woods in 1944 and is catalyzed further under the current increase in globalized trade and the industrialization of nations. For economists and professionals connected to global

capital markets, the U.S. is perhaps the most well-known centerpiece that establishes international benchmarks for guiding macroeconomic conditions.

As a result of the Bretton Wood Conference in 1944, the United States established its hegemonic stronghold over the global financial system. During this meeting of global powers, U.S. policymakers exploited the weakness of other nations with the intent to dominate the world through a system of free trade. Additionally, this meeting established the U.S. dollar as the official reserve currency, whereas as a result, many foreign nations pegged their currency to the U.S. dollar. Desai (2013) fundamentally lays out that the U.S. dominates global dynamics, which has led to uneven developments across varying continents and countries. Interestingly, as globalization is a vital determinant of the global financial market growth, Desai (2013) claims that it is not the case as a select few countries, particularly the U.S., control the growth opportunities for other countries. Following the creation of the Marshall plan coupled with the outcomes of the Bretton Woods conference, the U.S. overtook the role for world dominance. Luce (1941) suggests that the U.S. saw its ability to control the global economy following World War II and succeeded in making it the “Century of American dominance.” Desai (2013) outlines the reality that following the Marshall Plan and the emergence of the U.S. dollar dominating the direction of the global economy, Washington soon thereafter controlled 50% of the world’s wealth despite only comprising 6.3% of the world's population. Following World War II, the U.S. continued to use military Keynesian to establish a national security complex as they subsequently entered war with both Korea and Vietnam (Desai, 2013). Elected U.S. policymakers shift their financial, social, and political efforts to catalyze the initiatives of plutocrat cohorts – verbalized by Robert Reich as the “tyranny of the minority.” In so doing, targeted U.S. financial policymaking has shaped the nation’s contemporary capitalist prerogative that continuously benefits the wealthy minority.

The U.S. has a successful historical track record of altering domestic financial conditions, creating amplified spillovers into the global economy. Desai (2013) alludes to the actions of Henry Kissinger, former U.S. Secretary of State, who instituted oil shocks to protect the position of the U.S. dollar in the world economy in the 1970s. Through manipulation in economic conditions, seen best through the recent real-estate bubble in 2008, the U.S. historically continues to alter monetary regimes to protect its domestic

economy. In doing so, this U.S. hegemony hinders the growth prospects of other countries (Desai, 2013).

Calvo et al. (1993) points out the emphasized importance of relatively stable U.S. economic conditions and its spillover on the structural initiatives of developing countries. Yellen (2006) extends on previous literature when alluding that U.S. interest rate differentials increase global sensitivity. Yellen's analysis emphasizes the stronghold of the U.S. as the most significant player in the international capital market, and changes in monetary policy regimes will alter the global financial space under the specific business cycle phase. Past literature concludes that U.S. monetary policy and its intentions to maximize top-line revenue leaves lasting shocks on global economic conditions.

It is widely known that the increasing and large interconnectedness of the global financial market have led to the vast emergence of the Global Financial Cycle and Global Value Chain (Rey, 2013). Rey (2013) further adds that the 2008 Global collapse is not directly aligned with a countries' specific underlying macroeconomic conditions. Instead, through a VAR econometric model<sup>1</sup> Rey (2013) found that fluctuations in exchange rates and the direction of the U.S. market is a watershed determinant directing underlying macroeconomic conditions of international finance. Miranda-Agrippino and Rey (2015) establish the heightened importance of U.S. monetary policy and its driving influence on the global financial cycle.

Interestingly, shortly after the Second World War the U.S. originally intended to help developing countries during times of crisis through open market promotion coupled with their actions as "last resort" aid to minority group expansion in their respective market. But, considering empirical results and the narrative of existing literature, as well as practical case studies, these intentions of free-market initiatives are not true, as it is really a fallacy. Williamson's Consensus covers a neoliberal agenda and fundamentalism of the broader market. To promote neoliberal austerity, Williamson (1998) suggests this school of policy fosters open market conditions as the U.S. and mentioned global institutions create thoughtful policies that push "...prudent macroeconomic policies, outward orientation, and free-market capitalism." But, in reality, U.S. policy is not prudent and does not foster free-market sentiments. Relatively, changes in U.S. policy ripples into other

---

<sup>1</sup> Vector Autoregression is a stochastic model that uses panel data over a period of time.



economies, creating negative spillovers into financial conditions (Arora et al., 2000; Bräuning et al., 2008). Likewise, the Washington policymakers force many nations into predatory economic conditions while also amplifying instability throughout various domestic facets. This relationship is seen through the continued credit extension to the sovereign state of Argentina, which has defaulted twice since 2000<sup>2</sup> and nine times since their independence from Spain in the early 19th Century. Paradoxically while originally wanting to foster global growth through targeted support programs, the U.S. has done the opposite, as changes in Washington's policy curbs development initiatives in countries across the world. Since 1944, the U.S. directs the financial conditions of international finance, but fails to consider its effects on other global sovereign governments.

Empirically found in existing literature, the U.S. money-oriented interest surpasses the needs of the constituents where, as Reich (2007, 2016) suggests, such elected officials will seek out their optimal financial gain by pushing the private interest of the *tyranny of the minority* - causing the other global economies to become *el Gil* as they struggle to address changes in the U.S. economic prerogative effectively. This one-sided dynamic, supported by the private interest of politicians, deters the free market and thus allows policies of predatory practices to guide the direction of the global economy. Stiglitz (2010) adds that the overall market functions follows U.S. interest, causing many countries to deal with less accommodative conditions.<sup>3</sup> Without equivocation, current economic policies that Washington policymakers deploy on the world is coercive macroeconomic manipulation and outward orientation that has stemmed from forceful targeted-political monopolization dating back to the end of World War II<sup>4</sup> under the U.S. political-military hegemony.

An extension to previous historical literature outlining the rise and current position of America's hegemony, Stiglitz (2010, 2018, 2021) asserts that the United States deploys

---

<sup>2</sup> Historically, Argentina has been the most active issuer of EM countries. However, following their 2001 default, the Argentine government did not issue a single sovereign bond in the international market for 14 years.

<sup>3</sup> Less accommodative services are typically tight monetary policy deployed by the central bank typically taking form in a high interest rate environment - curbing market activity and inflationary pressures. This tight policy flows over onto other countries as they too will face tight conditions as alluded to in Arora et al., (2000).

<sup>4</sup> Outward political monopolization refers to the byproduct of hegemonic control following Bretton Woods and the Marshall Plan.

predatory practices that seek to exploit developing economies that lack robust infrastructure, which can hedge their position against global financial tailwinds. Additionally, the power of America's predatory influence is further heightened under the support of the IMF and World Bank. Clear, these global institutions were established under the prerogative of the U.S. and continue to fail to incorporate advancements in economic thought. Stiglitz (2010) claims that when countries face an economic downturn, the U.S. and world financial institutions like the IMF and World Bank promote contractionary policy that curbs positive development. This paper continues by providing ample evidence of the U.S. hegemonic control generating global instability. Stiglitz (2010) claims that these financial institutions that drive the global financial market inadequately interpret historical data and fail to deploy equitable market conditions effectively. Instead, these organizations advocate for policies that align with John Williamson's failed *The Washington Consensus* (2004). The works of Stiglitz (2010) are extended by Brown (2015), who claims free market conditions have been produced by white male populations that have dethroned the equitable landscape through neoliberal capitalism. Brown adds further that neoliberal capitalism in its purest sense is an imperialism project as it is a virulent manifestation that demonizes democracy. Since 1944, American legislation has been a watershed voice in global policy; the United States has the ability and scale to create a network of economic, political, and diplomatic equity. However, as Brown (2015) and Stiglitz (2010, 2018, 2021) point out, the democratic free market framework of U.S. neoliberal policy making is that of neoliberal capitalism solely benefiting the corporate self-interest and solidifying the global stronghold of the U.S. hegemony in the global market. Consequently, through the U.S. free market capitalist framework, the "tyranny of the minority" continues to direct domestic policy making, ignoring potential implications on other countries.

This oppressive political injustice is driven by regime changes in U.S. monetary policy, as the U.S. Federal Reserve has emerged as the most salient global central bank. Considering the Federal Reserve's independence, most U.S. policymakers<sup>5</sup> are driven off neoliberal sentiments, flawed ideology, and unilateral imposition of the rules – thus

---

<sup>5</sup> Take into account the word choice of "most," as my Senior thesis recognizes the important influence the FED has to adjust the free-market. However, many FOMC Governors have been selected to push a certain political agenda as they have been open and share certain beliefs of a political party.

prompting the mentioned amplified spillover riddling global economy with inequitable restraints. Peter Boockvar, CNBC contributor, emphasizes the significance of the U.S. financial system on the word as he stated, “The biggest risk is not Putin. It is J. Powell. It is Christine Lagarde – Bailey in the U.K.” off the back of the Russian Federation’s invasion of Ukraine in February 2022. Boockvar, like Stiglitz and Reich, provides a contemporary perspective on the coercive state of U.S. policy on the underlying macroeconomic direction of the global economy. While acknowledging the original intentions of U.S. policymakers to promote equitable financial conditions in the international market, Washington fails to do so as the nation's innate capitalistic framework misguides the FEDs monetary policy.

Miranda-Agrippino and Rey (2019) and Rey (2013) add that current U.S. monetary policy causes high co-movement in the global financial cycle. Both pieces of literature further document that regardless of a country's economic regime, changes in the United States monetary regime will affect the monetary conditions of countries connected to the global supply chain. Endogenously responding to changes in macroeconomic conditions, U.S. monetary policy has a powerful spillover to other global economies. However, Dees and Galesi (2019) verbalize that despite American financial interest causing spillover into the global economy, the U.S. influences macroeconomic activity to boost their strong emergence in the global market when deploying expansionary monetary policy. Interestingly, the Federal Reserve recognizes its role in affecting international financial variables and repeatedly emphasizes the heightened importance of analyzing potential spillover from changes in their policy. Former Vice Chairman of the Federal Reserve, Stanley Fischer made this point:

“...And of course, actions taken by the Federal Reserve influence economic conditions abroad. Because these international effects in turn spill back on the evolution of the U.S. economy, we cannot make sensible monetary policy choices without taking them into account...”

Its continued hegemonic control has only amplified U.S. monetary policies on the global financial cycle. Obstfeld (2019) expands on the American economic hegemony as the U.S. Federal Reserve continues to powerfully propagate in various international financial markets, driving economic spillover. Through today’s globalized supply chain, macro-financial spillovers are economically significant. Through their established political-military hegemon, Washington policymakers, particularly the FED, create global

synchronization of U.S. economic conditions, only amplifying as more countries become integrated. Put another way and considering Fischer's comment, international financial needs derive from the peak and trough movement of the U.S. economy. Developing countries continue to see negative spillover in their economy while also struggling to address monetary regime changes effectively. Following Alan Greenspan's increased stress regarding American economic policy and its relationship with the global financial turbulence of 1998, the U.S. soon after cut the Fed rates. Accompanying the announcement to cut the Fed rates, the FOMC stated that:

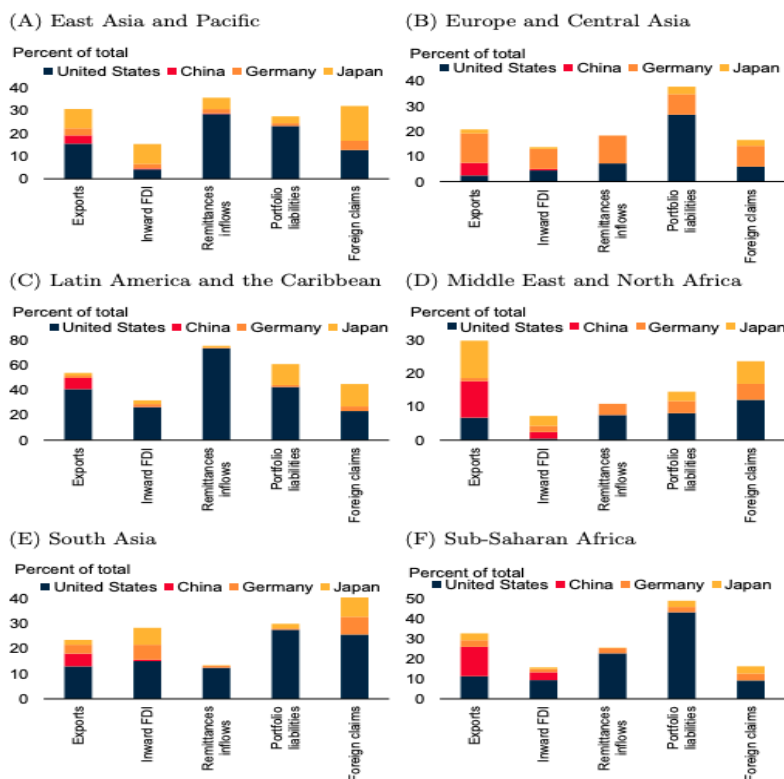
“The action was taken to cushion the effects on prospective economic growth in the United states of increasing weakness in foreign economies, and less accommodative financial conditions domestically.”

Years later, Ferrara and Teuf (2018) highlight U.S. accommodative monetary actions and references in shifts of international financial factors. This piece prefaces and builds off past research on how U.S. monetary policy amplifies change in the global economy and domestic markets. Research suggests that domestic American monetary policy priorities and commitment to appease market sentiment ultimately lead to spillovers in other international markets. Feldkircher and Huber (2016) concluding that spillovers created by U.S. monetary influence, supply and demand to see the significant result of policy tightening on negative output. Georgiadis (2016) adds further commentary stating that U.S. monetary tightening curbs global output where the spillover in the change of American outlook is more considerable than domestic changes. The monetary prerogative of Washington, in the context of the FED, heavily concentrates the policymaking autonomy of many emerging market Central Banks.

## **1.2 Concentrated Negligent Global Spillover**

Particularly strong in Latin American and other emerging market economies, seen in Figure 1 below, U.S. influence is densely concentrated across most emerging market regions. Countries considered as an emerging market economy is a nation in the process of developing – typically through industrialization – while also improving their currency,

banking, and stock market system. Similarly, these nations on average have elevated social and political uncertainty. These countries categorized as “emerging,” are projected to benefit from robust macroeconomic growth, but greater risk exposure. Emerging markets are a reliable proxy to illustrate the international financial system. Furthermore, this category of nations best represents the effects of U.S. monetary policy spillover on the world’s economic conditions. Most countries considered emerging markets depend heavily on the U.S. as they typically have a soft peg or floating rate exchange system to the U.S. dollar or issue various investments denominated in the dollar. Further, the U.S. has strong inflows of foreign direct investment throughout many nations and continues to exploit their market for their marginal gains. For example, this can be seen in the strong U.S. presence in Chile, as they are one of the largest lithium providers globally. Or Mexico as its proximity and low business cost makes many U.S. firms seek out production there. That being said and referencing Table 1, it is clear that the U.S. has a stronghold over many countries categorized as an emerging market economy. Directly exposed to U.S. developments, most emerging market countries are open to trade, thus making them more exposed to widespread spillover from changes in American monetary policy. These are just two examples of the U.S.’s greater macro-influence and dense ties to nations considered emerging markets. This spillover is heavily concentrated across all continental regions, as no nation is totally removed from the global economy and subsequent U.S. changes. In sum, U.S. economic policy continues to influence the economic conditions of emerging market countries.

**Figure 1: United States: Linkage Across EME**

Source: Kose et al. (2017)

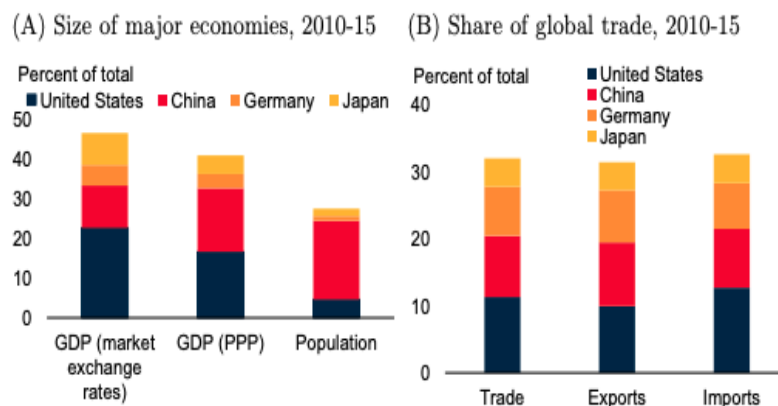
As shown in Figure 1 and 2, concurrently, the U.S. has a vital sphere of influence with emerging market countries, and analysis of America's impact on these countries must be further examined. Kose et al. (2017) found that when the U.S. monetary policy took a less accommodative thesis,<sup>6</sup> there were adverse economic shocks on developing capital flows and asset prices. An increase of 100 basis points in the U.S. long-term Treasury yield can potentially reduce capital flows into emerging market economies by 20 - 45% (Kose et al., 2017). Kose et al. (2017) later states that less accommodative policy had a negative association with an increase in domestic fragilities risks in price drops – hurting the overall economic conditions within the country. Adding further, Eichengreen and Mody (1998) use a sample of East Asian and Latin American countries from 1991 - 1995 to find a

<sup>6</sup> Less accommodative or contractionary policy is used to reduce the rate of inflation, a strong indicator of the economy overheating. This policy reduces the money supply and raises rates. In my thesis, the two are interchangeable and mean the same thing.

significant relationship where a rise in U.S. rates leads to a reduced spread. Moreover, the paper finds that an increase in the rates reduces issuances in the emerging economy bond market. Ultimately, Kose et al. (2017) found that U.S. monetary policy tightening is particularly amplified in emerging market economies and subsequently dampens sovereign bond spread in the long-run.

Changes in U.S. monetary policy and market conditions solidifies its sphere of influence - acting as the fundamental driving force of the global economy. Countries will see leveraged metrics<sup>7</sup> if the U.S. faces financial hardship or domestic unrest. For example, reported by Bloomberg Market Insights, months before the 2020 election, foreign markets and the loanable fund market reached historic lows. This reality can be attributed to the political uncertainty that came with this election cycle, as former President Donald Trump's anti-globalization rhetoric signaled a threat to the global supply chain and flows of American capital to developing economies. The emergence of changes in U.S. monetary policy intrinsically alters global macroeconomic conditions – further emphasizing the interconnectedness and weighted influence within the international market.

**Table 2:** United States: Trade and Size Global Linkage



Source: Kose et al. (2017)

Following the sparked continuation of American capital flows into the developing global economy in the 1990s, there was an increase in market turbulence with elevated

<sup>7</sup> The market is not trading at where it should be.

country vulnerability and a sharp decline in foreign interest rate spreads.<sup>8</sup> This condition adds further to the manipulative relationship changes in the U.S. monetary policy regime have on the global economy, in particular the monetary austerity of emerging market economies. In particular, when the FED deploys contractionary policy to cool down the economy and prevent inflationary pressures, foreign economies will see increased volatility due to such spillover. When the FED uses contractionary moves, especially hikes in short-term interest rates, the credit cycle of other countries will face increased risk premium levels, or elevated cost of borrowing levels. Historical episodes of global economic turbulence moved in tandem with an unknown drastic change in U.S. monetary policy and even during anticipated transition, addressed in Kose et al., (2017). Barring the global macroeconomic market with changes in monetary policy, the U.S. has catalyzed the expansion of the growing division of inequality, precariousness in international finance, and unrestrained Western capitalism across the global financial system.

The spillover from the U.S. political-military hegemony is seen through Mexico's economic collapse in the late 20th Century. For the better half of the late 1990s, the Mexican Central Bank faced multiple financial crises. The most significant recession period occurred during the Mexican "Tequila Crisis" of 1994 - 1995, which led to the most prominent international bond market compression.<sup>9</sup> Many emerging market analysts noted that this compression occurred due to heightened Mexican political and social uncertainty coupled with drastic changes in U.S. monetary policy. In 1994, the U.S. economy saw its most immense structural growth in 10 years – albeit seeing a paradoxical underperformance in its financial markets.<sup>10</sup> This convergence in economic development and financial market health can be attributed to the actions deployed by the U.S. Federal Reserve. For the first time since 1989, the FED tightened its domestic credit cycle to rein in the economy from runaway inflationary pressures. Under the guidance of the then-Chairman Paul Volcker, the FED raised interest rates by 250 basis points<sup>11</sup> – short-term

---

<sup>8</sup> The yield spread is the difference between yields (percentage of return to bond holder) on differing debt security.

<sup>9</sup> In March 1995, the Merrill Lynch Global Emerging Markets Spread closed at 1600 basis points and then dropped to 325 basis points just three months later in July 1995 (Bloomberg Terminal).

<sup>10</sup> In 1994, the stock and bond market underperformed - the worst since 1990. Theoretically, security market health moves in tandem with the well-being of the overall economy.

<sup>11</sup> A basis point is 1/100th of 1%. The basis point is used to show the difference in two bond yields. A general rule of that, is when the Fed cuts rates, as they did here, it causes the stock market to go up and



rates increased by 2.5% – which subsequently raised Mexico’s cost of borrowing. Referencing Figure 3, Volcker’s hike in the short-term U.S. yields caused the spread of already issued Mexican sovereign bonds to see elevated levels of risk premium, making it less attractive to investors.<sup>12</sup> Put differently, fundamentally increased levels of risk premium suggests worse economic conditions and a greater probability of meeting the bonds repayment. Likewise, this curbed the structuring process of bonds, as the Mexican government did not want to issue debt with high U.S. interest rates. Volcker’s rise in rates made riskier investments in emerging markets less attractive as the risk of these sovereign investments rose – soon drying up foreign capital flows into Mexico,<sup>13</sup> refer to Figure 3 below. While the U.S. policymakers adjusted their short-term rates to “rein in” its own market, Mexico faced spillover impacting the economic condition of the nation. Consequently, Mexico’s collapse soon thereafter led to a domino effect impacting Mexico’s regional counterparts.

### **1.3 U.S. Influence on Emerging Market Credit Cycles**

In practice, sovereign bonds are used to fund various government projects<sup>14</sup>. Soon after the U.S. rate hike, during the depreciation of the peso, Mexico’s finance minister Jesus Silva Herzog announced that the country could not repay its \$80 billion in debt – prompting the IMF and the U.S. to cut Mexico off from the global credit market. As financial unrest grew in Mexico, the U.S. FED initiated roughly six interest rate hikes jumping from 3% to 5.5%. During this time, President Carlos Salinas de Gortari imposed widespread privatization and market deregulation, causing immense unrest. Through privatization, the debt of many state-owned firms would be removed from Mexico’s account balance,

---

improve financial conditions as consumers will enter the credit market due to lower rates. Later, rates jumped up to 3% then 5%.

<sup>12</sup> The Treasury yield (blue line) is the benchmark rate used during the structuring process of a bond. Note, U.S. Treasury bonds are widely known as risk-free as the government will always repay the bondholder the par value upon maturity. The sovereign or corporate bond (red line) should be priced above the benchmark making the credit spread larger (i.e. more attractive as this investment will have a larger return).

<sup>13</sup> With their inability to pay off their debt, Mexico was downgraded and faced credit restraints. In such, they soon faced limited foreign investment as institutional investors assumed the government could not repay their debt and would eventually default.

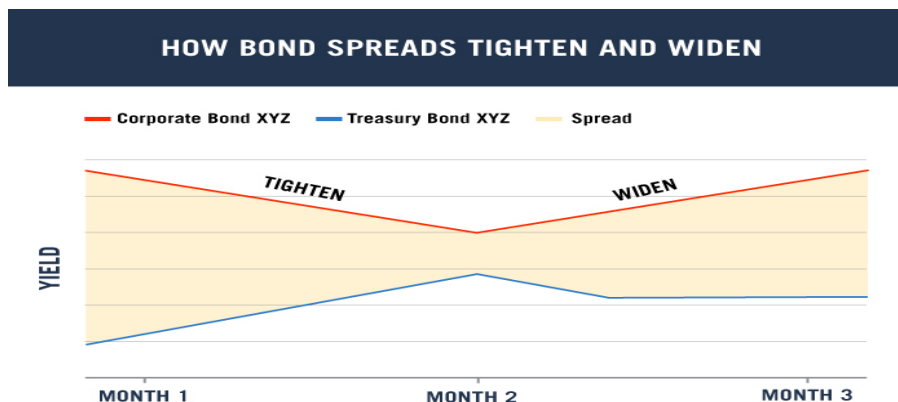
<sup>14</sup> Instead of dealing with raising taxes and the bureaucratic deadlock that accompanies it, governments will issue sovereign bonds to help finance projects.

making it easier to restructure outstanding debt. With the risk profile of Mexican sovereign bonds increasing,<sup>15</sup> the government lost significant capital flows. The markets soon panicked as the country's heavy debt load, and devalued currency caused its economic foundation to collapse. In this case, contractionary monetary policy in the U.S. caused a negative spillover into Mexico's economy among other emerging market countries in 1994 and preceding years. Used to fund various development projects, governments like Mexico in 1994 issue sovereign bonds to drive such economic growth.

Upon the establishment of the U.S. hegemony in 1944, the bonds structuring process has since been benchmarked to the U.S. 10-year, as Washington officials set the precedent that this rate is the universal risk-free security. Sovereign bonds are essential to economic growth for emerging market economies and proxy the economic conditions of the nation. Fundamentally, poor underlying macroeconomic conditions, on average, correlated with a higher cost of borrowing, or risk premium; vice versa. The international credit cycle and rating agencies look favorably upon sound macroeconomic fundamentals, as financial stability suggests a higher probability of meeting repayment conditionalities. That said, when the FED raises its rates – the benchmark to sovereign bonds – the investment decreases as the cost of borrowing will increase due to elevated levels in U.S. domestic markets. Sovereign bonds proxy the economic conditions of nations, or its perceived risk profile. In practice, the cost of borrowing for many emerging market countries comove with volatile oscillations in U.S. conditions.

---

<sup>15</sup> With heightened political uncertainty and a heavy debt load, investors thought Mexico would default - increasing their credit risk profile.

**Figure 3: Function of Bond Spreads<sup>16</sup>**

Source: FINRA

Sovereign bonds nominal spread<sup>17</sup> are common proxy to gauging the economic conditions of each respective emerging market country. To finance national projects<sup>18</sup> the government has two options: issue bonds or raise taxes. Raising taxes is very unpopular and a lengthy process riddled with political deadlock, thus making the issuance of a sovereign bond the optimal decision. In the same vein, given that many of these countries have blurred legal systems and political systems, the global credit cycle looks favorably upon U.S. financial conditions. That said, most sovereign bonds issued by emerging market governments are issued in a foreign currency as there is a higher risk in the local currency. During the structuring process, the yield<sup>19</sup> the bond is dependent on three country-specific variables. The first is a country's risk, which looks at the internal and external factors that could jeopardize the country's ability to pay off the debts face value. The second is creditworthiness is the nation's perceived ability to repay any debt - typically received from a global rating agency. The third is the exchange rate, where changes can pressure the government into a payout. The risk profile of the bond is then benchmarked to a risk-free rate, typically U.S. Treasury yields, seen in Figure3. The nominal spread is the sovereign

<sup>16</sup> The Treasury Line is the risk-free benchmark rate and when it rises it tightens the spread, making the investment less attractive.

<sup>17</sup> The sovereign bonds nominal credit spread is defined outlined in Figure 3.

<sup>18</sup> These projects are typically but limited too: municipal updates, education or social programs, among others.

<sup>19</sup> The yield on a bond is the derived return of interest from the security.

bond yield-to-maturity subtracted by the risk-free YTM. The spread of the bond reflects the return on investment of the bond, where a more extensive spread is more attractive to investors, refer to Figure 3. My thesis argues that the second country-specific variable, creditworthiness holds the most weight in the global credit cycle. Furthermore, this notion works off the premise that lenders solely gain about the repayment conditions and ignore other facts such as political risk and exchange rate value. The sovereign bond is a reliable proxy to reflex economic conditions in emerging market countries, and its spread illustrates the impact U.S. monetary policy has on their securities risk profile.<sup>20</sup> Similarly, sound macroeconomic fundamentals are a watershed component that holds a greater significance in the global economy.

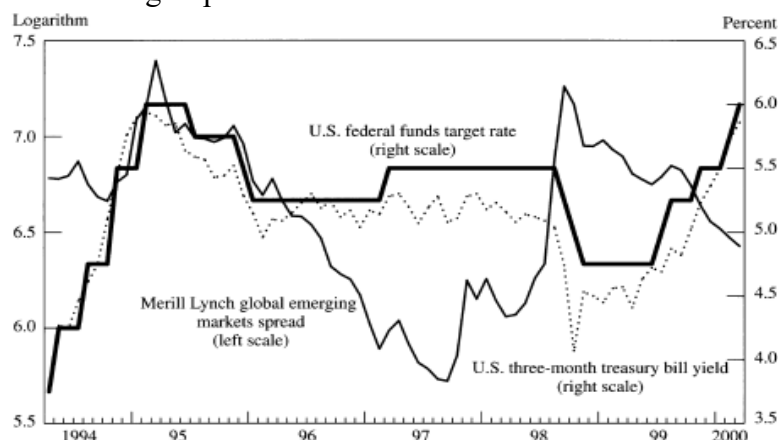
The existing literature is not definitively conclusive on how U.S. monetary policy affects EME sovereign bond spreads. Thus far, many specifications have been various variables of interest proxying the U.S. Monetary policy - specifically American Treasury yields. It is essential to mention that not all shocks in Treasury yields result from a change in U.S. monetary policy. Referencing Figure 4, there was a “flight to quality”<sup>21</sup> during the Asian financial crisis,<sup>22</sup> where the Treasury yields fluctuate drastically in the absence of any change in American monetary policy.

---

<sup>20</sup> This paper considers the bonds risk profile as how attractive the security is to trade.

<sup>21</sup> A common behavior amongst discretionary-macro investors, this financial phenomenon happens when investors sell-off their higher-risk securities during a financial downturn.

<sup>22</sup> The 1997 Asian Financial Crisis was caused by a hot money bubble where the Thai Baht exchange to the U.S. dollar collapsed the exchange rate. With the Thai Baht at a floating peg to the U.S. dollar, many investors feared a potential global economic collapse.

**Figure 4: EM Sovereign Spread and U.S. Interest Rates**

Source: Arora et al. (2000)

Theoretically, U.S. rates can increase emerging market sovereign bond spreads, as presented in Kose et al. (2017). This movement adds further, highlighting the influence of the U.S. hegemony and how it raises the risk premium, or the cost of borrowing, for many countries considered as emerging market economies. In practice, given that emerging market bonds are riskier, having a higher possibility of defaulting, the bond will be structured above the benchmarked risk-free rate. The benchmarked 10-year reflects the overall risk and shows the potential return on investment for an issued sovereign bond. Theoretically, if there are heightened economic conditions in the U.S., the FED typically will raise the 10-year to stop runaway inflation and a devaluation of the U.S. dollar. In such a move, if the U.S. raises rates, it is assumed these country's see increased cost of borrowing. Essential to the sovereign bond market, the movement of the U.S. 10-year will illustrate the potential return and perceived risk profile; fundamentally, sovereign issuers want a low U.S. 10-year, while U.S. FED interests want to protect its own market. Kamin et al. (1999) found that an increase in U.S. rates typically results in the investors reducing their risk appetite, making them risk-off, thus guiding their investment thesis away from riskier emerging markets.

Fundamentally refuting the framework of neoliberal free-market conditions, Kamin et al. (1999) finds that an increase in U.S. rates typically results in the investors reducing their risk appetite, making them risk-off, thus guiding their investment thesis further away from discretionary global macro opportunities. This paper adds further that through this decrease in investor appetite, many investors will then reduce their overall exposure in

risky markets like emerging markets which subsequently reduces capital flows in emerging market economies. Arora et al. (2000) analyzes how U.S. monetary policy influences emerging market country risk, proxied through sovereign bond spreads. This paper works off the relationship that U.S. yield tightening causes sovereign nominal credit compression in emerging market issuances which ultimately curbs the economic growth of many nations. Unlike other pieces of literature, this paper pays particular attention to country-specific fundamentals and how it drives fluctuations of country risk. Consistent with previous literature, this paper finds that the level of U.S. interest rates positively correlates with sovereign bond credit spreads. Arora et al. (2000) highlights that low indebtedness, sustainable fiscal policy, and other macroeconomic fundamentals are conducive to driving economic growth while also reducing country risk. Further, it is found that their policymakers must have a degree of freedom to influence development effectively. Although this paper emphasizes that country-specific conditions can impact emerging market sovereign risk profiles, the direction and regime of U.S. monetary policy are the most important. One major limitation of this paper is the analysis of domestic Central Bank policy making within these countries. Arora et al. (2000) is a piece of existing literature driving my thesis.

Extending to past research like Arora et al. (2000), Bräuning et al. (2008) presents an econometric analysis of the relationship between emerging market issuance and U.S. monetary policy. The investigation found that emerging market loan volume reacted more significantly to a change in U.S. monetary policy than the other developed markets. Furthermore, it was found that a 25bps easing in U.S. federal fund rate – lowered short term interest rates – is associated with an increase in cross-border capital flows and loans in the emerging market space. With a fixed-effects model, the analysis found the net difference between emerging market and developed market loan volume, which can be attributed to the fluid nature of the emerging market structure. Bräuning et al. (2008) suggests that when the U.S. tightens monetary policy to combat inflation or market runoff, their sovereign credit spreads face a high-risk premium. On the flip side, during monetary easing, where the FED lowers its rate, it is found that the cost of borrowing increased 32%, on average, when compared to developed markets. The results were incredibly robust and drove the correlated narrative that emerging market policymakers seek out stable foreign

capital inflows, thus making their open market operations more exposed to changes in U.S. monetary policy (Rajan, 2014). Bräuning et al. (2020) adds that this change in U.S. monetary policy is amplified due to the dominance of the U.S. dollar denomination. Such existing literature outlines the role of changes in economic regimes, particularly contractionary or policy tightening, and its amplified negative spillover in emerging market economies.

Despite the strong growth in emerging market corporate and sovereign debt, there has been little conclusive empirical literature outlining the yield movement in sovereign credit spread reflective of changes in American political interest, internal country-specific, and external shocks. Additionally, research lacks the address of the defensive monetary policy response deployed by many emerging market nations to hedge against U.S. spillover. To the same effect, there has been little political-economic examination on contemporary U.S. influence, particularly the 2008 Collapse influence on the emerging market credit cycle. The Global Financial Crisis of 2007 - 2009 precipitated an ongoing debate regarding the heightened importance of financial stability in achieving U.S. monetary policy objectives. The strategic role of monetary policy economic instability is an important question. Of equal importance, the part of the Central Bank's implementation plan may determine the effectiveness of such change and its spillover onto underlying macroeconomic conditions of many countries considered as an emerging market economy. The culmination of the U.S. political-military hegemony's targeted capitalistic objectives to remedy domestic conditions has led to the decay of the globalized market economy and the monetary autonomy of many international central banks. Since 1944, emerging market economies have seen high risk premiums or increased borrowing costs due to FED technocrats and their shortsighted conditionalities. My thesis hopes to add to the corpus of existing geopolitical and international monetary policy by analyzing how the U.S. continues to hinder the economic austerity of many emerging market economies and how country-specific conditions still make it hard for Central Bank officials to remove themselves entirely from Washington. Given the ever-changing global background, the future of international finance is poised to see robust economic growth, and U.S. policy-making must consider its implications on such prospects.

Chapters in my Senior Thesis are as follows: II. Methodology and Descriptive Data. This chapter will work on the literature throughout Chapter I, Introduction, by discussing previous models that I will use in my thesis and explaining each variable in detail. III. Empirical Analysis. This chapter will analyze the regression results outlined in Chapter 2, explaining each coefficient in the model and whether or not its results fall in line with the literature. IV. Latin America Case Studies: Argentina and Brazil. This chapter analyzes country-specific conditions and changes in FED policy and how it impacts each nation's risk premium. This chapter provides a qualitative narrative outlining the nation's policymaking complementing the results presented in the Empirical Analysis chapter. V. Eastern Hemisphere Case Studies: Turkey and the Russian Federation. Similar to Chapter 4, my thesis investigates U.S. policy's implications on two countries well-positioned in the global economy. Equally important, this section highlights the influence political regimes have on a nation's perceived risk in the global credit cycle. VI. Issues For Evaluation. In this chapter, I present the current policy making structure of the FED and emphasize the importance that they, Washington, acknowledges its role globally with the intent to preserve international stability in the long run. VII. Conclusion. In my conclusion chapter, I will tie the significance of the results and the study together and whether they can be used as guidelines for other countries considered emerging markets. In sum, my thesis aims to critique the current state of U.S. monetary negligence, in the context of the FED hegemon, that continues to plague the equitability of the global economy.



## 2. Methodology and Data

### 2.1 Model

This chapter presents the data and econometric model used to answer the research question. I will describe all of the variables deployed in the model and their respective country-specific metrics. The following economic model will be used to accomplish this task:

$$\begin{aligned} NominalSpread_{i,t} = & \beta_0 + \beta_1 US\_2yr_t + \beta_2 VIX_t + \beta_3 LIBOR_t \\ & + \beta_4 AB_{i,t} + \beta_5 Regime_{i,t} + \beta_6 FDI_{i,t} + \beta_7 Inflation_{i,t} \\ & + \beta_8 Spot_{i,t} + \beta_9 Vul_{i,t} + \varepsilon_{i,t} \end{aligned}$$

The subscript  $i,t$  stands for the country  $i$  in the year  $t$  (year-quarter together).<sup>23</sup> The working dataset for this paper consists of quarterly data from 2000 to 2020 for 8 countries considered as emerging market economies.

### 2.2 Data

The dependent variable in the two-way fixed effect regression is the nominal sovereign credit spread of the eight selected emerging market countries of interest. Proxying the macroeconomic conditions of the respective emerging market economies, the nominal credit spread indicates the risk profile and the yield or the cost of borrowing. This thesis will use the U.S. 10-Year Treasury yield as the risk-free benchmark rate [Figure 2]. My thesis uses the long-term interest rates, *LTIR*, of each country to proxy the economic health of the respective emerging market economy – widely accepted, sustained credit markets suggest sound market conditions as it moves with the economies booms and busts.<sup>24</sup> My thesis pulls the long-term rates from Bloomberg Terminal or the St. Louis Federal Reserve database. However, for Argentina, my thesis uses its Central Bank Federal Funds rate as this rate, on average, moves parallel with projected long-term interest rates.

<sup>23</sup> Q1 (January - March); Q2 (April - June); Q3 (July - September); Q4 (November - December).

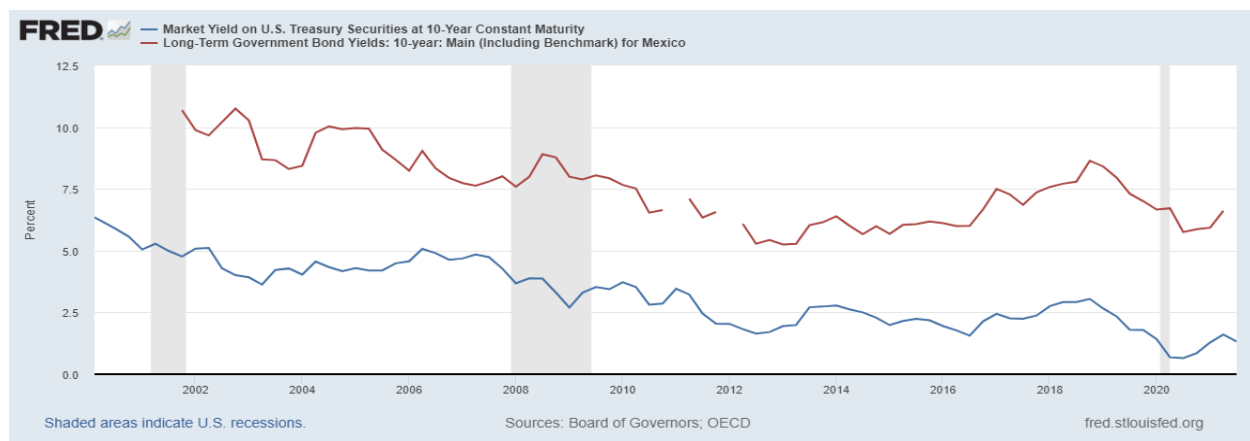
<sup>24</sup> During the busts of the economic cycle, credit cycles on average see a credit crunch – vice versa.

The nominal sovereign bond credit spread is country  $i$  long-term interest rate subtracted by the U.S. 10-Year Treasury Yield.

$$\text{Nominal Credit Spread} = \text{LTIR}_{i,t} - \text{US\_10yr}_t$$

Theoretically, given that most EM sovereign bonds are deemed to have higher default risk, the issuances have a higher borrowing cost, creating a larger spread. Similarly, the higher the spread, the higher risk due to unfavorable economic, political, and social conditions. Equally important, when the FED moves the U.S. 10-Year Treasury yield, the perceived risk or cost of borrowing will comove, where a drop in the benchmark rate, on average, suggests a lower cost of borrowing. While accounting for the economic and political landscape of each country of interest, my thesis hypothesizes that decaying economic and less democratic political conditions will have a positive correlation with the nominal credit spread – suggesting that illiberal market economies will, on average, see a higher risk premium.

**Figure 5:** Mexican Government Bond Benchmarked to U.S. 10-Year



**Source:** St. Louis Federal Reserve

The first independent variable used is the U.S. 10-Year Treasury Yield. The U.S. 10-Year is a debt obligation issued by the U.S. Treasury Department that pays a fixed

interest every six months to its holder. Equally important, the Federal Open Market Committee establishes the yield given the macroeconomic conditions in the respective U.S. business cycle. The decisions guiding the direction of the 10-year is driven off the dual mandate.<sup>25</sup> The U.S. Government pays the par value of the Treasury note to the holder at the maturity date. A variable of interest, the U.S. 10-Year yield is a benchmark proxy on current macroeconomic conditions in the United States. Gyration in various asset classes, on average, are driven off the changes in the 10-Years movement. Correspondingly, as illustrated in Figure 5 above, credit cycles and market conditions of most emerging market economies typically move in tandem with changes in FED targets. Furthermore, 10-Year is a widely used risk-free rate as it is a strong yield to signal investor confidence and the sentiments of the FED under the current macroeconomic environment. Recurrently, the 10-Year yield sits around 1.3-1.5%. This data will be pulled from the St. Louis Federal Reserve's database using reported average quarterly yields.

The U.S. 2-Year Treasury yield proxies' short-term macroeconomic sentiment throughout the United States. Akin to the 10-Year Treasury Yield, the 2-Year is a government debt security that matures in 2 years. The U.S. 2-Year data will be pulled from the St. Louis Federal Reserve, using its average quarterly movement. My assumption is that the U.S. 2-Year will have a positive correlation with sovereign spreads, however it will be negligible as sovereign bonds maturities, on average, have a longer maturity than 2-years.<sup>26</sup>

1-Month LIBOR<sup>27</sup> is a globally used benchmark that large global banks use when lending to each other in the international interbank sector. Like the U.S. Treasury yields, the LIBOR rate can be seen as a protective guide when structuring a fixed-income security. In that, it best represents the direction of lending in the financial space. LIBOR has been accepted worldwide and will be another variable of interest for such a reason. The methodology of this rate is driven on a floating rate debt instrument<sup>28</sup> used to hedge against in-time interest rate exposure. LIBOR data will be pulled from the St. Louis Federal

---

<sup>25</sup> The dual mandate is presented in Chapter 6.

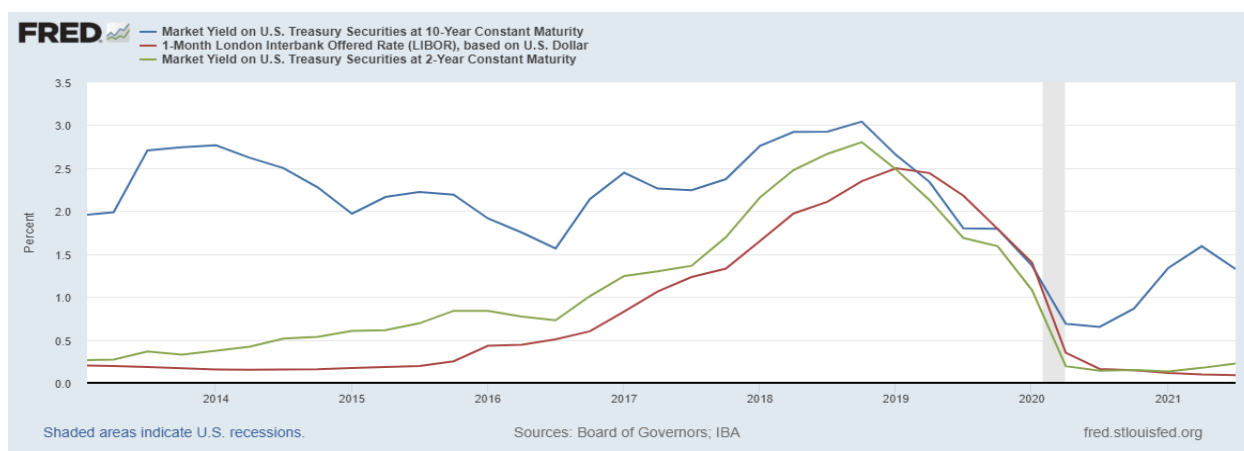
<sup>26</sup> Typical sovereign issuances are sized at ~300 - 500+ million, with a mean duration of ten years. So, when governments issue 2-Years, they will not be exposed to large sways in U.S. policy and conditions.

<sup>27</sup> LIBOR is an acronym for the London Interbank Offered Rate.

<sup>28</sup> Also referred to as a "Floater," this is an debt instrument where its interest payments are driven off an predetermined underlying interest rate.

Reserve database using its listed averaged quarterly data. Note, LIBOR is likely to be replaced by SOFR<sup>29</sup> by the end of 2022 – it will be interesting to see how global credit cycles react to this transition. I expect a positive correlation between the quarterly 1-Month LIBOR rate and the cost of borrowing; however, it will be negligible as U.S. treasury yields are the most commonly used risk-free rate.

**Figure 6.** Quarterly Average of U.S. 10-Year and 2-Year Treasury Yield and 1-Month LIBOR: *Movement in Quarterly Treasury and LIBOR Average During Financial Cycles*



**Source:** St. Louis Federal Reserve

The variable current Account Balance measures the trade balance of a country as well as the international transfer of capital either through remittance or money entering the country from another sovereign government. This variable is a country-specific metric that will reflect the country's capital market, service, and willingness to global trade. In practice, countries with a positive account balance are a net creditor, suggesting that they will lend to other countries. I will pull registered quarterly data in USD millions from OECD's Current Account Balance database. For the countries not a part of the OECD, I will use the Bloomberg Terminal and their Central Bank website. An important indicator of a country's economic health, I hypothesize that this country-specific variable will have

<sup>29</sup> SOFR is an acronym for Secured Overnight Finance Rate. This transition from LIBOR to SOFR because LIBOR was not based on real transactions and was speculated to be easily manipulated. SOFR is thus a backward-looking rate using transactions used in the U.S. Treasury repo market.

a positive and significant impact on the country's sovereign credit spread as they are more exposed to changes in the global economy.

The Political Regime captures the governance structure and its liberal democracy conditions. A watershed country-specific variable, the political health of an emerging market country is considered when determining the creditworthiness during the bonds structuring, as well as the investors risk appetite. Moreover, on average, it is assumed that a country with illiberal economic and political conditions tends to face a higher cost of borrowing. This dataset will be pulled from the V-Dem Institute's Country-Year Democratic Rating, using the *Liberal Democratic High* score ranging from low to high (0 - 1). V-Dem clarifies the principles of a liberal democracy stating the government with a higher score, or more democratic will protect the right of all cohorts against the tyranny of the minority and the state. A score of 0 categorizes the political structure as a polyarchy while a score of 1 has liberal democratic conditions. Given the scope of my selected countries, my thesis assumes any score above a .400 to be "more" democratic, whereas those on the higher end, or closer to 1, have more liberal conditions. Similarly, any score below .399, my thesis considers them to be "less" democratic, having more traits aligning to a polyarchy or autocracy. In sum, this variable judge the democratic qualities of the government and the level of democracy during the nation's election cycle. Given that the democratic structure of a country rarely changes drastically from democratic to non-democratic in one year, this data point will be pulled each quarter of that respective year. I hypothesize that there will be a negative, but statistically significant coefficient, suggesting that as countries become more liberally democratic, the cost of borrowing will decline – vice versa.

Inflows of Foreign Direct Investment (FDI), is the amount of money invested by a foreign company or individual not from the country. Interestingly, FDI may slow down in certain countries due to heightened political and social uncertainty. That said, FDI is reflective of the risk profile viewed by foreign investors. Rather than buying treasury securities from countries, FDI is another proxy that can be viewed as the economic landscape of the nation. This paper will pull quarterly FDI points from the U.S. Bureau of Economic Analysis (BEA) from 2000 - 2020. However, the BEA only covers quarterly FDI for three of the eight selected countries. These countries are: *Brazil*, *Korea*, and

*Mexico*. The data for the remaining five countries will be pulled from the United Nations Conference on Trade and Development (UNCTAD) database. Note, the UNCTAD has annual data, so my thesis will create an aggregated quarterly version of the reported annual FDI figure by dividing the number by four – equally distributing the inflows of investments across the four different fiscal quarters. Both the reported figures from each database are listed in U.S. dollar millions. Despite FDI improving public financial projects and privatization becoming more prominent, my assumption is FDI will have a lagged correlation to the cost of borrowing. In sum, given that development projects take months and years to finish, the effects will not be seen immediately, thus driving my assumption for improved cost of borrowing quarters preceding. Overall, I hypothesize that FDI will have a negative relationship with nominal credit spread.

Country Inflation will be proxied through annual Consumer Price Index (CPI) from 2000 - 2020. CPI shows the measure of average change each year in the prices paid by consumers. My thesis will put quarterly CPI data from the OECD's database, St. Louis Federal Reserve, and the Bloomberg Terminal. Note, the OECD's CPI inflation annual inflationary growth rate is driven on the base year is 2015, covering total services. All CPI series created by the OECD has 2015 = 100 as the reference year which allows users to see annual differences across countries. Across all three sources, the figures are indexed to the U.S. dollar. Showing the change in prices, inflation will assist in outlining the economic conditions of the respective emerging market economy. Of equal importance, fundamentally procyclical high inflationary levels within a country can amplify the default risk and increase the country's real rates, driving them to see, on average, a higher cost to borrow. Therefore, I predict higher levels of inflation will have a positive and significant correlation with nominal sovereign credit spread, *ceteris paribus*.

The Spot Currency Exchange Rate to the U.S. dollar is an essential proxy to determine the economic conditions of any country. The spot exchange is the current price level of the U.S. dollar and its direct real exchange rate value for another respective currency. Most of eight selected countries once had a hard or soft peg to the U.S. dollar. Albeit, despite most of them now having a floating exchange rate, the movement of the U.S. dollar sways the real exchange rate value of most global currencies. Fundamentally, a low valued currency will make the country's exports less expensive to foreign countries

in the global market – vice-versa. Additionally, this variable may highlight currency risk, which occurs often if a nation pegs their domestic currency<sup>30</sup> or issues a debt security when they have hyperinflation. The significance of currency in emerging markets is best shown in the 1998 Ruble Crisis of 1997 Asian Financial Crisis. This data will be in relation to the U.S. dollar<sup>31</sup> and is pulled quarterly from the Bloomberg Terminal. I expect an insignificant correlation between the currency exchange rate to the sovereign issuance given that most emerging market countries issue bonds are U.S. dollar denominated.

The Vulnerability Index is an adapted database using the World Bank's Worldwide Governance indicators to reflect country-specific governance and social conditions. This set of data will provide a gauge of how well a government can effectively carry out policy and how it monitors various aspects of life. This index will use data pulled from the World Bank's Governance Database from 2000 - 2020. The six variables that I will use are: *voice and accountability; political stability and absence of violence/terrorism; government effectiveness; regulatory quality; rule of law; control of corruption*. Further, my senior thesis will use the reported upper bound interval as it implies an aggregated best case. My thesis then uses the average of the six variables creating the range from -1 to 1. Scores on the lower bound, closer to -1, suggest higher volatile conditions which can be attributed to inequitable economic, political, and social conditions. Note, prior to 2002, the governance indicators were updated every two years whereas following 2002 it has been updated every year. That being said, the data set is missing governance indicators for 2001; data points from 2001 will be pulled from 2002. This variable will reflect social vulnerability. This thesis assumes that a lower vulnerability index will have a significant and positive correlation, as the country will face a higher cost of borrowing under such inequitable conditions.

The CBOE Volatility Index (VIX) is a globally used index that represents real-time expectations for the S&P 500 index (SPX)<sup>32</sup> market's relative strength. This index provides a forward-looking 30-day projection of market volatility, providing a strong gauge of

---

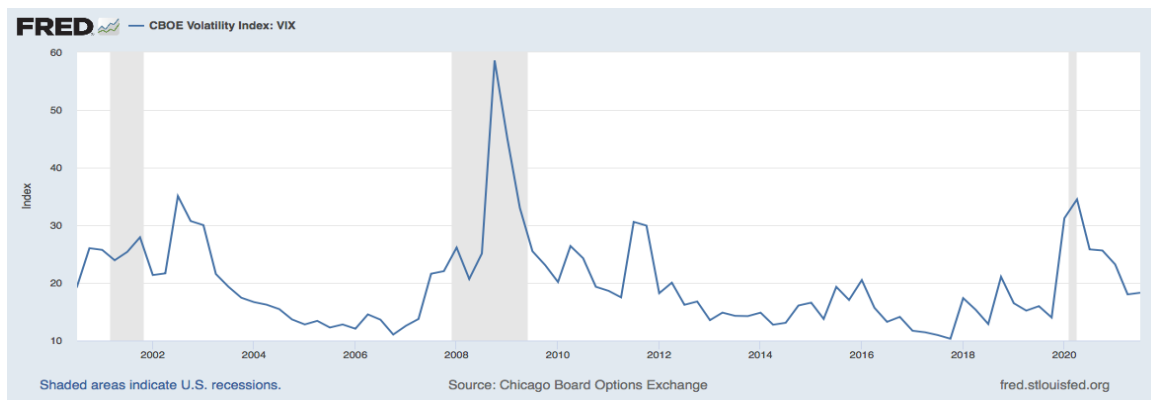
<sup>30</sup> This is highlighted in the Latin America Chapter's Argentina analysis.

<sup>31</sup> This is the aggregated value of one U.S. dollar to another currency. For example, in Q1-2019, one U.S. dollar equated to 5.57 Turkish Lira.

<sup>32</sup> The Standard and Poors (S&P) 500 Index tracks the performance of the largest 500 publicly listed companies. The S&P 500 is a commonly used U.S. equities index that reflects domestic stock market health

market sentiment and investment confidence of global investors towards the U.S. market. When the market is failing or is projected to face a negative shock, the VIX will rise. The movement of the VIX relative to the business cycle is best seen in Figure 7. The shaded area represents U.S. recessionary periods and subsequent contractionary conditions. Equally important, the VIX's ebbs and flows detail the risk appetite, where a rise is typically associated with increased investments towards safe low-yielding assets. Tracking fear of the S&P 500, when the VIX spikes, theoretically tells investors to shift or hedge their investment portfolio's exposures away from exposed equities to bonds among other "safe" securities. My senior thesis will pull the quarterly closing figures of the VIX from the Bloomberg Terminal. My assumption is, when the VIX rises, there will be a positive relationship, as decaying conditions in the U.S. hegemony will spillover onto countries in the global economy, increasing their cost of borrowing.

**Figure 7: CBOE VIX Movement from 2000 to 2020**



**Source: St. Louis Federal Reserve**



## 2.3 Descriptive Statistics

**Table 1:** Pooled Latin America Countries from 2000 to 2020

Latin America						
Country	Variable	Observations	Mean	Stdv.	Min	Max
Argentina	LTIR	84	30.68	33.78	1.05	116.48
	nominalspread	84	27.44	32.81	-1.72	110.68
	spot	84	25.75	18.83	6.09	113.9
	inflation	84	193.74	116.57	97.76	502.87
	ab	84	-914.66	3150.03	-9396.4	4297.83
	vul	80	-0.22	0.15	-0.49	0.08
	regime	84	0.62	0.03	0.59	0.67
	fdi	84	1889.25	1192.23	413	8194.81
Brazil	LTIR	84	12.83	5.16	2.18	27.97
	nominalspread	84	9.59	4.34	1.49	27.97
	spot	84	2.7	0.94	1.56	5.61
	inflation	84	78.82	27.09	37.4	127.49
	ab	84	-8781.93	9017.29	-26391.8	4438.8
	vul	80	-0.03	0.13	-0.25	0.17
	regime	84	0.73	0.09	0.51	0.8
	fdi	84	11189.44	6173.51	2535.88	24355.45
Colombia	LTIR	72	8.96	2.7	5.17	15.41
	nominalspread	72	6.02	2.13	3.01	11.9
	spot	84	2466.04	540.8	1762.5	4055.75
	inflation	84	103.51	14.87	77.75	132.73
	ab	83	-1985.04	1570.17	-6206.74	132.73
	vul	80	-0.36	0.17	-0.65	-0.14
	regime	84	0.47	0.05	0.42	0.54
	fdi	84	2355.51	1213.55	430.12	4052.5
Mexico	LTIR	73	7.58	1.41	5.25	10.75
	nominalspread	73	4.53	0.98	2.6	6.93
	spot	73	13.7	3.77	9.04	23.67
	inflation	84	84.8	20.73	51.66	124.31
	ab	59	-3820.48	3887.1	-10096.39	15598.44
	vul	80	-0.17	0.14	-0.41	0.09
	regime	84	0.46	0.03	0.41	0.5
	fdi	84	7066.73	1747.59	4463.39	12054.14

**Table 2:** Pooled Eastern Hemisphere Countries from 2000 to 2020

Eastern Hemisphere						
Country	Variable	Observations	Mean	Stdv.	Min	Max
Russia	LTIR	74	10.87	7.06	6.68	50.19
	nominalspread	74	7.42	6.54	1.67	44.19
	spot	84	39.95	16.46	23.44	78.42
	inflation	84	68.9	32.87	18.99	125.17
	ab	83	15259.8	7781.42	2621.63	35653.74
	vul	80	-0.71	0.06	-0.86	-0.58
	regime	84	0.14	0.03	0.1	0.23
	fdi	84	6589.38	4676.63	662.77	18963.92
Turkey	LTIR	84	25.13	17.29	8.75	60
	nominalspread	84	21.89	16.31	6.01	55.41
	spot	84	2.38	1.65	0.59	7.72
	inflation	84	77.36	43.69	12.65	190.7
	ab	84	-6875.56	5523.64	-20797.19	6142.34
	vul	80	-0.19	0.17	-0.47	-0.01
	regime	84	0.35	0.16	0.1	0.53
	fdi	84	2733.42	1578.17	245.5	5511.75
Qatar	LTIR	45	3.84	1.01	1.63	5.93
	nominalspread	45	1.59	0.86	-0.43	3.35
	spot	84	3.64	0.01	3.64	3.76
	inflation	84	96.34	19.36	61.11	119.86
	ab	84	4335.51	5081.73	-2067.32	15495.39
	vul	80	0.47	0.12	0.33	0.72
	regime	84	0.1	0.01	0.09	0.11
	fdi	84	323.82	631.48	-703.16	2031.18
Korea	LTIR	81	4.06	1.67	1.39	7.76
	nominalspread	81	0.93	0.88	-0.62	3.16
	spot	84	1128.23	98.63	915.28	1383.1
	inflation	84	89.1	12.64	66	105.71
	ab	84	10249.84	9392.68	-5934	32636.6
	vul	76	0.78	0.08	0.68	0.96
	regime	84	0.72	0.07	0.61	0.81
	fdi	84	10.02	21.38	-58.95	51.3

**Table 3:** Selected U.S. and Global Conditions

Global Rates					
Variable	Observations	Mean	Stdv.	Min	Max
U.S. 10-Year	84	3.24	1.31	0.66	6.03
U.S. 2-Year	84	2.04	1.7	0.14	6.57
VIX	84	20.16	8.55	9.51	53.54
LIBOR	84	1.87	1.9	0.15	6.65

The descriptive statistics presented in the tables above show relevant information addressing the dependent and independent variables used in my thesis. The variables, US\_10yr, US\_2yr, CBOE VIX, and LIBOR are categorized as global rates as my thesis assumes there are watershed drivers guiding the macroeconomic landscape. Similarly, the variables, LTIR, Currency Spot, Inflation, Account Balance, and FDI are country-specific economic variables gauging the market health of each respective emerging market economy. Variables, Political Vulnerability and Regime represent the political and social conditions of each country. Furthermore, to better analyze the results my thesis categorizes the countries into two distinct groups – *Latin America* and *Eastern Hemisphere*. The countries in *Latin America* are Argentina, Brazil, Colombia, and Mexico. Similarly, the countries grouped in *Eastern Hemisphere* are Russia, Korea, Qatar, and Turkey. Note, due to limitations on data collection, there are some missing observations. However, my thesis uses R-Studio, which takes into account missing variables, making them negligible on the overall result of my fixed effect regression.

### 3. Empirical Analysis

This chapter contains an analysis of the results collected from the econometric model and a brief discussion of their implications in the context of U.S. hegemony and emerging market credit cycles. In particular, this chapter presents three different fixed effect regressions, where the first model highlights the causal relationship of all eight selected countries to FED policy and U.S. market conditions. The remaining two sections are regionally specific, divided into *Latin American* and *Eastern Hemisphere* groups, analyzing the casual relationship of internal and external shocks on sovereign credit spreads.

My thesis uses a panel fixed effect regression analysis to best illustrate the changing political and economic landscape of all eight countries. While accounting for individual heterogeneity across variables, each regression has four-panel estimates to better investigate the impact U.S. conditions and country-specific policy have on emerging market risk premium. All four-panel estimations are fixed effects models controlling for

the differences in average values across the eight emerging market countries. Note the fixed-effect approach does not produce results for variables that do not change quarter-over-quarter.

I set the sovereign nominal credit spread as the dependent variable in all three regression. Given that I calculate nominal credit spread by subtracting the US-10yr from each country's long-term interest rate, LTIR, I do not incorporate them in the regression. Equally important, across all three regressions, each model pairs political vulnerability and regime together for the first two while separating them in estimations 3 and 4. Accounting for multicollinearity, these two variables interfere with the results' statistical significance. When referencing Table 4 below, there is relatively strong correlation between political vulnerability and regime – creating multicollinearity found in my preliminary results. That being said, despite collecting similar results, these two variables are fundamentally different as the political regime analyzes the governing structure of the respective country. In contrast, political vulnerability examines country-specific social conditions and constraints. In sum, due to their fundamental differences regarding their technical metric gauge, the first two estimations pair the variables together, while the remaining keep them separate from each other.

**Table 4:** Correlation between political vulnerability and political regime

Country	Correlations
Turkey	0.851
Colombia	0.789
Mexico	0.753
Brazil	0.702
Qatar	0.443
Korea	0.318
Argentina	0.169
Russia	-0.414

### 3.1 Collective Emerging Market Fixed Effect Regression

In the first regression, my thesis uses all eight countries to analyze the causal relationship of the dual mandates short-term U.S. policy targets and country-specific characteristics on the risk premium of emerging market economies. Considering that eight countries have seen robust economic growth in the past 21st Century and accounting for the current globalized landscape of international finance, these results proxy the effects FED policy has on the cost of borrowing in the global credit cycle.

**Table 5:** Fixed effect regression analyzing the effects of U.S. conditions and country-specific variables on the risk premium of sovereign spread from 2000 to 2020

	<i>Dependent variable:</i>			
	nominalspread			
	(1)	(2)	(3)	(4)
US_2yr	5.272*** (1.329)	4.191*** (0.346)		4.243*** (0.344)
VIX	0.150** (0.061)	0.138** (0.058)	-0.001 (0.065)	0.157*** (0.060)
LIBOR	-0.860 (1.127)			
spot	-0.0005 (0.002)		-0.002 (0.003)	
inflation	0.007 (0.011)			0.022** (0.011)
ab	0.0001 (0.0001)			0.0002** (0.0001)
vul	19.698*** (5.054)	16.385*** (4.519)	21.440*** (4.222)	
regime	8.760 (8.893)	9.454 (8.031)		34.586*** (7.038)
fdi	0.00001 (0.0002)	-0.0001 (0.0002)	-0.001*** (0.0002)	
Observations	560	576	576	581
R <sup>2</sup>	0.297	0.283	0.064	0.296
Adjusted R <sup>2</sup>	0.277	0.268	0.046	0.282
F Statistic	25.529*** (df = 9; 543)	44.528*** (df = 5; 563)	9.717*** (df = 4; 564)	47.858*** (df = 5; 568)

Note:

\* p<0.1; \*\* p<0.05; \*\*\* p<0.01

Table 5 has four regressions where the sovereign nominal credit spread is held constant as the dependent variable. As presented earlier, increased risk premium, or the elevated cost of borrowing levels, suggests “less favorable” political and economic conditions in the respective country. The U.S. 2-Year Treasury Yield and CBOE VIX have a positive relationship with the nominal credit spread. The results confirm my initial hypothesis, that when the U.S. FED raises its 2-Year by 1% the cost of borrowing for emerging market economies increases. Correspondingly, when the S&P 500 is projected to see elevated volatile conditions in the future, as proxied through a one-unit increase in the VIX index, emerging markets face amplified spillover with an increase in their cost of borrowing. Conversely, LIBOR has a negligible effect on the sovereign nominal credit spread. Given that SOFR is removing LIBOR in 2023 due to rate manipulation, my original hypothesis is affirmed. Consistent throughout every estimation, these results confirm my thesis that the U.S. political-military hegemony negatively impacts the economic austerity of emerging market economies.

Moreover, these results suggest that changes in underlying macroeconomic variables, seen through the U.S. 2-Year and decaying market conditions benchmarked through the VIX, elevate the risk premium conditions in emerging markets. This result is seen through the results, highlighting the continued myopic perspective of the FED, as these eight countries saw elevated risk premium levels throughout the 21st Century. In sum, not only do changes in FED policy constrain the credit profile of these countries, but public market sentiment does as well, but not to the same magnitude. Adding further to the narrative presented in the four case studies, former Austrian Chancellor Metternich's original adage should be updated for the U.S. – “If Washington is sneezing, the rest of the world catches a cold.”

Political vulnerability, inflation, account balance, and the political regime all have positive relationships with the sovereign nominal credit spread. As expected, with increased political exposure, proxying increasing inequitable social conditions, and tight downward pressure on socioeconomic mobility, emerging market economies face a higher cost of borrowing. Increased political instability is best seen through *Corralito* in 2001, where Argentina's long-term interest rate was north of 115.3%. Another example is

following the *Gezi Park* protests wherein 2013 Turkey's cost of borrowing increased to unsustainable levels. This result supports my original thesis that decaying social standards or increased upheaval, on average, raises the cost of borrowing in the global credit cycle. Surprisingly, the political regime positively correlates with the nominal credit spread. These results suggest that, with a unit increase in their V-Dem liberal democracy score, moving further away from autocracy or a polyarchy, emerging market economies see an increase in their cost of borrowing. Paradoxically, this result is the most emblematic, as I initially hypothesized that political regimes would negatively affect the nominal credit spread. While acknowledging this result, my thesis considers this result negligible as macroeconomic stability outweighs erratic policy in the global credit market. Rather, this supports the narrative that participants in the global credit market weigh macroeconomic fundamentals more so than the nation's political landscape. This is further evident in the preceding four cases, particularly pertinent in the 4.2 Argentina and 5.1 Russia sections.

Illustrating an improved credit profile, when emerging market economies increase their current account balance, they see an increase in the cost of borrowing, *ceteris paribus*. This metric should be zero, but in reality, it depicts whether the nation is facing a deficit or surplus. To my surprise, as these countries become net creditors, they see a high-risk premium. Despite refuting my hypothesis, this result is fascinating. In particular, this suggests that as emerging market economies see an increase in their account balance, making them a net creditor, theoretically, they should become more connected to the global credit cycle. In the same vein, as they see a one-unit increase, the cost of borrowing increases. These countries then amplify their exposure to changes in the U.S. political-military hegemony as they are more related to other countries.

Moreover, inflation has a positive correlation with the cost of borrowing. This result highlights that, with increased inflation, nations will see elevated levels in risk premium – as I initially hypothesized. Put differently, when inflation rises by 1% the cost of borrowing will increase by .022%. Holistically market participants face downward pressures under increased inflationary conditions as it constrains their financial ability. During conditions of runaway inflation, the domestic credit cycle tightens as borrowers are less susceptible to lend as individuals, on average, struggle to meet lending conditionalities. Equally important, given that firms and citizens spend less, market growth remains stagnant,

limiting the nation from reaching projected growth prospects. Widely acknowledged, tax legislation in emerging markets and developing countries inevitably see's dense concentrations of tax evasion as many participants avoid meeting the requirements of their bracket. Under increased inflation, the government will see a further decrease in their tax collection, straining their financing ability. As anticipated, rising inflation levels increase the cost of borrowing.

FDI has a negative relationship with the sovereign nominal credit spread, confirming my original hypothesis. This result states that with a one-unit increase in FDI, the risk premium declines, on average. Many emerging market economies are poised to see tremendous growth in the near term due to their ability to scale, low production costs, vast reserves of natural resources, improving socio-economic traits, and other prospects. With this, many foreign enterprises have shifted large flows of capital targeted to private and public projects that will help provide handsome top-line revenues figures and earnings metrics for many emerging market corporations. Practically, as governments see inflows of money from foreign investment cohorts, there is no need to issue sovereign debt to fund a municipal project. In essence, FDI is another alternative for the government to finance various projects, replacing tax and debt issuance initiatives. To the same effect, once these projects are complete it is fair to assume that the country has improved domestic economic conditions, which lowers the government's risk premium. The spot price has a negligible effect on nominal credit spread. Given the nature of the emerging market credit cycle, this result holds true both fundamentally and practically. Following the establishment of the U.S. hegemony in 1944, the U.S. dollar and short-term rates benchmarked most sovereign issuances. Widely considered a “safe haven” currency, most sovereign issuances in emerging market economies are not denominated by the local currency.<sup>33</sup> Instead, almost all of them are U.S. dollar-denominated, making their currency's real exchange rate value trivial. Equally important, many countries now work off a floating exchange rate, which typically is weighted towards the U.S. dollar – which in practice, should not drastically deviate if the country's central bank subscribes to an orthodox monetary thesis.

---

<sup>33</sup> Note, other commonly used currency denominations are the Swiss franc, yen, and euro.



### 3.2 Eastern Hemisphere Fixed Effect Results

This section analyzes the causal relationship of U.S. conditions and country-specific trends against the nominal credit spread for the selected *Eastern Hemisphere* countries. These countries are Russia, Turkey, Qatar, and Korea.

**Table 6:** Fixed effect regression analyzing the effects of U.S. conditions, global rates, and country-specific variables on the risk premium of Eastern Hemisphere countries

	<i>Dependent variable:</i>			
	nominalspread			
	(1)	(2)	(3)	(4)
US_2yr	-1.018 (1.076)		1.041*** (0.346)	
VIX	0.119** (0.047)	0.133*** (0.042)	0.139*** (0.051)	0.179*** (0.052)
LIBOR	1.083 (0.901)			1.048*** (0.273)
spot	0.005 (0.008)		0.011 (0.009)	
inflation	-0.061*** (0.022)	-0.060*** (0.020)	-0.145*** (0.020)	
ab	0.0003*** (0.00005)	0.0003*** (0.00005)		0.0003*** (0.0001)
vul	-28.210*** (4.666)	-28.440*** (4.041)	-4.519 (4.152)	
regime	59.454*** (7.566)	60.261*** (7.058)		50.380*** (5.045)
fdi	-0.001*** (0.0002)	-0.001*** (0.0001)	-0.001*** (0.0002)	
Observations	271	271	271	284
R <sup>2</sup>	0.581	0.578	0.444	0.426
Adjusted R <sup>2</sup>	0.562	0.564	0.424	0.412
F Statistic	39.828*** (df = 9; 258)	59.667*** (df = 6; 261)	34.692*** (df = 6; 261)	51.261*** (df = 4; 276)
<i>Note:</i>				*p<0.1; **p<0.05; ***p<0.01

Akin to the results presented in Table 5, the U.S. 2-Year Treasury Yield and CBOE VIX in Table 6 have a positive relationship with the sovereign nominal credit spread of emerging market countries in the Eastern Hemisphere. Despite being further removed

geographically, when the FED raises short-term rates, proxied through the U.S. 2-Year, the cost of borrowing increases. When the U.S. 2-Year rises by 1%, the sovereign nominal credit spread of four *Eastern Hemisphere* countries increases by 1.041%, ceteris paribus. Similarly, when the VIX rises by one-unit, nominal credit spreads increase. Despite the VIX pricing in future volatility in the S&P 500, this fear spills over onto these Eastern countries, subsequently tightening their credit profile and raising their cost of borrowing. My original hypothesis is affirmed through these results, suggesting that elevated U.S. conditions and shortsighted changes in FED policy amplify over to emerging market economies, ultimately harming their economic austerity. Likewise, despite many of their Central Banks using orthodox monetary policy<sup>34</sup> and countercyclical measures during heightened global financial distress, these countries are innately incapable of protecting themselves from U.S. spillover.

Surprisingly, LIBOR has a statistically significant and positive relationship with the credit spread. This result suggests that, with a 1% increase in LIBOR, on average, the risk premium rises by 1.048%. These results show a similar movement to the U.S.-oriented variables presented above and highlight its regional effect. Given that LIBOR is based on overnight rate estimates by London banks, this rate is commonly used in Europe and in many other Western countries. Given the regional proximity of these governments to the London banks comprising LIBOR, it can be assumed that they, *Eastern Hemisphere* countries, are more exposed than the *Latin American* group – this is presented in the preceding section. Additionally, it can be assumed that these four countries will use banks in London over the U.S., so when the syndication groups of these banks structure sovereign issuance, they may use LIBOR. The currency spot in Table 6 yields a negligible relationship. This can be attributed to the sovereign issuances being predominantly denominated in the U.S. dollar or the floating exchange rate system, which favors the movement of the U.S. dollar.

To my surprise, Table 6 highlights a negative causal relationship between political vulnerability and the risk premium of the four *Eastern Hemisphere* countries. This result

---

<sup>34</sup> Note, I say many of them, as I argue that the Central Bank of Turkey among other technocrats in Ankara are unable to carry out “orthodox” policies under Recep Tayyip Erdoğan. Erdoğan has fired three central bank governors since the onset of the novel coronavirus pandemic as he opposed raising rates.

states that when domestic inflationary levels rise by 1%, the cost of borrowing will decrease. As addressed in the section above, this fundamentally does not hold. When a nation faces runaway inflation, its downward force constrains its purchasing ability, thus limiting its range to meet specific loan conditionalities. Argentina following the *Convertibility Plan* in 2001 is the poster child negating this result found in Table 6. More specifically, as Argentina entered the 21st Century, they saw historically high inflation levels. With this downward pressure coupled with a drastic devaluation in the peso, the Central Bank of Argentina struggled to meet the IMF's repayment schedule, which sparked their economic collapse in 2001. Similar to the regime results, this inflation result suggests the unpredictable conditions found in emerging market credit cycles. The political vulnerability of these countries has a negative correlation with the nominal credit spread. Both of these variables yield a relationship that I did not originally hypothesize. As the political vulnerability increases in these countries, seen through heightened social upheaval, on average, these four countries will see a rise in their cost of borrowing.

Consistent throughout three estimates, FDI inflows negatively correlate with the nominal credit spread. This result suggests that, on average, a one-unit increase of FDI inflows leads to a .001% decline in the cost of borrowing. Pragmatically, countries issue debt to help fund various targeted projects, typically municipal initiatives. Other alternatives are to raise taxes, which naturally face deadlock and backlash, or these countries can receive external investment taking shape through FDI. With increased inflows of FDI, it is widely assumed that the nation in question will have improved economic and social conditions. The framework of FDI and the results presented in Table 6 complement each other.

Conversely, the current account is negatively associated with nominal credit spread – a relationship I hypothesized as positive. However, improving account balance suggests that the country is more connected with other countries and international financial conditions, exposing them to changes in U.S. policy. In short, these results illustrate the spillover of the U.S. hegemony on the economic autonomy of many emerging market Central Banks. Likewise, despite being further removed geographically and many leaders of these nations critiquing the role of Washington technocrats, these results suggest that it

is still challenging for such countries in the global economy to be entirely removed from this Western power.

### 3.3 Latin America Fixed Effect Results

This section analyzes the causal relationship of U.S. policy and country-specific characteristics on the nominal credit spread of my four *Latin American* countries.

**Table 7:** Fixed effect regression analyzing the effects of U.S. conditions, global rates, and country-specific variables on the risk premium of Latin America countries

	<i>Dependent variable:</i>			
	nominalspread			
	(1)	(2)	(3)	(4)
US_2yr	6.257*** (2.092)	6.157*** (0.532)	6.350*** (0.547)	
VIX	0.126 (0.099)		0.137 (0.093)	-0.069 (0.117)
LIBOR	0.217 (1.797)			
spot	-0.002 (0.003)	-0.001 (0.003)	-0.001 (0.003)	
inflation	0.004 (0.013)	0.009 (0.013)	0.010 (0.013)	0.015 (0.016)
ab	0.0001 (0.0002)			0.0004** (0.0002)
vul	29.145*** (7.738)	22.754*** (5.630)	22.387*** (5.625)	
regime	-2.493 (17.697)			47.670*** (18.273)
fdi	0.001* (0.0004)	0.001** (0.0002)	0.001** (0.0002)	
Observations	289	305	305	297
R <sup>2</sup>	0.380	0.354	0.358	0.039
Adjusted R <sup>2</sup>	0.353	0.336	0.339	0.016
F Statistic	18.798*** (df = 9; 276)	32.380*** (df = 5; 296)	27.452*** (df = 6; 295)	2.918** (df = 4; 289)

*Note:*

\*p<0.1; \*\*p<0.05; \*\*\*p<0.01

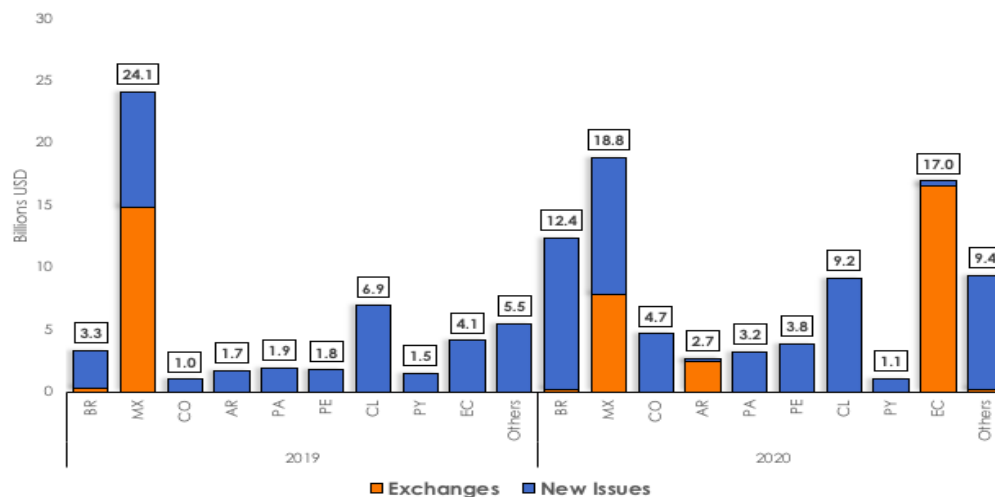
The *Latin American* countries regressed in Table 7 yield fascinating results. The U.S. 2-Year Treasury Yield has a positive relationship with the credit spreads of these four countries. The third estimate in Table 7 states that when the U.S. 2-Year rises by 1%, the nominal credit spread increases by 6.350% adding further to the U.S. hegemony presented above. In particular, the relationship of their country-specific macroeconomic variables to nominal credit spread is negligible. More idiosyncratically, the CBOE VIX, LIBOR, spot price, and inflation were not statistically significant at the 95% and 99% confidence levels. Interestingly, inflation had no relationship which is ironic given the historical trouble many *Latin American* nations have faced.

Political vulnerability has a positive correlation with nominal spread. As presented in my methodology section, this relationship fundamentally makes sense. This result suggests that as *Latin American* countries saw elevated levels of political vulnerability, their cost of borrowing increased. Under drastic social unrest and inequitable conditions, the inevitable backlash will discolor the country's legitimacy in the international market and its perceived credit profile. For example, following the Venezuela riots in 2019, S&P downgraded them to Caa3, forecasting a negative outlook which suggests further decaying credit conditions. Heightened social unrest is prevalent throughout many emerging market economies as well as developed countries but macroeconomic fundamentals, on average, leapfrogs social and political conditions.

A common trend amongst all three regression, the political regimes of the four *Latin American* countries have a positive relationship with their sovereign nominal credit spread. Albeit, the political agenda of any government, will guide the nation's perceived risk profile. However, as shown in Figure 8 below, emerging market issuances continue to surge despite various internal and external shocks. Additionally, Central Banks, like the U.S. FED are fundamentally independent from any political affiliation. The appointed officials of these Central Banks exercise orthodox monetary policy to help hedge against lingering tailwinds from domestic or external shock that may expose the structural integrity of its economy. For example, consider the firing of Naci Agbal, former Central Bank Chief of Turkey. Just in Q2-2021, annual inflation clocked in just above 16%, the highest it had been since early 2019. To combat this, Agbal and the Central Bank committee attempted targeted raising rates, while Erdoğan demanded that rates remain low. This micro-case

study of Turkish policy best depicts the friction between the political targets of the respective government structure with the apolitical foundation of Central Banks. Having said that, through the results presented in the preceding case-studies, all three econometric models and country-specific models, my thesis finds that the global credit cycle weighs the macroeconomic landscape of the country more than its government's political agenda. Inflows of FDI and account balance positively correlate with nominal credit spread. These two variables suggest an increase in interconnectedness with the global economy, increasing their nominal credit spreads, given the possibility of potential collapse or unfavorable conditionalities as they are more exposed to Washington's monetary influence.

**Figure 8:** Latin America Debt Issuances from 2019 to 2020



Source: Bloomberg

## 4. Latin America Case Study: Brazil and Argentina

The Global Financial Crisis particularly shocked emerging market economies, as many policymakers of these respective countries thought they were removed from the economic swings in the global financial system due to economic reforms they instituted years prior. Through deregulation of the financial sector coupled with little oversight by

U.S. institutions<sup>35</sup> and globally recognized rating agencies,<sup>36</sup> most countries in the Latin American region attempted to mitigate against such spillover from the U.S. market through changes in short-term policy targets. The 2007 collapse hurt U.S. financial conditions and the economies of many countries widely considered as emerging markets. With the initiative to promote the interests of the “tyranny of the minority,” the capitalist elite, these practices of private U.S. banks both curbed and ultimately hindered many emerging market economies from attaining their projected high growth prospects. Equally important, myopic policy moves by the U.S. The Federal Reserve further amplified such spillover onto emerging market economies, making it harder for these respective countries to appropriately alter their own short-term domestic policies targets to stabilize domestic economic conditions. By analyzing the global economic environment before and after the collapse of the U.S. housing market, the forcefully manipulated dependence of emerging market economies towards the U.S. is clear. In particular, my thesis analyzes the movement of risk premia, or perceived investment risk of emerging market countries following changes in U.S. policy and domestic country-specific conditions.

My thesis argues that conditions in emerging market countries diverge from the conditions in the U.S. This co-movement of divergence is shown in Figure 9 below, between the U.S. 10-Year Treasury Yield and Bank of America’s Latin America Emerging Market Corporate Index Option-Adjusted Spread. Pulled from the St. Louis Federal Reserve’s database, Figure 9 shows the percent change, where the U.S. 10 year (blue line) drops during times of economic crisis (shaded region). This dip in the 10-year follows traditional monetary theory, where the U.S. FED lowers rates to protect against a credit crunch, prompting consumer spending to ignite growth amongst other positive macroeconomic market functions. Interestingly, when the 10-Year dips, the risk for emerging market corporate securities is lower, as shown through the rise in the option-adjusted spread (red line).<sup>37</sup> Given the parameters of this chapter, when analyzing the

---

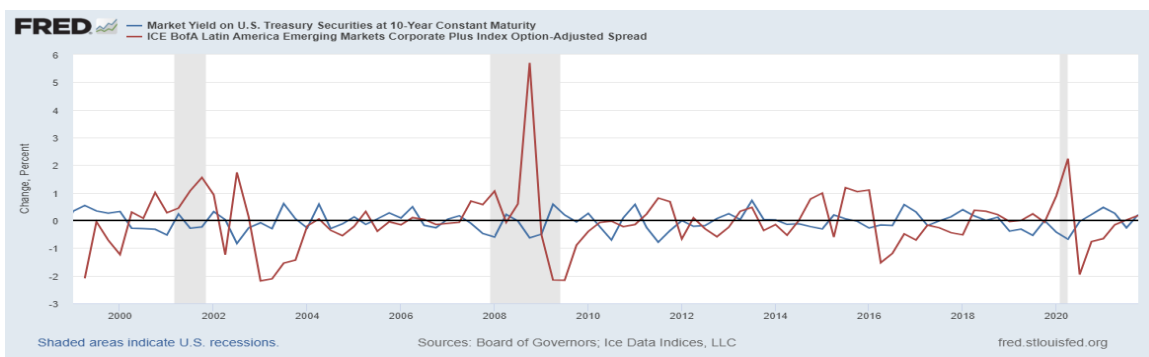
<sup>35</sup> Such institutions are but not limited to: the U.S. Securities and Exchange Commission, the Federal Reserve Board among other groups.

<sup>36</sup> These rating agencies are S&P, Moody’s and Fitch where many large private banks were able to forcefully coerce such groups to provide false ratings. Verbalized differently, private banks offered loans through mortgages well-knowing these borrowers could not meet the repayment conditionalities.

<sup>37</sup> Fundamentally, the option adjusted spread (OAS) goes down when the interest rate volatility increases for the respective securities. In the case of the OAS, if the perceived market risk on the investment goes up, then the option adjusted spread goes down.

movement of both lines pre- and post-Global Financial Crisis, the risk-premia or the perceived risk toward Latin American corporate investment lowers when U.S. treasury yields drop. This is also seen in Figure 8 above. When the FED reduced rates during 2008, “risk-on” investment for Latin American corporations decreased; however, as seen below, U.S. Treasuries will inevitably correct, leading to a decline or increase in Latin American risk.

**Figure 9: U.S. 10-Year Treasury Yield to BofA LatAm Corporate Index**



**Source: St. Louis Federal Reserve Database**

This chapter illustrates how near-sighted U.S. policy and interest, proxied through the 2007 - 2008 Financial Crisis, is destructive to many emerging market countries' economic prospects and conditions. This chapter will complement previous literature, highlighting how domestic policy moves in the U.S., driven off the interest of the private wealthy ruling elite, ultimately compromises the economic austerity of many global countries. Thus, this chapter explores Argentina and Brazil's social, political, and economic conditions before the global financial collapse and the subsequent short-term policy moves made by their respective Central Bank officials to adjust national financial needs following the collapse of the U.S housing market in 2007 - 2008. Of the four Latin American countries in my Senior Thesis, the case studies of Brazil and Argentina best represent the structural rigidity of the global economy that makes it increasingly complex for international governments to avoid such spillover following changes in U.S. economic conditions adding to the claim that no country is an "island" in our contemporary global



economy. Further, due to the vast size and global influence of the two economies, Argentina and Brazil provide two different case studies and results of macro-management during times of heightened global economic uncertainty. Moreover, there is limited research adding a qualitative and quantitative analysis outlining the demise of this region and how despite U.S. spillover imposed extra burdens on economic recovery, many Latin American countries, particularly Brazil, were able to sow the seed for an eventual recovery.

This chapter begins with an overview analyzing pre- and post-Global Financial Crisis conditions and policy moves of both Brazil and Argentina, emphasizing the case study of Brazil as the “base case” successful story of sound economic oversight which then inevitably led to the countries relatively quick recovery. In contrast, Argentina is the “poster child” of poor neoliberal policy under the Washington Consensus that plagues the equitable growth prospects of many similar emerging market countries. My senior thesis analyzes the influence of U.S. policy spillover on the global economy and how countries considered emerging markets alter short-term monetary policy targets and political initiatives to protect the health of domestic economic conditions. In so doing, subsequent chapters will then highlight similarities and differences in financial between the Eastern Hemisphere, emerging market economies, predominantly in the Latin America region to those developing countries in the Western Hemisphere with the intent to provide top-level analysis of amplified U.S. spillover driven by U.S. Federal Reserve's myopic moves in the policy. This chapter will complement my critique of the U.S. hegemony and its negative limitations on the economic growth and austerity of many emerging market economies.

## **4.1 Brazil**

The chapter looks closely at how following the transition from Fernando Cardoso to then-President Luiz Inácio Lula da Silva, the global financial system regained confidence in the local Brazilian economy due to improvements in social initiatives and underlying macroeconomic conditions, which reinvigorated the nation’s high growth prospects, reduced inflation, curbed national poverty before the 2007 U.S. housing market collapse. Furthermore, this chapter then considers the success of Lula's “tripod” as it acted as economic scaffolding allowing the Brazilian government to fluidly adjust to changes in

the global economy, preventing further recessionary fears. This chapter provides a holistic overview of Lula's countercyclical policies that helped the Brazilian economy navigate against amplified collapse initially caused by U.S. negligence during the 2008 housing market collapse. Despite being propped up with "sound" economic conditions, Lula's administration carried out exceptionally sound macroeconomic crisis management moves in policy that my thesis views as a regional success story. By examining Lula's relatively orthodox economic thesis, this chapter will present Brazil under his administration and how he was able to solidify the nation's influence globally while also protecting the country's perceived risk premia in the global credit market. This chapter considers the U.S. political-military hegemony and how Brazilian technocrats adjusted social, political, and economic targets to adjust its underlying macroeconomic variables to reorient the market.

#### 4.1.1 Brazilian Economic Scaffolding

In the 1990s, Brazil began to implement macroeconomic reforms that sought to liberalize and modernize its economy following decades of macroeconomic volatility. However, such growth is relatively low and unstable compared to the nation's period of industrialization from 1930 through 1980. Brazil benefited from the favorable global economic conditions that occurred during the 1990s; such success can be attributed to their domestic policy moves. During the mid-1990s, the then-President Itamar Franco<sup>38</sup> appointed Fernando Henrique Cardoso as Finance Minister. The latter put forth the *Real Plan* – a monetary program inspired by the achievements of the Argentine Plan.<sup>39</sup> A multimodal stabilization plan, Cardoso's *Real Plan*, introduced a new currency, the *real*, and an exchange rate that was comparatively linked to the real effective movement of the U.S. dollar. The *Real Plan* was implemented to hinder the government's ability to periodically raise rates, a common practice widely known as indexing inflation. The *Real*

---

<sup>38</sup> Former President Itamar Franco was in office from December 1992 - December 1994.

<sup>39</sup> The Argentine Plan is the "Convertibility Plan" (1991 - 2002). However, it is worth mentioning that the Argentine Plan eventually failed to appropriately adjust its real value due to its rigid fixed-exchange structure. As will be explained earlier, Argentina should have moved away from a nominal value under this plan to its real value, as the devaluation of other EME currencies (i.e. Mexican Peso, Brazilian Real) following the 1994 Tequila Crisis and 1997 Asian Financial Crisis led to widening current account deficits and economic slowdown. Considering the role of a globalized economy, the Argentine Plan is not feasible.

*Plan* succeeded in ending hyperinflation without drastically limiting domestic economic growth in Brazil.<sup>40</sup>

Regarding regulation, supervision, and governance, Brazil historically has one of the most transparent financial markets relative to other countries.<sup>41</sup> Despite such high growth prospects and protection, in the 1990s, these conditions soon deteriorated due to a collection of external shocks. Among these economic crises were the Long-Term Capital Management (LTCM) and the Russian financial crisis of 1998, which increased the average risk premium of emerging market countries and then acted as a significant bottleneck of capital flows to these economies. Moreover, there was Mexico's "Tequila Crisis" in 1994, the Asian Financial Crisis (AFC) in 1997, the early on-set of Argentina's Great Depression in 1998, and the appreciation of the U.S. dollar against other currencies in the 1990s. Through the greater half of the 1990s, emerging market credit cycles faced tighter conditions and shifts in the international landscape forced downward pressure on many Central Bank officials. Soon after that, in 1999, due to the increasing pressures from capital flight, the then-President Cardoso implemented an inflation-targeted mandate built off a floating exchange rate. Brazil deployed a macroeconomic policy "tripod" that acted as protective scaffolding against such external shocks working off three aspects: inflation-targeting, flexible exchange rate mandates, and fiscal austerity. Unlike their Argentine counterparts, whose structural rigidity of the *Convertibility Plan* led to their subsequent economic demise, Brazil under Cardoso saw that the *Real Plan* needed to use real exchange rate price adjustments rather than nominal exchange rates under a pseudo-fixed exchange rate system. This flexible domestic policy response meant that, in Brazil's economic conditions from 1999 onwards, the domestic wages and prices of the real needed to fall to compete with the U.S. dollar and other falling emerging market currencies.

In such a move, Cardoso's administration sought to keep capital inflows, mitigate against the depression of Brazilian exports<sup>42</sup> and maintain equitable economic standards.

---

<sup>40</sup> Through such success, Cardoso garnered popularity among Brazilian nationals, prompting him to run for president a seat he ultimately won taking - succeeding for Franco. Many political theorists equate Cardoso's mold to that of former Presidents Juscelino Kubitschek and Getúlio Vargas.

<sup>41</sup> This strength is due to the Securities and Exchange Commission (CVM), which was established in 1970 under banking Law 6385/01. This law was then modernized to contemporary conditions in 2001 under the new law 10303/01, which successfully oversaw the movement of the global capital market

<sup>42</sup> This aspect is vital as Brazil is filled with natural resources and thrived off such sectors following the "commodity boom."

Unlike their Argentine counterparts, Brazil pivoted away from its relatively fixed exchange rate, a pseudo-hard peg to the U.S. dollar. Later, in 2000, the Fiscal Responsibility Law (FRL) was approved by Congress. A move to fiscal austerity, Brazil's governance during heightened external shocks aimed to protect their considerable economic growth prospects. The Fiscal Responsibility Law was a hard-budget constraint that was an orientating guideline for financial and budgetary affairs at all levels of government.<sup>43</sup> In yet another move, Cardoso carried out this initiative to ensure Brazilian stability by clearly outlining financing mandates in the country. This policy "tripod" established economic austerity to enable Brazil to protect and subsequently reap improved economic conditions in the following years. Brazil strengthened and modernized its domestic institutions by privatizing quasi-sovereign<sup>44</sup> national and subnational financial institutions<sup>45</sup> with its fiscal austerity efforts. By removing ties to these banks from their national balance sheet, Brazil under Cardoso saw improvements in its financial sector's durability under external and domestic economic global headwinds. Above all, the financial industry sustained improved economic management through the Fiscal Responsibility Law's oversight. For example, the government sold and reduced their stake in Vale S.A.<sup>46</sup> and Telebrás.<sup>47</sup> However, it is still worth addressing that they retained their control over major notable firms such as Eletrobras and Petrobras, the national utility company and globally recognized petroleum producer. Despite strengthening Brazil's account budget by supporting its financial system through privatization, they also kept Caixa Economica, Banco do Brasil,<sup>48</sup> and the Brazilian Development Bank, the nation's largest growth-oriented bank that matches the sizes of those two commercial banks. Brazil could appropriately address macroeconomic shocks through both "tripod" policies and

---

<sup>43</sup> Enforced by the Federal Court of Account (TCU) among other local courts, this guideline covered conditions for: tax exemptions and limits; loan guarantees; public debt assumption; the publication of documents outlining national planning and accounting to ensure transparency.

<sup>44</sup> Quasi-Sovereign is a firm that has public and private characteristics, partially owned by the respective government.

<sup>45</sup> In particular, these financial institutions are banks both national and subnational (i.e. only present in a particular region).

<sup>46</sup> Vale is a recognized multinational mining company, particularly well-positioned in: manganese accounting for ~70% national market share; nickel; iron ore copper cobalt. Further, they have a strong position and influence in the nation's operation, operating major ports, railroads and hydroelectric plants.

<sup>47</sup> The government of Brazil still has ownership of Telebrás, but reduced their stake in the company. Telebrás is a telecommunications firm that manages the nation's communication system.

<sup>48</sup> Caixa Economica and Banco do Brasil were the two largest commercial banks at the time.

strengthened banking institutions. Conversely, in such forward-looking policy moves, there was little focus to boost productivity, structurally protect social security plans and open the economy.

Following Cardoso's well-received tenure, the 2002 election saw a short, benign market "dip."<sup>49</sup> Before the election, investors priced this "dip" as there was a shared sense of "nervousness" towards the Brazilian market as the global market was fearful of a Lula presidency categorizing him as a radical left-wing populist that would not seek to revitalize the economy. With this narrative, the Brazilian Real devaluation and the nation's risk premia rose as its credit risk increased.<sup>50</sup> The depreciation in the Real led to an 8.5% increase in manufacturing and 15.3% rise in export growth, while the previous periods of low growth had pent up external demand. But despite such outlooks, months before the election, Lula delivered his "Letter to the Brazilian people," which targeted the ranging concerns of domestic and foreign investors. In particular, Lula presented his strong intentions towards maintaining stability in the macroeconomic variables and the market economy. Lula stated, "The path of structural reforms that democratize and modernize the country, making it fairer, more efficient and, at the same time, more competitive in the international market" later adding that Brazil must ensure external vulnerability to the global economy as then "...leverage economic growth." Likewise, Lula made it apparent that he wanted to ensure similar economic standards to that under Cardoso and stated in office his economic thesis would be:

- Maintain a floating exchange rate.
- Maintain a primary surplus.
- Carry out established contracts.
- Reduce poverty and inequality while also carrying out an anti-inflationary target strategy.

Through this letter, Lula made his commitment to the market economy clear through his intentions to control inflation and the nation's fiscal equilibrium. Following three failed attempts to win the Presidential seat, the Workers Party candidate (PT), Lula, finally won

---

<sup>49</sup> My thesis uses market "dip" interchangeably with a decline in economic conditions. On average, "dips" is commonly seen across most stock markets during election cycles.

<sup>50</sup> Indexed to the U.S. dollar, the Brazilian Real devalued by 135.5 (i.e. 1 USD = 135.5 reals)

office in 2002. Once in office, he followed through with his neoliberal and orthodox economic thesis in the Cardoso administration. To further emphasize his commitment, Lula traveled to the U.S. and met with then-President George W. Bush and met with senior officials at the Inter-American Development Bank and World Bank, two significant sources of financing in Latin America.<sup>51</sup> Similarly, to strengthen regional economic conditions, Lula visited Presidents Eduardo Duhalde and Ricardo's Lage of Argentina and Chile, respectively. Lula was highly transparent in his desire to work with international and regional markets and institutions to improve Brazil's domestic economic conditions. In such a move, Lula exceeded macroeconomic targets in multiple regards. First, every year from 2003 through 2008, the nations reported primary surpluses were north of 3% of GDP while the public debt ratio to GDP declined from 72% to 64%. In so doing, global rating agencies structured Brazilian government bonds at "investment grade" instead of "non-investment grade," making them high-yield investments with significantly high-risk premiums.

Apart from the high-flying BRIC nations, Brazil saw robust economic expansion through substantive inflows of foreign investment, averaging 4.6% in economic growth per year and substantial trade surplus in the nation's account balance. It is worth emphasizing again how favorable the international scenario was due to the economic rebound of the U.S. following the technology bubble, as strong U.S. conditions and a thriving global financial system were critical positive shocks that directly led to GDP growth<sup>52</sup> among many global markets. Similarly, under this rapid economic growth and a more comprehensive range of social transfers under Lula's administration, Brazil saw a massive decline in poverty. This can also be seen when Lula launched *Bolsa Familia*. This social assistance program provided condition-grants based on cash transfers or subsidies contingent if they kept their child in school. In 2004, *Bolsa* directly assisted 4.1 million households and 11.4 million two years later in 2006. The *Bolsa* was well-received amongst the public as its benefits families' budgetary costs and well-being. Lula also created the *Zero Hunger Program* that helped the poor factions by giving them food which greatly benefited farmers in its agricultural sector.

---

<sup>51</sup> Lula wanted to restore confidence in the Brazilian market of Western politicians and financiers.

<sup>52</sup> A favorable global financial system helps most countries through higher net exports, thus raising GDP.

Notwithstanding that fact, Lula's style of politics did not fit the mold of a populist, as he had a strong interest in the majorities – meaning his political thesis did not have any focus on socialism.<sup>53</sup> During his early years in office, he became popular amongst many through his willingness to address the nation's heightened poverty levels while remaining fiscally responsible. Akin to Cristina Fernández de Kirchner, former President and now Vice-President of Argentina, Lula financed national social programs under the global economic boom. Lula kept the economy open to foreign and domestic investors, filled his cabinet with tenured financial professionals, managed the fiscal balance to show Brazil's free-market and neoliberal advantage to major global players.<sup>54</sup>

Moreover, this economic boom worked in tandem with increasing demand from emerging market economies, particularly in China, soon leading to a commodity boom and a surge in prices.<sup>55</sup> Complementing these boom years prior, Brazil found large oil reserves, positioning them to become one of the most sizable global suppliers. With this discovery and the nation's abundance of natural oil, Brazil saw a rise in capital inflows as investors saw the tremendous upside<sup>56</sup> due to the nation's vast reserve of natural resources. Brazilian oil and its quasi-sovereign and private firms benefited more from the 2000s Energy Crisis. However shortly after, with the U.S. invasion of Iraq and tension in the Middle East in conjunction with oscillation in the U.S. dollar, Brazilian oil, among other emerging market reserves, was viewed as a high-yielding investment. U.S. policy and global diplomacy briefly negatively impacted the economic conditions of Brazil and many other emerging market economies. Through this boom and China's steady economic rise, Brazil scaled their export focus of natural resources, trading more of their soybeans, meat, nickel, silver, and iron ore, which helped foster Brazilian economic growth. Coupled with a global focus towards Brazilian commodities and production, there was a sizable transition of workers

---

<sup>53</sup> Many other political figures throughout Latin America worked off populist platforms, making Lula's actions and political prerogative different when compared to other national counterparts. Rather, Lula's background in Trade Unionism established his goal to bring all Brazilians out of poverty, which I argue is not in the populist mold.

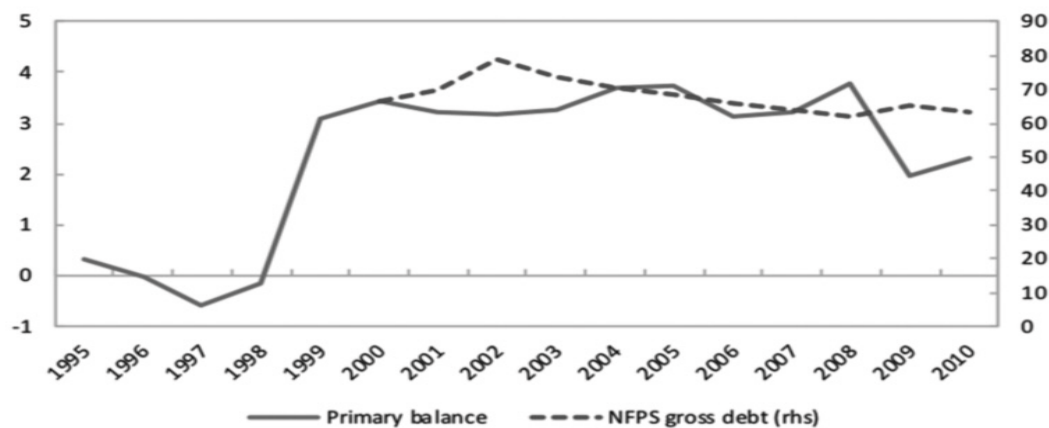
<sup>54</sup> These players are but not limited to: the IMF, Brazilian elites, Brazilian banks, U.S. Banks or "Wall Street", Washington, among others.

<sup>55</sup> The commodity boom occurred for more than a century in the 21st Century. After years of underperformance, under the optimism of global economic growth and reflationary trades, commodities experienced a huge rally in price.

<sup>56</sup> Major Brazilian firms, particularly Petrobras, have the upstream and downstream ability to maximize their "top-line" revenue margins as they scale the oil production cycle.

from the informal to the formal sector, further improving the economy as their workers now had the means to pay their taxes. From 2000 through 2012, 12.3 million formal jobs were created compared to the 2.1 million made during the 1990s. With an increase in the nation's job force and the government's control of major commercial banks (i.e. Caixa Economica and Banco do Brasil), Lula created programs that allowed for loan extensions and made credit more accessible with practical repayment terms. During his first year in office, those who lived in extreme poverty comprised 11.1% of total population, while three years later, it dropped to 7.2% in 2006 and 4.7% in 2011 just when Lula had left office. Equally important, with Lula's work, the nation's GDP per capita rose from \$8,038 in 2003 to \$13,418 in 2010. Before the 2007 crisis, Lula restored global confidence in the Brazilian economy by reinvigorating nations' high growth prospects through low inflation, increased employment, more accessible access to credit, and reduced poverty of the middle and extreme-lower class cohorts. In short, when looking at the pre-Global Financial Crisis economic conditions, it was clear how successful Lula's administration was during his first term<sup>57</sup> as he successfully navigated through U.S. oriented global shocks.

**Figure 10:** Brazil's Gross Debt, as a percent of GDP, to Primary Balance



Source: IMF

<sup>57</sup> It is worth mentioning that Lula's second term saw 7% economic growth.



### 4.1.2 Lula's Excellent Macro-Management

Lula's Brazilian economy hit the proverbial BRIC wall following the collapse of the U.S. housing market in 2007. In stark contrast to its reported economic conditions prior to the 2007 - 2008 Global Financial Crisis, Brazil was drastically hit despite Lula's impressive moves to modernize its economy under high capital flows and trade liberalization. Having a relatively closed economy,<sup>58</sup> the collapse of the U.S. housing market in 2007 had a damaging effect on industrial output which in-turn rippled through various aspects of the Brazilian economy. Of equal importance, both domestic and foreign banks curtailed their credit facilities, leading to a national credit crunch.

A watershed global event, for the first time in nearly a decade, Brazil reported a trade deficit. Most notably, exports dropped 29% of \$518 million in January 2008. Conversely, Brazil posted \$2.3 billion in trade surplus by the end of 2008. Additionally, Brazil's role in the global supply chain diminished, with exports to the European Union (EU) falling to 27.4% and to the U.S. by 36%. Equally consequential, the 2007 Global Financial Crisis shifted the international trade landscape, enabling China to leapfrog over Brazil, reinforcing Brazil's deficit in manufactured goods and further decreasing the nation's trade balance. Brazil continued to increase exports of primary goods to China, but its manufacturing sector was hit the hardest as the global market substitutes Brazilian products with cheaper Chinese goods. Nationally seeing dearth trade finance, regional producers saw even more of a profound effect. For example, the Brazil fruit industry, heavily embedded in the Northeast region, saw a decline of 1/3 of their exports as smaller producers and farmers did not have the financial ability or credit to ship their goods to large national distributors. A more sobering result is that many of these smaller farmers were forced to furlough 20,000 workers, in what is considered the poorest region of Brazil. When referencing the efforts of Lula's *Bolsa* and *Zero Hunger* initiatives, the 2007 - 2008 collapse was a huge blow to domestic producers and the nations fight to address serve-unemployment figures. Soon after, in 2009, real GDP growth turned negative due to tightening in global financial conditions, an abrupt halt on credit growth and falling exports leading to a negative net exports account. Addressing the uncertainty and diminishing of

---

<sup>58</sup> Note, I argue the Brazilian economy is relatively closed as there is a dense collection of sovereign and quasi-sovereign firms that have a strong monopoly on certain industries (i.e telecommunication, gas, oil).

the global financial system, Lula's administration deployed countercyclical policies. For example, the government responded with large moves in quasi-fiscal policy by utilizing the lending operations of public banks, commonly referred to as policy lending. In this case, policy lending can be viewed as development lending, in which under the oversight of the government, these banks will provide policy-based financing.<sup>59</sup> The government's strategically targeted loan system helped various sectors and individuals meet financing requirements. The government also carried out other fiscal moves such as, decline in the nations primary balance<sup>60</sup> by 2% of GDP. This suggests that the government provided a tax break or tax concession reducing the liability on the taxpayer. In practice, this move is very beneficial during times of such economic crisis, as this improves the population's solvency churn ratio and further stimulates the economy. Through these moves, Brazilian trade figures were able to reach pre-financial crisis levels in 2010, where aggregated real GDP growth surpassed 7%. Soon after, the emergence of the 2007 crisis halted Brazil's high economic growth through drastic deceleration in GDP, exports, manufacturing, investments, and exports.

While many other governments and central bank officials were plotting strawman<sup>61</sup> exit scenarios from the crisis, Lula acted aggressively to pull Brazil out of the financial crisis. Over and above that, Lula carried out various protective countercyclical policies to thwart a failing economy. Lula succeeded in avoiding amplified spillover from the U.S. driven Global Financial Crisis, which soon after catalyzed Brazil's self-confidence in its government's ability to steer the economy. Lula slightly changed the orientation of his government's economic policy, by focusing on government-led development initiatives – this thesis change is widely known as the *new matrix of economic policies*. Note, it is worth mentioning Lula's new economic prerogative still encompassed principals of the “tripod,”

---

<sup>59</sup> As previously mentioned, many of the largest commercial banks in Brazil were either fully or partially owned by the Brazilian government. In so doing, this policy allowed the government to not have the bank's debt or “liabilities” on the national balance sheet. Rather, these banks can be viewed as a pseudo- “Shell” company that seeks to address the credit crunch.

<sup>60</sup> The primary balance is a key variable for the government's debt conditions, as it is the net interest of payments of the budget balance. Put differently, it is the difference between the collected revenue to the amount the government spends on various municipal projects.

<sup>61</sup> The Strawman scenario is interchangeable with the brainstorming process of creating various actions and their subsequent responses. A common financial term, this suggests many other nations were moving slowly or acting accordingly to how they should effectively address the pandemic. However, this contention is up to your discretion.

due to the allegiance of state intervention in the economy as well as a slight distrust in the market which justifiably stemmed from Global Financial Crisis and its byproducts. With the intention to adjust domestic conditions first, Lula sought to stabilize the Real by taxing inflows of foreign capital. Some of the major policy moves by Lula's administration was the use of Petrobras. With Petrobras, Lula increased the government's control of the oil sector, which he leveraged as a watershed industrial asset. For domestic use, the government used their control over Petrobras to sell oil well below market price.<sup>62</sup> This surprised many market analysts as crude oil in nations like Brazil amongst other emerging market countries, is the dominant input for the economic conditions of market growth.<sup>63</sup> Similarly, despite the high initial costs, Petrobras used to open development contracts to extract deep-sea drilling platforms amongst other costly investments.<sup>64</sup> Through the firm's political investment,<sup>65</sup> Brazil saw equitable gas prices as well as increased dividends through Petrobras growth in operating scale. This is best seen where Petrobras' trailing twelve-month (TTM) revenue doubled from \$81.7 billion in June 2007 to \$150.6 billion in March 2012. Using Petrobras as a revenue gain instrument, Brazil, unlike many other emerging market economies, benefited from the low gas prices to maintain domestic production, but also reaped the benefits of Petrobras' strategic development, despite the high initial costs. Using the government's connections in the private market, Lula's administration strategically hedged itself from lingering exposure from U.S. influence following 2008.

Lula's government carried out moves that injected liquidity into the markets through the use of financial institutions under heightened government intervention, during the 2007 - 2008 Global Financial Crisis. Recalling the moves by the Lula administration prior to the collapse of the global economy, through the government's control over Caixa Economica, Banco do Brasil and the Brazilian Development Bank (BNDES), he lowered rates and made credit accessible. However, similar to actions in the

---

<sup>62</sup> Typically, during an economic crisis the price of gas is foreboding, as it is widely reflective of market health due to its universal use deployed in almost all aspects of life.

<sup>63</sup> Theoretically, it is deduced that when the price of oil is high, the producer or the consumer will limit its consumption - vice versa. In practice, if the prices are low then production will see optimal conditions.

<sup>64</sup> One example of such costly investments was Petrobras's development of Abreu e Lima, a refinery in close proximity to Venezuela.

<sup>65</sup> In typical emerging market fashion, it is worth mentioning the fraudulent scheme of Petrobras that was exposed by the nation's justice system.

U.S., Brazilian banks did similar moves that occurred in the U.S. where they gave generous terms and lent to consumers that did not qualify for such loan obligations. Fundamentally, these terms well exceeded the “use life” of a car that the consumer bought with the nation's new lending credit facility. To mitigate against their own domestic economic collapse, the Brazilian government shifted focus to providing liquidity to its national development institution and banks such as the Brazilian Development Bank. Correspondingly, Lula expanded the landscape of activity for public banks, where the government injected liquidity funding into the Brazilian Development Bank. The Brazilian government continued to provide funding to national development bank for the following years<sup>66</sup>. In fact, the intention of this move was to give state-owned banks the ability to finance large companies, enabling them to maintain their operating efficiency while also attempting to reach pre-global financial revenue figures.

During the Global Financial Crisis, there was looming stock of consumer debt, which in most cases is expected.<sup>67</sup> Interestingly, in certain instances, the Brazilian Development Bank loans helped purchase government and foreign assets. In such a move, the government was able to provide an extension of liquidity and extra financing cash to the nation's largest financier, which akin to that of the Petrobras move, established a well-positioned revenue stream back to the government. Through the Brazilian Development Bank, public credit participation grew 34.2% from March 2008 to March of 2009. With this rise in the domestic Brazilian credit market came a decline in foreign banks of 21.8% to 20.5%, and a dip in private bank participation of 44.0% to 41.9% all during March 2008 to March 2009. Complementing Lula’s support to Brazilian Development Bank and other commercial banks was the *payroll deduction loan* established in 2004. Passed by Congress in 2003, this law allows banks to offer loans with the repayment conditions through automatic future payroll deduction. This plan highlights Lula’s administration's willingness to offer lines of credit to his citizens, with the macroeconomic intentions to drive growth and consumers. Intuitively, this program sought to improve the nation's human capital while also giving many citizens the means to spend, which is a key detriment

---

<sup>66</sup> In 2014, the amount of funding to the Brazilian Development Bank reached roughly 9% of the nation's GDP.

<sup>67</sup> During economic crises, the real exchange rate value of the dollar will depreciate making it harder for the borrower to pay off the loan and meet its recurring terms.

for economic growth, as Brazil's Real GDP was declining years prior. A forward-looking personal lending plan, this initiative used the future income of the borrower as collateral thus giving the consumer lower credit risk and favorably low rates when compared to other credit lines. Yet another move was Lula's initiative to stimulate institutions to borrow more through lowered national tariffs on electricity use for utilities firms, with the contingent clause of end use by the state. These moves can be viewed as a "three-pronged" approach, where operations costs were lowered through below-market price oil and electric tariffs breaks. Subsequently, the national economy would see an increase in production and the nations would slowly "untie" its credit crunch through the expansion of Brazilian Development Banks scale of operation. Not just in the utilities space, but Lula also had a collection of tax breaks for many other important industries, while also providing loans to state enterprises.

Through his moves to expand Brazilian credit offerings, Lula's countercyclical policy resumed consumption growth. Brazil was able to effectively carry out these programs as through the favorable backdrop presented pre-Global Financial Crisis, Lula's administration was able to amplify the government's policy space to create a foundation that lays better conditions for its people. This economic-oriented policy shift is alluded to by Lula in his 2010 address to the World Bank Forum, "We were successful at our tasks because we reestablished the role of the state as a promoter of development." Lula then added, following in-line with the policy focus towards economic conditions, that Brazil succeeded in creating a "model and emphasized access to credit, tax reductions and the stimulus consumption." A rising BRIC, Lula's policy reduced the government's risk premium and soon thereafter enabled Brazil to alter the nation's financial focus which in turn created the foundation for subsequent economic growth. Lula verbalizes this success in a 2009 interview with the Financial Times when he states, "There's no time to waste just having meetings and listening to a lot of people talk. The counter-cyclical measures have to be implemented immediately." While many global discretionary macro investors raised questions about government intervention in public finance, Lula expanded his regime's broadband coverage to seize the opportunity to push for a strong role of the state in the economy through swiftly implementing counter-cyclical policy. When compared to their regional counterparts, Brazil was arguably the most successful in combating amplified

spillovers from the Global Financial Crisis. Strong-arming the banks with the intention to increase lending, aggressively cutting targeted rates, lowering bank reserve requirements to help lending while also providing tax breaks in the consumer goods sector<sup>68</sup> laid out the framework for Lula to further remove Brazil from feeling further decline in economic conditions. The economic scaffolding of Lula's "Tripod" and the government's ability to fluidly adjust to changes in domestic conditions, enabled Brazil to mitigate against amplified U.S. economic erosion. The moral of the story is that Lula was able to help guide the Brazilian economy and stabilize the governments risk premia out of U.S. driven 21st Century financial Armageddon, retaining global confidence in the Latin American country.

#### **4.1.3 Brazil, *A New Economic Miracle?* In the Context of a Fixed Effect Model**

Providing a quantitative analysis of Brazil's economic landscape, this section uses a fixed-effect model from 2000 to 2020 to illustrate the relationship between volatility in risk premium by country-specific political and financial conditions. Widely considered the "country of tomorrow," these results correspond with the mobilization of Brazilian economic austerity under an ever-changing macroeconomic global, and regional landscape.

---

<sup>68</sup> The consumer goods sector relates to goods purchased by households and individuals, rather than industries and their manufacturer. The two tax cuts in Brazil were home appliances and automobiles.

**Table 9:** Brazil Fixed Effect Model from 2000 to 2020

	Dependent variable:			
	nominalspread			
	(1)	(2)	(3)	(4)
US_2yr	0.917 (0.866)		2.967*** (0.853)	
VIX	-0.046 (0.046)			-0.065 (0.042)
LIBOR	-1.060 (0.715)		-2.152*** (0.769)	
spot	3.424*** (0.856)	3.599*** (0.770)		2.120*** (0.609)
inflation	-0.156** (0.071)	-0.153*** (0.027)		-0.163*** (0.023)
ab	0.0001 (0.0001)			-0.00003 (0.0001)
vul	-1.702 (8.959)		13.795*** (3.064)	
regime	20.243** (8.686)	20.457*** (6.529)		
fdi	0.0002* (0.0001)	0.0001 (0.0001)		
Observations	80	84	80	84
R2	0.624	0.598	0.370	0.554
Adjusted R2	0.575	0.578	0.345	0.531
F Statistic	12.895*** (df = 9; 70)	29.403*** (df = 4; 79)	14.870*** (df = 3; 76)	24.497*** (df = 4; 79)

Note: \*p<0.1; \*\*p<0.05; \*\*\*p<0.01

Table 9 isolates country-specific variables and selected global figures proxying underlying drivers for international finance, regressed on Brazil's nominal sovereign credit spread from 2000 to 2020. When referencing the first regression, spot price, inflation, and political regime were the only statistically significant results. More specifically, the spot price was positively associated with nominal spread. On average, the nominal credit spread will increase – this result yields true across three different regressions. Given the current nature of the U.S. hegemony and the volatility of the U.S. dollar, these regressed results add to the existing literature on Washington's manipulation of other currencies. The U.S. dollar is typically used to denominate sovereign issuances as it is widely considered the optimal “safe haven” currency following its political-military forceful imposition in 1944. Likewise, the direction of the international exchange market works off the real value of the U.S. dollar so elevated local currencies in emerging market economies will lead to high levels of borrowing.

Similarly, given that many Central Bank technocrats of emerging market countries are hawkish, particularly the four selected case study countries, they typically use monetary tightening to keep inflationary pressure low. This result is seen when Brazil kept the *reals* exchange rate value low following Mexico's 1994 "Tequila Crisis," the Asian Financial Crisis in 1997, and Argentina's economic downturn during the early 21st Century. Additionally, Brazil has a floating exchange rate guided on the currencies of the global market, particularly the U.S. dollar, so, as present in the regression above, when the Central Bank raises the real exchange rate of the real to the dollar, their credit profile tightens. As commonly found in global finance, when currencies try to appreciate against the dollar, they face higher borrowing costs due to the U.S. hegemony's manipulation of international conditions.

Interestingly, inflation is negatively associated with Brazil's nominal credit spread. In particular, the results suggest that, *ceteris paribus*, when there is a 1% increase in inflation, the cost of borrowing decreases. Fundamentally, this does not make sense. Under high levels of domestic inflation, it is harder for Brazilian citizens and enterprises to meet specific payment conditions. That said, this then strains the Central Bank's balance sheet, hindering their ability to meet sovereign repayment. In sum, there are increased financial pressures on all Brazilian cohorts, which should subsequently increase the borrowing costs.

Similarly, Brazil's political regime yields a similar statistically positive relationship with its cost of borrowing. Regressions 1 and 2 highlights that the cost of borrowing increases with a one-unit increase in the government's liberal democratic rating. Presented throughout this thesis, this result is fascinating as it is widely assumed that improved democratic conditions are associated with developments in economic growth prospects. But, as seen in the regression above, this is not the case. While acknowledging these results, as is valid in all emerging market economies, not just the results found with Brazil, the international credit cycle is relatively agnostic to the political structure when dealing with risk premium and borrowing. More idiosyncratically, given Brazil's economic strength, the vastness of natural resources, and sound quasi-sovereign enterprises, it can be accepted that macro-financial conditions surpass or are weighed more favorably than political characteristics. With that said, as presented empirically in the aggregated fixed effect model in Table 5 and preceding country-specific results and the qualitative economic



policy analysis, risk premium or the cost of borrowing in the emerging market credit cycle is weighted more favorably to Brazil's macroeconomic health than erratic changes in political conditionalities. This result is seen in contemporary and practical issuances in the global credit market.

Conversely, political vulnerability yields a positive and significant relationship with Brazil's nominal credit spread. Practically, this suggests that a one-unit increase in domestic vulnerability, proxying a decline in domestic social conditions, on average leads to a rise in the cost of borrowing. Looking further into these results, this suggests that elevations of inequitable domestic donations and social tensions show a higher cost of borrowing. A common concern throughout many emerging economies, is that international finance weighs the contention of probable social upheaval over shifts in the political landscape.<sup>69</sup> But, this is evidently not the case as seen in the yield political regime results. Surprisingly, the CBOE VIX, Account Balance, and inflows of FDI have a negligible relationship with Brazil's nominal credit spread. In the context of the S&P 500, the insignificant result of the VIX suggests that Brazil is relatively removed from the volatility of the U.S. market. While Brazil's account balance, measuring its foreign trade does not impact its cost of borrowing and inflows of foreign investment, proxied through FDI, has a similar negligible effect.

To no surprise, the US\_2yr has a positive and significant relationship with Brazil's cost of borrowing. Through the third regression in table 9, a 1% increase in the US\_2yr leads to a 2.96% increase in the nation's risk premium. As expected, these results complement my original hypothesis that the shortsighted increase of short-term yields by the FED negatively affects the economic conditions of emerging countries, as they see an increase in the cost of borrowing. Surprisingly, the movement of LIBOR is negatively significant in Brazil's nominal credit spread. Albeit, a removed global rate that is being replaced in 2023.<sup>70</sup> These results suggest that as commercial banks increase their overnight

---

<sup>69</sup> It is important to note that these two variables, regime and vulnerability, look at different political traits. Political Regime looks at the political structure of the country and detailed political moves in policy, how power is distributed amongst elected officials, and its role in bringing economic growth through targeted policy. While political vulnerability looks at the social conditions faced by the citizens of the respective country. Moreover, at face-value, the political regime has some spillover onto the vulnerability, but the World Bank and V-Dem look at different guiding metrics.

<sup>70</sup> LIBOR is being replaced by SOFR in 2023, due to manipulation and it being too backward looking.

lending rates, proxying the improvements in the global financial sector, Brazil's cost of borrowing lowers. Moreover, this relationship alludes to the role of private commercial banking in the global credit cycle. It can be inferred that Brazil's macroeconomic austerity and policy targets hold greater weight than its political landscape.

## 4.2 Argentina

Unlike Brazil, this chapter then uses Argentina as a case study to highlight how domestic rigid economic policy, corruption, and the influences of the Washington Consensus all prevented robust financial success. Akin to that of the Chapter on Brazil, the first section highlights the effects of the Washington Consensus and the limitations of Domingo Cavallo's *Convertibility Plan*, which, when analyzing the plan holistically, relative to the global market and the monetary financial ability of the FED would not practically be successful in Argentina. After illustrating the tight economic conditions of Argentina before the Global Financial Crisis, the subsequent section then addresses the nation following the 2007 - 2008 collapse. Looking closely at the tenure of *Kirchnerismo*, I analyze the movement of both Nestor and Cristina and how their basis of "neo-developmentalism" led to improvements in Argentina's declining economy and political thesis under heavy debt burdens, tight credit access, and severe social unrest. In a similar manner to the Brazil section, in this case, my thesis will provide a grand view of the Argentine economy before and shortly after the Global Financial Crisis adding further to previous literature addressing the role of the U.S. on the movement of emerging market risk premiums; particularly heightened in Latin America. Arguably the most parabolic country exposed to U.S. and political-military hegemony and other external shocks, the intent of this chapter is to present such amplified spillover emerging market economies.

### 4.2.1 Argentina: Economic Zigzag

In 1989, Argentina fell into severe hyperinflation following decades of stagnant manufacturing outputs, multiple failed attempts to stabilize the economy, and high inflationary pressures. However, Menem's neoliberal economic thesis led to profound

economic growth during his early years.<sup>71</sup> Adhering to the Washington Consensus, Menem's Argentina received support from the International Monetary Fund (IMF), which stopped hyperinflation, boosted economic growth, prompted inflows of foreign investment, and addressed the nation's materializing fiscal deficit. Much of this initial financial success came from the *Convertibility Plan*. Under the guidance of the IMF, the Argentine Minister of Finance, Domingo Cavallo, implemented the convertibility plan. Introduced in 1991, this plan was established as economic scaffolding to readjust the financial conditions during drastic times. This plan was a "hard" fixed exchange that pegged the nominal exchange rate of the Peso to one U.S. dollar.<sup>72</sup>

Furthermore, this plan stripped Argentina's Central Bank of the ability to print money freely. This plan intends to promote market efficiency and productivity while also including other market-oriented structural reforms. Menem's government showed no signs of being able to feasibly pay off the debt as it continued to grow during the 1990s. Under such circumstances, the IMF continued to offer lines of credit to Argentina while negotiating their repayment terms. To counteract this decay, the convertibility plan was adjusted in 1992. This structural adjustment to the currency board allowed the Argentine Peso to convert to the U.S. dollar, leading to a hard-pegged exchange rate system.<sup>73</sup> Cavallo's adjustment in the pegged currency increased the investment appeal in Argentina in the international market. The global financial system shifted its perspective on Menem's economy, wherewith this newfound confidence, investors worried less about currency devaluation or any other forms of instability

During this time and even years before, Argentina was praised globally for its success under the IMF's support, market-oriented reforms, economic growth, and stabilization. Such discretionary financial ease was primarily due to moves by the U.S. Federal Reserve and their short-term monetary actions to raise interest rates. The then-Federal Reserve Chairman Alan Greenspan's countercyclical move benefited the value of the U.S. dollar, but the Argentine Peso was nominally appreciated under Cavallo's

---

<sup>71</sup> Note, this neoliberal success took shape under the Jorge Rafael Videla dictatorship in 1976.

<sup>72</sup> This currency board exchange fixed the par value of the U.S. dollar to the peso which was set equally to 10,000 australes. Note, Australes was the Argentina currency at the time that went away December 1991 that was subsequently replaced by the peso, the national currency used today.

<sup>73</sup> This system can be viewed in the same light to the Gold Standard in the 1970s.

Convertibility Plan. Yet, despite both the IMF and the U.S. issuing rhetoric supporting neoliberal market-oriented principles, this influence innately does not succeed in practice, as will be discussed in the coming section. Following the implementation of the convertibility plans' broader agenda, on average till 1997, Argentina's economy grew 6% per year, where stabilizations soon followed through the aid of such structural reform. Cavallo's plan succeeded, where the Argentine peso began to retain its nominal exchange rate value relative to other emerging market currencies while domestic inflation subsided. Years of financial constraints and inflation soon left the minds of Argentine nationals, as in the early 1990s, were able to purchase goods and services at a reasonable price. Menem's administration had a negative primary balance with the Argentine peso gaining nominal strength in the global market. Due to pervasive corruption, they carried out large, expensive municipal spending projects while having a relatively high tax churn rate.<sup>74</sup> Despite changing the direction of its national economic thesis, Argentina faced fairly negligible periods of recession, but they were short-lived as Menem's rigid economy was mild. I argue that this period for Argentine economic growth was relatively calm in part to the depreciation of other local currencies in the Americas, as the peso was fixed at par with the U.S. dollar, coupled with the increase of interest from the U.S. and foreign groups due to the co-movement of the peso to the dollar. As previously established, the U.S. dollar is globally viewed as a "safe haven" asset, while the peso moved with the dollar, the risk premium or perceived risk towards Argentina lowered. The period following the Mexican "Tequila Crisis" in 1995 saw the development of a financial contagion that plagued the economic integrity and health of many developing countries both in the Americas and Asia. However, The decline in the Mexican peso truly tested the strength of the convertible plan; as Argentine output fell, unemployment surpassed 18%, and interest rates surged. Nevertheless, during this time of economic uncertainty, Cavallo's convertibility plans, "credibility,"<sup>75</sup> and robust structure was able to guide Argentina to a V-shaped recovery.<sup>76</sup>

---

<sup>74</sup> In my paper, the tax churn rate addresses how many people do not pay their taxes.

<sup>75</sup> Many global analysts suggest that the convertible plan's credibility stems from the support of the IMF.

<sup>76</sup> Fundamentally, a V-Shaped recovery illustrates a short decline in the economy, where there is then a rapid recovery - indication a rapid economic recovery to pre-crisis economic conditions.

Like many of their regional counterparts, Argentina soon entered a severe and prolonged recession in 1998 due to a collection of external shocks in the macroeconomic global financial system. These compounded global shocks were the devaluation of the Brazilian Real, the LTCM crisis, and the Russian default in 1998. Interestingly, like other Latin American countries, Argentina did not see significant spillover from the Asian Financial Crisis in 1997. In part, the relationship between the IMF and Argentina is long-standing, lasting well before the nation's looming economic collapse in 2000. Since becoming an IMF member in 1956, successive Argentine administrations have sought and agreed to roughly 17 emergency policies geared towards financial bailout through extended conditional refinancing. As I raise throughout the entirety of my thesis, outside of the nation, this long-standing relationship truly highlights poor macroeconomic management. The brinkmanship of the IMF's relationship with Argentina falls in line with *Ajuste*, which translated in English means "adjustment." *Ajuste* encompasses short-term policy moves to protect economic conditions in Argentina to limit a shock to the nation's risk premium. Furthermore, this short-term policy orientation looks to change or alter the conditions imposed by the IMF to then "prop up" and provide financial protection to the Latin American country during times of economic turmoil. Doubts on the Asian Financial Crisis were set aside due to the difference of monetary regimes and the IMF's strong-armed influence over the government's economic perspective due to *Ajuste*. An IMF report urged for "A credible and strong macroeconomic and structural plan," which historically and continues through *Ajuste*. In this given scenario, the countries in the Americas and Asia were riddled with large sums of declining economic conditions. That being said, *Ajuste* working in tandem with the Convertibility Plan, allowed the Argentine government to exercise structural adjustments while also altering monetary and fiscal targets to mitigate against an amplified spillover following a collection of economic collapse following the 1994 "Tequila Crisis."

Despite changes in short-term policy, changes in U.S conditions, and amplification in the global economy following financial crises, it is challenging for emerging market countries to avoid negative spillover entirely. Interestingly, soon after that, Argentina did not see a quick recovery in contrast to their emerging market counterparts. Instead, the nation reported sluggish GDP figures sparking mass concern on the debt load. Under a

stagnant economic backdrop, the countries struggled to repay their debt load and its accompanying conditions, further strengthening the government's spending power.<sup>77</sup> Entering a debt spiral, Argentina soon saw credit tightening reflected through Greenspan's initiative to raise rates, which grew the nation's risk premia.<sup>78</sup> As presented in Chapter 2 Data and Methodology chapter, when the FED raises rates such as the 10-Year Treasury Yield, the risk premium or perceived risk of return declines as the nominal spread, or difference between the Argentine Long-Term Rate to the 10-Year decline. As U.S. rates increase prompting investors to avoid investment in emerging market economies, this ultimately dries up inflows of investment leading to the already mentioned credit crunch. Additionally, with the convertibility plan, a pegged peso to the U.S. dollar caused the Argentine government to raise interest rates in pesos, where this large native account balance and debt load saw an increase in its risk premia. In a similar event to the 1997 Asian Financial Crisis, the rise in U.S. treasuries led to credit tightening towards Argentine bonds subsequently leading to a decline in foreign investment which then hindered domestic capital market growth. In practice, a fixed-exchange rate between the peso and the dollar would not be feasible, possibly due to the natural cyclical differences between the two countries. Through their already established tightfisted relationship, the IMF offered Argentina financial support which turned into poor implementation of reforms and fiscal promises. Adding further to *Ajuste* initiative, the IMF offered new terms of repayment which again abetted the ever growing coercive conditionalities put on Argentina. With an increasing debt load and an innate inability to meet the IMF's repayment terms paired with a political instability, corruption and a worsening global economy, Menem's administration lost control over Argentina's market which then led to large flows of capital flight.

Granted, hindsight 20/20, my thesis adamantly believes with the utmost conviction that Argentine fiscal policy could have been more sustainable if Cavallo's plan had been replaced. The conditionalities imposed by the IMF worsened the debt situation in Argentina as the public sector debt reached 47.5% of GDP. By 1999, Argentina entered a full

---

<sup>77</sup> A common tool, taxation is used to help fund various municipal projects to promote economic growth.

<sup>78</sup> Risk premia, is interchangeable with risk premium, which proxies the nation's investment appeal, where a rise in risk premia suggests more risk or a smaller chance of a guarantee on return.

recession. Both Former President Carlos Menem and Domingo Cavallo, Minister of Finance are both equally at fault for destroying Argentina's financial system and economy. Of equal blame, myopic changes in U.S. policy as well as the IMF's *Ajuste* thesis, stripped Argentina's economic austerity which induced the nation to face economic collapse. Though Menem's populist platform<sup>79</sup> led to his quick rise, his tenure as President was cut-short as his neoliberal-populist perspective did not meet his goals, rather it led to the demise of the Argentine economy.

Following Menem's time in office, Fernando De La Rúa, former mayor of Buenos Aires, won the presidential election in 1999. Even though the convertible plan's fixed exchange rate failed, the currency board continued under De La Rúa's time in office. With rising U.S. yields and national debt growing, Argentina could not meet the repayment terms in U.S. dollars. In the second fiscal quarter of 2001, Argentina was at its peak of economic collapse. At its height in 2001, Argentina's government attempted drastic financial chemotherapy. The most demonstrative event in Argentina's demise was Cavallo's *Corralito* in 2001. There was capital flight of foreign investors, but a mass of deposit runs<sup>80</sup> soon negatively impacted Argentina's financial sector. In December 2001, Cavallo and Argentine authorities gave the go-ahead to partially freeze the account as many citizens were pulling their savings and selling pesos to buy U.S. dollars which further devalued the peso. Mass riots and protests<sup>81</sup> soon ensued with this national bank freeze that inevitably forced De La Rúa out of office. National unemployment rose as many citizens in the middle class lost their jobs and savings, where they soon critiqued the government failure in neoliberal policies calling upon a new government and economy.

By the end of December 2001, there was severe social and political unrest in Argentina, where soon after, the country formally defaulted on its IMF loan. The largest sovereign default in history, adding up to \$85 billion, the national poverty rate rose to 55% of the population, unemployment sat at 25%, while GDP per capita fell to 20%. During times of economic crisis, the U.S. FED, the lead firefighter, tightened interest rates by

---

<sup>79</sup> Menem's platform was heavily centered around anti-establishment and anti-party. This thesis is especially ironic due to his willingness to allow IMF support, despite years of dealing with their predatory practices.

<sup>80</sup> A bank run is when a mass of people simultaneously withdraw their deposits due to concerns of solvency.

<sup>81</sup> In Argentina, these riots are widely referred to as *Cacerolazo*.

raising them to curb runaway inflationary pressures, partly attributed to U.S. markets pricing in future growth prospects following the Dot-Com bubble. Under this restrictive policy, it restored its credibility by reversing credit easing by hiking up rates by 25 basis points in November 1999 and Federal Fund Rate Targets by 6.5% well into January 2001. Once into 3Q-2001, U.S. real short-term rates sat north of 4%, where core CPI inflation oscillated around 2.5%, due to the FED hike in interest rates to curb runaway inflation. Still, the U.S. saw a primary drag on growth in 2001, causing them to recognize the shortfalls of the contractionary forces described above. The September 11th, 2001 attack on the World Trade Center in New York dropped U.S. consumer confidence amongst other market confidence indicators. The terrorist attack on U.S. soil, particularly on the World Trade Center, beacon international finance, and ever-changing macroeconomic policy targets under the FEDs guidance, led to contractionary policy in the U.S. and global market. The FEDs policy enabled the IMF to use *Ajuste*, as Argentine markets sought to adjust their macroeconomic variables to appease international market conditions, as guided by the U.S. FED. As the FED raised interest rates to combat domestic inflationary pressures, the perceived risk premium towards Argentina increased as the nominal yield tightened.

By January 2002, Argentina abandoned the convertible plan and a national banking crisis followed. With historically high social and financial costs, the economy contracted by 20% since 1998. Verbalized by Doctor Juan Grigera, professor at King's College London, “The outbreak of the largest crisis in recent Argentine history in 2001 marked the turning point for a country that used to be ‘the poster boy’ of Washington Consensus policies.” Following the nation's economic collapse during such recession, Argentina would see economic and political oscillation in policy where neoliberal ideologies catalyzed a “fluid equilibrium” that guided the country well through 2015<sup>82</sup>.

Following their economic fall, Argentina saw the rise of *Kirchnerismo*, whose basis of “neo-developmentalism” improved the government's economic and political thesis. *Kirchnerismo* was a populist movement emerging from Néstor Kirchner and his wife Cristina Fernández de Kirchner, who were both presidents consecutively. Due to increased Chinese demand in the early 2000s, Argentina’s industrial and monetary policy pushed the

---

<sup>82</sup> Argentina had an ever-changing landscape where after De La Rúa , Rodriguez Saa and Eduardo Duhalde two Peronists took office. Thereafter came Nestor Kirchner and Cristina Fernandez Kircher.



country into a new economic phase where it had again reached high growth prospects and a moderately stable economy that was only augmented under Kirchner's Peronist beliefs. Moreover, Argentina increased their wages and a decline in poverty soon after. Some of these programs that helped combat poverty were *Planes Trabajar* and *Plan Familia*. With this growth, Kirchner's Argentina could restructure debt. Unlike those before them, Argentina's government put forth a stable and competitive exchange rate which soon after brought in an influx of FDI inflows. A year-and-a-half in office, Kirchner was able to rebalance the peso on a similar peg to the Brazilian real.<sup>83</sup> Like Lula's successes in Brazil, Kirchner's administration focused on public work and social initiatives. More specifically, they focused on improved access to credit, reinvigorating the export sector, targeted tariffs, which all benefited from improvements in macroeconomic conditions and a strengthening international market. Despite this growth in the credit market, Argentina remained either in default or in the restructuring process with several private Western banks and lending institutions.

Unlike their predecessors, economic conditions under *Kirchnerismo* opposed U.S. influence and the constructive confluences imposed by Washington Consensus. Regularly avoiding the IMF among other international organizations, Argentina's monetary prerogative began to shift as the public aligned with Kirchner's move to resist the IMF.<sup>84</sup> Following the recession, Argentina's political identity moved away from neoliberalism, as we saw under Menem, to the center-left while under *Kirchnerismo*. Following 2003, the Kirchner regime sparked positive growth prospects in Argentina's GDP due to increased tax revenue<sup>85</sup> and market growth. From 2003 till 2008, Argentina ran a fiscal surplus which correlates to the strong posted government revenue growth. Unlike Brazil and others in their Latin American cohort, Argentina's economy zigzagged due to political corruption, poor neoliberal policies, coercive conditionalities imposed by the IMF and the Washington Consensus, which all led to the decay of the nation's macroeconomic fundamentals.

---

<sup>83</sup> Despite the real and the peso being relatively close in regards to real value, this would eventually change. As the FED continued to manipulate the spot of the U.S. dollar, the peso devalued while the *real* appreciated.

<sup>84</sup> Many citizens were and still are critical of the IMF as they view them as the sole reason for Argentina's economic collapse.

<sup>85</sup> Kirchner focused heavily on corruption which correlates to the increase in tax revenue and a lower "tax churn rate."

### 4.2.2 Post-Global Financial Crisis: *El Gil Coming to Fruition*

Contested by many, Argentine-U.S. relations, under the neoliberal rhetoric of the Washington Consensus, continues to drive the nation's economic downfall. Referred to as the "poster boy" of the Washington Consensus, Argentina has seen a fragmented economy as many Argentine politicians and central bank governors struggled to maintain stable macroeconomic conditions as U.S. policies continue to change the landscape of international finance, and external shocks continue to spoil such developments. Ironically, unlike her husband Nestor Kirchner, who, while in office, was able to scathe off further economic collapse and pull Argentina into a cyclical recovery period through the Chinese-driven commodity boom, Cristina Kircher claimed office during a period of relative heightened financial instability. Under *Kirchnerismo* the Argentine economy saw robust growth from 2003 through till 2011, except in 2008 during the watershed Global Financial Crisis. Heavily dependent on its commodities space, Cristina Kirchner carried out a protective tax hike<sup>86</sup> on soybean exports, which in its base case helped generate \$2.3 billion in government revenue. Seeing a drop in Argentine commodity exports, this decline amplified other aspects of the national economy, particularly curbing advancements in industrial manufacturing. To numerically gauge this decline, Argentina's annual GDP growth was 4.8% during 2008 through till 2013, where the government reported growth under 1% at least once. Although this targeted tax hike sought improvement in the government's "wallet,"<sup>87</sup> there was mass mobilization by farmers in the *CONINAGRO*, farming association, the rural Argentine federation, and other agricultural dependent interest groups. To remedy the situation, rather than entirely removing the tax, Kirchner adjusted the tax to 35% and nationalized Argentina's social security system soon after that. Soon afterward, in 2011, export revenues contributed to 20.5% of the national revenue, a historical high, whereas it sat under 11.8% in 2006 before the collapse of the global economy in 2007. Likewise, having seen a loss in revenue, Argentina was able to use its new-nationalized pension system to cover the loss. To hinder the development of national

---

<sup>86</sup> Soybean taxes rose from 35% to 44.1% in 2007 to 2008.

<sup>87</sup> Seeing the decline in exports, a main source of government revenue, Kirchner sought to expand the government's spending ability (i.e. "wallet") by increasing the nominal worth of these goods.

political unrest, Kircher carried out programs such as *Plan Argentina Trabaja*<sup>88</sup>, *Programa de recuperación Productiva (REPRO)*<sup>89</sup> y *Asignación Universal Por Hijo*<sup>90</sup>.

Like most of its regional counterparts, but not to the same effect as Lula's Brazil, Argentine policymakers fluidly adjusted their policy to establish sound political, social, and financial scaffolding to attempt to mitigate against massive collapse during the downturn of the global economy in 2007 - 2008. While the U.S. and the global economy were affected by the subprime mortgage crisis, Argentina recovered to pre-global financial crisis conditions relatively quickly. Highlighting that Argentina's real GDP growth<sup>91</sup> did not surpass 0.9% in 2009, it soon after revitalized from 2010 through 2011, jumping to 9.2% growth and 8.9%, respectively. Under *Kirchnerismo*, the appeasement of the citizens and corruption were both equally important. Under Kirchner's oversight, the government could further expand their report revenue, as *Impuesto a las Ganancias*, income and profit taxes, and Value-Added-Taxes (VAT) only grew from 2.9% to 2.2% from 2006 - 2011. Through Kirchner's proactive economic, social and political oversight, Argentina benefited considerably following the 2007 - 2008 economic collapse as most reported economic conditions were able to reach economic conditions previously seen in years before the collapse of the global financial system, under Néstor Kirchner.

In arguably the most indicative move in monetary austerity, Argentina's exchange rate rightfully pivoted to one of a floating rate system following the 2007 collapse of the global financial system.<sup>92</sup> Before the global economic collapse in 2007, Cavallo's Convertibility plan lacked wage and price flexibility. It prevented the Argentina peso from appropriately adjusting its real exchange rate value to changes in external shock and regional geographical trade patterns. I argue that this was a beneficial strategic move. Under the convertible plan, due to the devaluation of the Brazilian real in 1999 and the rise in U.S. dollar appreciation, the Argentine peso was not competitive among other regional

---

<sup>88</sup> Translated as, Argentina Works Programme, this government initiative created 100,000 jobs.

<sup>89</sup> REPO translates to Programme of Productive Recovery, which provides subsidies to failing firms. REPO provided paid furloughed, through covering the firm's costs of wages.

<sup>90</sup> Translating as, Universal Benefit for Children, Kirchner provides easier access to credit to prevent stagnation in employee wages.

<sup>91</sup> Rather than Nominal GDP, Real GDP is the best metric to gauge aggregated growth and production in the same year as it adjusts for inflation. Rather than nominal, Real GDP best reflects the economy.

<sup>92</sup> This encompasses the pivot from the hard-fixed issues in the convertibility plan to a floating exchange.

currencies. Equally detrimental, under Cavallo's plan, regardless of the cyclical conditions, Argentina's government was pressured to align its domestic monetary conditions with moves in policy by the FED. As this thesis has already alluded to in previous sections, following the U.S.'s forceful imposition on international finance, the global economy follows major U.S. policy moves amongst other key macroeconomic variables.<sup>93</sup> Albeit not entirely successful, Argentina under the guidance of Cavallo, Frigeri, Lenicov, and Lavagna,<sup>94</sup> all adjusted economic targets to appease the nation's perceived risk premium to maintain stable domestic financial conditions and inflows for foreign investment. Falling in this line of thought, the peso and its complementing fiscal policy would have seen more sustainable results.<sup>95</sup> Further, once the markets slowed down, there was no sound political reasoning for De La Rúa's administration to continue with Cavallo's fixed exchange rate system as it only further hindered economic growth. First presented during Duhalde's regime, Roberto Lavagna, the then-Minister of Finance, introduced measures to lift the structural rigidity of Argentine fiscal policy, which then brought subsequent peso appreciation to the U.S. dollar through a float-exchange rate.

The depreciating peso assisted in recovering Argentina's manufacturing, exports, and purchasing power. While exports adjusted, Kirchner also put forth an inward-looking import policy that taxed imports, making its nominal value in Argentina more, ultimately discouraging imports. Relatively diverse, Argentine exports thrived under Kirchner's move, as reported merchandise exports doubled from 2006 to 2011, jumping to \$48 billion. Similarly, with a stabilizing peso, merchandise exports were valued at \$74 billion in 2011. In terms of the global market, the peso rebounded due to depreciation in the real exchange rate, which subsequently enabled manufacturing and the domestic credit market to see a relatively stable correction, enabling all sectors of the economy, particularly oil, agricultural, manufacturing, and merchandise goods to scale their operations and posted revenue margins. Looking at the change in exchange rates from a regional perspective, following the depreciation of the Brazilian real, Argentina moved the peso to its true value,

---

<sup>93</sup> Such key variables include but are not limited to: movement of the U.S. dollar, employment figures, real GDP, industrial production, consumer spending, inflation, construction spending, home sales, etc.

<sup>94</sup> All four of these officials were: Domingo Cavallo, Rodolfo Frigeri, Jorge James Lenicov and Roberto Lavagna, respectively. Most importantly, he acted as Argentina's Minister of Economy.

<sup>95</sup> As that will be argued later, it was neither economically sound or feasible for Menem's Argentina to use a fixed-exchange rate currency board.

relative to other emerging market currencies instead of the hegemon U.S. dollar. External financiers and investment sought out Argentina opportunities due to more “welcoming” economic conditions. Driving this growth, Argentina assisted the manufacturing sector through export promotions<sup>96</sup> and horizontal fiscal incentive<sup>97</sup> schemes to increase trade. Kirchner also deployed horizontal sectoral initiatives, where each of the Argentine businesses would use the investment to expand their operating and production scales or improve their technological abilities. These horizontal promotions were targeted to all enterprises, targeting small and medium enterprises (SMEs). This adjustment in import-and-exports is best seen as Argentina’s balance of payments surplus decreased in 2009, illustrating the rise in outflow income, exports, and imports. While adjusting their revenue pipeline, Cristina Kirchner allocated focus to debt reduction initiatives in 2012. Kirchner’s regime sought to curb a rise in future debt burdens national and regionally. Kirchner succeeded in lowering the debt burden on the nation; Argentina saw a decline in their public debt-to-GDP sharing from 60% to 41.6% during 2006 - 2011.

Under Minister Lavagna’s macroeconomic agenda institutionally established in 2002, domestic capital markets conditions were able to stabilize. Under the Argentine Constitution, Kirchner exercised the decrees on “necessity and urgency”<sup>98</sup> to reduce poverty and unemployment while also meeting growth objectives and subsequent growth targets. This decree was more successful under Kirchner than Menem due to Lavagna’s economic success. Kirchner’s economic success should be attributed to Lavagna as without his orthodox and heterodox approach<sup>99</sup>. Further, under Lavagna’s guidance through his established thesis in Argentina monetary policy, Kirchner used this decree to intervene in the markets and release pressure on the domestic markets, ultimately making this decree successful when compared to Menem. After the Global Financial Crisis, due to uncertainty in the global market, the nation’s struggling to adjust their underlying economic conditions and the nation’s policymakers to further remove themselves from the U.S spillover, the

---

<sup>96</sup> Some examples of export promotions are but not limited to: temporary admission and export free zones.

<sup>97</sup> Fundamentally, these horizontal schemes are funding or various forms of financial support to a single agent (i.e. business) to use at their own discretion.

<sup>98</sup> Despite working under such loose circumstances, there any decree by the President (i.e. Kirchner and future president) were subject to oversight by the Chambers of Congress. This political check hindered the possibility of potential tyrannical moves.

<sup>99</sup> The orthodox policy in question was conservative fiscal policy (i.e. prudent government spending) whereas heterodox approach was Lavagna’s target to address and negotiate Argentina’s debt, respectively.

“necessity and urgency” clause was used a handful of times. The matter is Lavagna’s established fiscal policy that aided the country through economic storms. Many political commentators are quick to praise Kirchner; however, my thesis adamantly gives the highest praise to Lavagna as he created Argentina’s post-crisis financial framework. The most notable case was the government’s intervention in Yacimientos Petroliferos Fiscales (YPF), a privately held oil firm. With many questioning the financial health of YPF, Kirchner’s government intervened for 30 days to preserve the firm’s integrity, wealth and assets while also meeting the nation’s demand for oil. Despite many comparing Kirchner’s move to Chavismo, this precautionary measure strategically protected Argentina’s domestic market, a hedge against the uncertainty of visibility in global economic conditions. In parallel, Argentina agreed to a collection of terms under the *Latin American Integration Association* (LAIA) while also helping establish *MERCOSUR*. Very soon, towards the end of the *Kirchnerismo*, Argentina lost control in its ability to curb innate institutional corruption, rising inflation, and macroeconomic stagnation. As I have and continue to argue, Lula’s Brazil best pulled itself from the Global Financial Crisis relative to its regional counterparts. Coming off a dark period in economic history, Argentina, under the Kirchners, was able to find its footing for a moment. Still, due to such previously mentioned internal and external shocks, the country entered yet another cyclical period of poor economic conditions. Given the monetary policy moves of Kirchner, the success should be attributed to economic scaffolding imposed by Lavagna as his prudent macroeconomic management led to relatively sound financial Argentine financial austerity shortly after the Great Financial Crisis. In the grand scheme of the global financial system, Argentina was once the “poster child” of the Washington Consensus economic reform and is now the image for poor macroeconomic management through their vying relationship with the IMF, U.S. policies, and the interest of many other private Western institutions. Equally important, while Argentina has the ability to scale its domestic market and benefit from robust growth, its Central Bank struggles to adjust targeted short-term rates due to changes in the U.S. capitalist monetary prerogative.

### 4.2.3 Argentina Fixed Effect Model

Arguably the most symptomatic of regional and global spillover, this section presents the results from Argentina's fixed-effect model. More specifically, this section adds to the proposed qualitative case study by empirically analyzing the role of the U.S. hegemony as well as Argentine-specific economic and political conditions on the cost to borrow in the global market, in the context of its risk premium.

**Table 10:** Argentina Fixed Effect Model from 2000 to 2020

Dependent variable:				
	(1)	(2)	(3)	(4)
	nominalspread			
US_2yr	0.681 (1.041)		19.355*** (0.646)	
VIX	-0.154*** (0.057)	-0.159*** (0.045)		
LIBOR	16.297*** (0.921)	16.907*** (0.217)		
spot	-0.009 (0.033)		-0.148** (0.073)	-0.026 (0.205)
inflation	0.008 (0.005)		0.023** (0.010)	-0.096*** (0.030)
ab	0.0001 (0.0002)		0.001** (0.0004)	0.006*** (0.001)
vul	1.311 (4.647)			185.013*** (23.795)
regime	2.713 (26.299)	33.835** (16.319)	-128.856*** (46.467)	
fdi	-0.0001 (0.001)			
Observations	80	84	84	80
R2	0.990	0.990	0.938	0.475
Adjusted R2	0.989	0.989	0.934	0.447
F Statistic	794.924*** (df = 9; 70)	2,594.374*** (df = 3; 80)	237.151*** (df = 5; 78)	16.957*** (df = 4; 75)
=====				
*p<0.1; **p<0.05; ***p<0.01				

Following a similar approach used in Brazil's fixed effects model, this model first regresses the most statistically significant variables and then looks at different pairings of country-specific political and economic variables in regressions 3 and 4. Yielding a similar relationship to Brazil, inflows of FDI has a negligible relationship with its cost of borrowing. Note FDI was the only statistically insignificant variable in the Argentina

model. Variables US\_2yr, LIBOR, account balance, and political vulnerability all have positive relationships with Argentina's sovereign nominal credit spread. With a 1% increase in the US\_2yr, Argentina's cost of borrowing rises.

Similarly, when the 1-month LIBOR benchmark increases by 1%, Argentina sees a rise in the cost of borrowing. The relationship of the US\_2yr with Argentina's risk premium illustrates the U.S. hegemony's stronghold over international financial conditions, remarkably amplifying the economic tightening of emerging market credit cycles. Interestingly, the positive result of LIBOR contests the grounds of the sole U.S. hegemony. However, given Argentina's owed debt account, they have entered agreements with the *Paris Club* and other European countries individually. I recognize the positive relationship between LIBOR and Argentina's cost to borrow.

Furthermore, this alludes to the presented claim that as the FED raises its rates to meet the requirements of the *dual mandate*, Argentina faces downward pressure from Washington through increased cost of borrowing. This relationship is seen when referencing the exit of Cavallo's *Convertibility Plan*, where following increasing U.S. rates and regional currencies, Argentine technocrats struggled to address such changes accordingly, which sent the nation into a spiral of sovereign defaults, elevated inflation, and a higher risk premium. All these macroeconomic increases drove up the nation's risk premium, which can be attributed to the FEDs shifting targets. Paradoxically, the CBOE VIX negatively relates to Argentina's nominal spread. This result suggests that as the VIX rises, proxying increased volatility in the S&P 500, Argentina's cost of borrowing lowers. This result contradicts the US\_2yr movement, meaning that Argentina's sovereign credit spread, proxying its underlying market health, is removed from significant changes in the U.S. market. It is worth mentioning that the direction of short-term rates by the FED seeks to adjust underlying macroeconomic conditions of the economy while the S&P 500, seen through the VIX, benchmarks the health of companies, investment sentiment, and confidence within the stock market. As many know, the economy and stock market are not the same. Considering this difference, these variables suggest that Argentina is exposed to changes in economic conditions but not the S&P 500, among other major indices that illustrate the U.S. equities ecosystem.



The positive relationship between political vulnerability and risk premium is logical when considering Argentina's social framework. This result suggests that a one-unit increase in political vulnerability is correlated with a rise in the cost of borrowing. This relationship is best represented in 2001, where in Cavallos *Corralito* capital controls led to elevated social tensions and protests outside the banks causing some to take their lives. This demonstrative event added further to Argentina's already robust exposure to capital flight. Equally important, Argentina nationals are limited in their socio-economic advancement with downward inflationary pressures and poor municipal or project financing. Surprisingly, when Argentina improves its account balance, they see an increase in the cost of borrowing. This relationship proxies the nation's exposure to international trade. Moreover, benchmarking Argentina's connection to the global market, this result alludes that as the government becomes more connected, they are ultimately more exposed to changes by the FED and its subsequent spillover.

The variables, currency spot, inflation, and regime negatively affect Argentina's risk premium. Argentina's political regime yields a different narrative compared to the three other case study results. Confirming my original hypothesis, this suggests that as Argentina becomes more liberally democratic, moving further away from a polyarchy, they see a drop in their cost of borrowing. Like many regional counterparts, Argentina's political ecosystem has been highly volatile, moving from a liberal state to a welfare state and a neoliberal state. Not to mention the heightened economic decay due to many U.S. banks, vulture funds, and the IMF is imposing coercive pressures on the economic austerity of the nation. Argentina's shifting political, social, and economic conditions have tightened the Central Banks efficacy rate. When considering the political developments from Menem to Kirchner and now to Alberto Fernández today, these results confirm my original hypothesis that improving democratic leads to developments in macroeconomic standards, which subsequently spillover onto advancements in lowered cost of borrowing. However, dating back to Cavallo's term in 1991, historically Argentina has had poor macroeconomic conditions as they have defaulted on sovereign debt four times from 2000 to 2020. That said, given the nation's poor economic standing, it can be inferred, when compared to seven other selected countries, that the global credit market allocates weighted assessments to the political thesis of the Argentine government due to their poor financial track record. Unlike

Brazil, when the real exchange rate of the Argentine peso increases, proxied through a one-unit increase in its spot price, the cost of borrowing drops. Similar to the narrative presented in the regime variable, the appreciation of the peso suggests improving market functions within the Argentina economy.

Further, when inflationary levels rise by 1%, the cost of borrowing increases at the 95% confidence level while it drops at the 99% confidence level. Severely complicated with mixed results, like their Latin American counterpart, due to Argentina's lagged establishment of Central Bank legitimacy in the eyes of international finance – Argentina's policy is reasonably inconsistent over time. Still, their economic macroeconomic management has failed since the turn of the 21st Century. Of equal importance, Argentina's economic austerity is exposed to changes in short-term rates by the FED, among other U.S.-oriented economic conditions. The poster child of the failed "Washington Consensus," due to its poor economic scaffolding in part due to the IMF, Argentina faces elevated risk premium adding further to their incessant sovereign debt default cycle.

## 5. Eastern Hemisphere Case Study: Russia and Turkey

Like Latin America, emerging market countries in the Eastern Hemisphere have undergone a series of economic cycles that co-move with changes in FED policy targets, U.S. economic conditions, among other regional and global external shocks. Of the four countries in the *Eastern Hemisphere* group, both Russia and Turkey have undergone structural changes in their respective economic operating models to effectively address amplified U.S. spillover before and after the 2008 Great Financial Crisis. Like many Latin American emerging market economies, many nations located in the Eastern Hemisphere, following the collapse of the Soviet Union, saw the rise of populism and more liberal political conditions, which subsequently improved their risk premium or cost of borrowing.

When referencing the V-Dems Institute *liberal democratic* ratings of both Turkey and Russia,<sup>100</sup> the two countries exhibit political conditions that suggest underlying

---

<sup>100</sup> Refer to the *Political Vulnerability* independent variable presented in the Methodology and Data Section for additional information on the rating.

polyarchy or autocratic traits rather than a liberal democracy. With this politically-oriented metric, the selection of these two countries will examine the qualitative role of country-specific social and governing conditions on a nation's risk premium – working in tandem with the results from the regression analysis. Further, this study will highlight the weighted influence of country-specific characteristics over external changes in FED policy and U.S. markets. Equally important, due to their vast reserves of natural resources, global sphere of power, and historically sustainable macroeconomic conditions, a case study on the Central Bank of Russia's response to domestic economic collapse in 1998 and 2008 Global Crisis complements existing literature on the vastness of the U.S. economic hegemony. Ranking the lowest in Europe for corruption, or the most corrupt, in the *Transparency International's Corruption Perceptions Index for 2020*, it would be fair to assume agents in international finance would avoid investment opportunities in Russia due to less security investment returns. Accepted by many academic scholars and market analysts, on average, there is an assumed positive relationship between cost of borrowings under high levels of corruption. This suggests, when the country sees a spike in their reported *political vulnerability* coefficient, this increases their risk premium, as they see a larger credit constraint and burden to borrow given such political condition. Admittedly, riddled with corruption throughout its political system, Russia still sees large inflows of foreign investment annually. Paradoxically, despite the nation's high levels of corruption under President Vladimir Putin's illiberal rhetoric, Russia best illustrates how country-specific changes in monetary policy and social initiatives can still drive economic growth – protecting themselves from such spillover of U.S. conditions. To the same effect, the Russian Federation best highlights the innate weighted preference towards sovereign financial stability over the political thesis of the government. Correspondingly, given the current backdrop of heightened Russian policy in the global landscape, this chapter addresses the economic austerity of the nation and how it can avoid spillover from U.S. policy.

Akin to the Russia analysis, the Turkey section addresses how this watershed country to European production previously implemented structural changes that allowed them to avoid further negative ramifications following the fall of the U.S. housing market.

However, given Turkey's more liberal democratic conditions<sup>101</sup> relative to the Russian Federation, an analysis on Turkey adds to existing literature suggesting that a mixed economy driven by industrialization will find its footing during economic uncertainty. Although this section will be driven by two cases, like the Chapter 4's Latin America assessment, this analysis illustrates how in most cases, changes in FED short-term policies have a more significant effect on the economic conditions of international finance. Notwithstanding the sphere of influence of the FED, this chapter addresses the impact of domestic political and market conditions on their causal relationship with emerging market risk premium through decaying underlying macroeconomic conditions.

Similarly, eventually gaining its identity of a mixed economy, the first section of the Turkey section outlines the nation's increased role in the global economy. It allowed itself to boost its economic conditions following its *Lost Decade* in the 1990s. The subsequent section then addresses how, like Russia, structural changes in the economy following the 2008 collapse allowed the nation to move past further economic decay. To empirically depict Russia's transition following 1991, this last section of the Russia case study provides a country-specific fixed effect model from 2000 to 2020. Best providing a benchmark of Russian risk premium, the results are regressed by select political and financial characteristics. In so doing, these three sections will provide a holistic qualitative and quantitative commentary on Russia and its exposure to U.S. spillover and other external shocks.

Russian and Turkish economic influence is longstanding; however, with regards to the political landscape of both countries, they fail to promote equitable conditions. However, despite this widely acknowledged belief, foreign investment still seeks out opportunities in both countries<sup>102</sup>. In terms of emerging-market credit investments, it assists in addressing the influence of U.S. short-term policy conditions over watershed components proxying the direction of international finance. In the same vein, it also adds

---

<sup>101</sup> Referring to V-Dems liberal democratic scores, Russia displays more political conditions of a polyarchy over Turkey. That said, refer to the Methodology and Data section to refresh yourself on this variable.

<sup>102</sup> Note, this can be attributed to Russia's dense collection of oil and gas whereas Turkey is the "back-bone" of European production following their massive industrialization effort in the 1980s and early 2000s.

further to the ability of domestic policy and how, if strategically carried out, can navigate against such myopic policy changes to improve sovereign risk premium.

## 5.1 Russia

For the more significant part of the 21st Century, Russia has been a shining star of emerging market economies, with massive capital flows, sustained current account surplus, and soaring international reserves. The nation's vast geographic position astride the Eurasian region benefited the ever-changed sectors within global finance. With a treasure-trove of natural resources, well-equipped workforce, and an extensive collection of financial resources as well as successful private and state-owned enterprises, the Russian Federation is widely contested as the envy of economic stability. Ironically, this was not the case 31 years ago.

### 5.1.1 *Salvaging A House in Flames*

Following the 1980s, there has been a collection of attempted multilateral liberal revolutions in the former Soviet Union (USSR). Albeit, not the original target for Russia's new-found liberal prerogative, the first implementation of the nation's liberal transition saw the dissolution of the Soviet Union, the former Eastern hegemony, into 15 independent and autonomous states, which all sought out their own governing thesis. Namely the pursued authoritarian governing model in Turkmenistan, to that of Estonia's relatively liberal thesis. Soon after that, backed by respected international agents, namely liberal Russian politicians, led by the then-soon-to-be President Boris Yeltsin, initiated liberally-oriented market policy from 1991<sup>103</sup> through to 1998, despite many oligarchs and elites not subscribing to their relatively unorthodox démarche.<sup>104</sup> This goal to establish neoliberal market conditions of equitable austerity for domestic enterprises is widely titled the "coming Russian boom." Aside from the monetary focus of my thesis, it is worth highlighting that the liberal program successfully brought forth sound and profound social

---

<sup>103</sup> This Russian Liberal cohort took power in Autumn 1991, following the Soviet Union collapse on December 26, 1991.

<sup>104</sup> Unlike politically-targeted revolutions prior, in particular, the *Bolshevik Revolution*, this initiative did not lead to the death of millions, famine and or disease as it did under Vladimir Lenin's leftist coup d'état.

improvements bringing the end of shortages and state socialism to the USSR.<sup>105</sup> Instead, due to innate bureaucratic deadlock and poor visibility,<sup>106</sup> the legitimacy of the post-Soviet Russian government liberally-oriented revolution dwindled as they failed to establish the financial scaffolding for a civilized market economy. This failure to quickly impose liberal market standards is highlighted in Anatoly Chubais<sup>107</sup> address to the United Nations Economic Commission for Europe, where he states, “We must recognize that we didn't fully understand the scale of the process which we had undertaken. We thought there would be a very difficult three years, five years, eight years. Now, unfortunately, it is clear that reform takes decades.” Instead, the rise for alternative policies took the forefront, speaking louder than any liberal initiatives. Under such change and as verbalized by Domenico Mario Nuti, emerged a “mutant” economic system in Russia, heightened under national corruption, poverty and inequality coupled with “state desertion.” Russian novelist A.I. Solzhenitsyn alludes to this in his commentary that “As a result of the El'tsin epoch, all the main areas of our national life, economic, cultural and moral, have been destroyed or stolen” adding further that Yeltsin's monetary policies were “...pseudo-reforms...leaving more than half of the country's population in poverty.” Following the exit of the Soviet Union in the global international economy, Russia under the Yeltsin period saw drastic changes in its economic model. Still, it failed to meet the conditions of an equitable market economy. Furthermore, under the financial oversight of Yeltsin's regime, I argue that Russian economic “backwardness” only intensified.

Following the collapse of the Eastern hegemony in 1991, the operating model of Yeltsin's Russian economy pivoted,<sup>108</sup> seeking major structural reforms in the subsequent preceding years of 1992 - 1998. However, in practice, the El'tsin epoch failed to influence liberal market conditions on the Russian economy.<sup>109</sup> Instead, it mutated to a market

---

<sup>105</sup> Liberalization in Russia led to other improvements as well, such as: the ability to create a private business; freedom of expression, speech, and travel; the ability to create non-state organizations.

<sup>106</sup> Poor visibility addresses the uncertainty and inability to forecast or predict the results of certain initiatives. This reality still holds true today, as many oligarchs prevent the rise of equitable conditions.

<sup>107</sup> The then-First Deputy Prime Minister of Russia, Anatoly Chubais was an influential voice in the privatization in Russia and laying the foundation for the nation's liberal market economy.

<sup>108</sup> This pivot addresses the move away from the Soviet's centrally planned command economy (“socialist planning”), which slowly went away from 1988 - 1991.

<sup>109</sup> George Soros defended this claim during the 2000 Davos Conference when he stated, “For ten years ... we had the ability to influence things in Russia and move them in the right direction and we flubbed it.”

economy with lingering adverse Soviet characteristics, preventing Russia from achieving substantive economic growth. During its transition, the Russian economy received support from many private organizations in the international financial ecosystem, the *Group of Seven* (G7),<sup>110</sup> the IMF, and other global cohorts. Despite such support, as alluded to earlier, this transition failed, which led to a subsequent mutant economic system. Even though verbalized as a mutant economy, Boris Yeltsin's system was a mutant *market* economy that limited Russian economic growth.<sup>111</sup> There are seven conditions of El'tsin's mutant economy worth mentioning, which my thesis believes further amplified the nation's perceived risk premium before the 2008 Global Financial Crisis.

*Firstly*, arguably the most damaging aspect of Yeltsin's failed transition was the lingering primitivism of the economy, which curbed division of labor. The economic reforms under Yeltsin could not address the remaining structural underpinnings left by the Soviet's command economy. Russian economic primitivism can be best seen through the nation's heavy focus on its agricultural sector and its weak stock market exposed to the oil sector. When referring to *Goskomstat*<sup>112</sup> official statistics in 1999, household sector<sup>113</sup> production comprised 91.2% of produced potatoes, 88.1% of honey production, 79.6% of vegetables, 56.9% of meat, 55% of wool, 48.3% of milk, 30.1% of egg, respectively. A more sobering statistic found by *Goskomstat* was in their 1996 survey, where roughly 43% of food consumed in Russian households came from the plots in the household sector.

Moreover, the concentration of enterprises in the agricultural sector declined from 76.9% in 1985 to 40.6% in 1998. Similarly, yet small, reported national production by family farms increased from 1.1% to 2.1%, where the household sector jumped from 23.1% in 1985 to 57.3% in 1998. Indeed, according to the St. Louis Federal Database, *Production*

---

<sup>110</sup> Established in 1975, G7 is an intergovernmental forum that seeks to sway and improve issues facing the global economy. The G7 members are widely viewed as the "most advanced" in economics in international finance. These members are: the U.S., the U.K, Canada, Germany, Italy, France, and Japan. Ironically, in 1998, Russia was then invited to join this cohort, making it the G8. That said, in typical Russian fashion of uncertainty, they were removed in 2014 following Russian interference with Ukraine's state austerity.

<sup>111</sup> Due to Russia's vast collection of oil reserves coupled with pent up inflows of foreign capital, under a market economy Russia was poised to see robust macroeconomic growth. That said, due to such limiting factors imposed by Yeltsin's mutant economy, these growth prospects were not met. In such, this is why my thesis argues that Yeltsin's mutant *market* economy limited growth in Russia.

<sup>112</sup> *Goskomstat* is the Federal State Statistics Service for Russia.

<sup>113</sup> In this dataset, *Goskomstat* considers the following participants apart of the household sector: gardens, allotments, private plots, dachas (Russian phrase for Summer Home; in a previous survey by *Goskomstat* it was suggested that ~25% of Russian's in large cities had Dachas).

of *Total Industry in Russian Federation* did not see sustained net positive increase<sup>114</sup> quarterly reported total production from Q2-1993 through till Q4-2000. Akin to that of the reported stagnant total market production figures, Russia through, most of the El Sins period, did not reach sustained positive year-over-year growth till 1999,<sup>115</sup> following the exit of Yeltsin. The landscape of the Russian economy was primitive, as many market participants did not shift from the agricultural to an industrializing sector. This can be attributed to negligent division of labor, as a more diverse division of labor is, on average, associated with a rise in economic trade and output. Likewise, other statistics that highlight the primitive state and technical regress of Russia's transition increased horse ownership in the household sector. Despite mass industrialization efforts domestically, globally, and regionally, the correlated shift in horse ownership in conjunction with household agricultural production adds further to the claim outlining the primitive and regressive state of the Russian economy. Ironically, despite being widely accepted that division of labor is inevitable to take shape in a market economy, this was not the case under Yeltsin following the Russian's economic movement away from its original command economy. Further, when referencing Figure 11, it is clear that El'tsin's liberal market economy divides do not have an appropriate focus on division of labor, as there was a sense of pseudo-horizontal integration<sup>116</sup> in the production of the nation's agricultural sector and subsequent household consumption. During Russia's economic transition experience under the El'tsin regime, national production was backward, as the heavily dependent importance on the subsistence sector curbed growth prospects and division of labor.

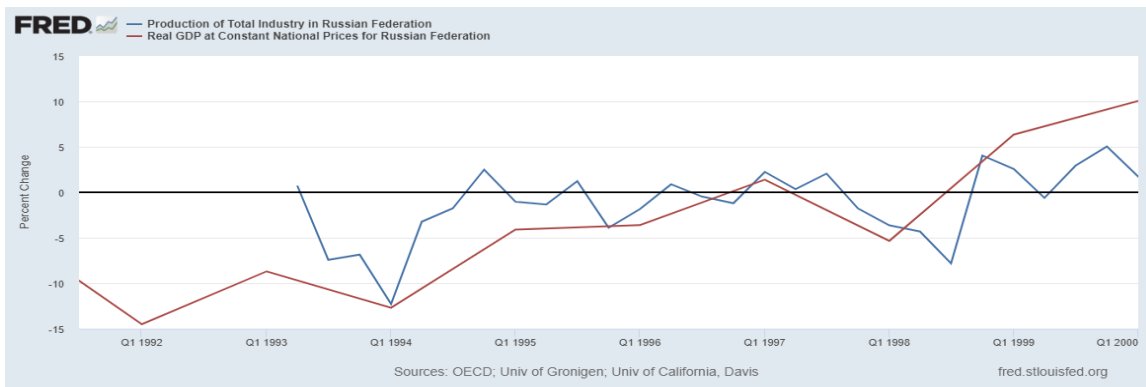
---

<sup>114</sup> When referencing Figure 1, my thesis considers *sustained* growth as a reported duration longer than two fiscal years. In this case, Russia achieved sustained levels of total production in Q4-2000.

<sup>115</sup> This can be seen through the reported *Real GDP at Constant National Prices for Russian Federation* figures on the St. Louis Federal Reserve's database [Figure 1]. This St. Louis FED metric accounts for inflation and benchmarks the production of goods, denominated in the Russian Ruble.

<sup>116</sup> During this period, my thesis argues that there was horizontal integration in the Russian agricultural sector, as many of these households curbed sector expansion and growth in the greater national agriculture sector. Put differently, closed-looped focus on production and consumption, accounting for 43% in 1996, prevented privatized producers from entering and subsequently succeeding in the sector.



**Figure 11: Production of Total Industry in Russian Federation to Russia's Real GDP**

**Source: St. Louis Federal Reserve Database**

*Secondly*, following a similar premise to primitive market conditions common during the Yeltsin regime, there was a shift towards a relatively common reliance on the barter system – particularly in the agriculture and industrial sector. Uninterruptedly rising from 1992 through till 1998, by early 1998, *Goskomstat* reported that roughly 50% of industrial sales had undergone barter conditions.<sup>117</sup> As presented in Wegren (2000), “barter trade has virtually replaced monetized exchange” in the agricultural sector. Akin to that of the Russian Federation during Yeltsin’s two-term presidency, the nation’s market economy regressed as the primitive barter system surpassed a monetized exchange system. During this time, Russia had its own currency under a floating exchange rate, enabling monetary austerity to adjust the real value of the ruble in the domestic market. However, due increased perceived risk in Russian markets, both domestically and internationally, the Central Bank could not adequately adjust such rates causing them to face a larger cost of borrowing. The lagging monetary exchange system, due to the rise of the barter system, adds further to the limitations imposed on the Russian Central Bank. Contested by many,<sup>118</sup>

<sup>117</sup> Note, the qualifications of barter conditions were not presented. My thesis assumes it encompasses the universally acknowledged definition of barter, assuming that hard currency was absent, rather two goods or services were exchanged between the respective market participants.

<sup>118</sup> The reason for the rise of barter exchange, over monetized trade is contested by many. Some of these contentions are but not limited to: deflation, insolvency, Chubais’s failed privatization attempts, tax evasion, and criminalization. Due certain limitations on my research, my thesis does not have a clear agreement to a particular contested condition. Instead, I argue that all of these conditions are lingering standards during the transition of the Russian government in 1991.

the triumph of the barter system, but regardless of your subscription of the cause, adds as another indication of Yeltsin's failed attempt to modernize the Russian economy.

*Thirdly*, towards the end of the El'tsin tenure, the Russian state could not improve the public view on its ability to enhance its efficacy as a public defender. Following the collapse of the Soviet Union, the Russian government failed to solidify a structured state apparatus to govern and provide equitable yet stringent oversight on political units, affairs, and actions. For example, political appointments were often made for financial or political reasons, typically overlooking the respective politicians' previous administrative and technical qualifications. During the El'tsin period, the political landscape in the Russian Federation saw the rise of nodes in *grabbing-hand*<sup>119</sup> advising and kleptocracy. This is supported by the analysis in Frye & Shleifer (1997), where they argue that the *grabbing-hand* model was more prevalent in Moscow than Warsaw. The authors added further that this rise of corruption, proxied through the *grabbing-hand* model is why there was less robust development in enterprise growth in Moscow than in Warsaw.<sup>120</sup> In sum, through this vein, the Russian Federation had a parasitic system of governance, as they lacked an efficient state apparatus to promote equitable conditions.

Fundamentally the same, the *Fourth* aspect of Yeltsin's mutated market economy was the prevalence of financial-driven criminalization. More specifically, the Russian Federation saw the development of a Hobbesian market economy come to fruition due to the *krysha*. In its literal translation, *krysha* means "roof," but this Russian colloquial term imposed market Hobbesian conditions where private enterprises paid for protection. With a rise in criminalization during Yeltsin's two terms, many organizations did not reconsider killing their competing counterpart as Russia failed to establish an effective legal system<sup>121</sup> as a byproduct of the government's absent efficient state apparatus. In practice, many oligarchs would contract criminals to carry out hits against those who posed a threat to

---

<sup>119</sup> *Grabbing-hand* policies is an enlightened perspective on historical and even contemporary policies governing financial markets as well as various macroeconomic conditions. This notion addresses corruption in the government and how it has many guises supporting advancements of private interest.

<sup>120</sup> Note, when compared to Poland, my thesis adamantly argues that Russia's more severe depression can be attributed to the nation's stagnant expansion of private enterprises.

<sup>121</sup> With the absence in an legitimate legal system, many enterprises turned to "Judge Kalashnikov," a phrase paying homage to the Russian made Ak-47 assault rifle. In this case, this phrase alludes to the personal action carried out by many, by either themselves or paying someone else to kill their competitor.

their agenda. Interestingly, membership in the Federation Council and Duma<sup>122</sup> was highly sought after, as those who held a seat in the Federal Council were granted immunity to criminal allegations.

*Fifthly*, the prevalence of opportunistic behavior in the financial sector. Following the decree of Yeltsin's administration to establish the Russian economy to that of a liberally oriented market economy, many market participants sought to maximize their control of economic resources. In this case, the "name of the game" was control over one's cash flows.<sup>123</sup> More specifically, a capital flight that was soon accompanied by a credit crunch in the domestic market. As presented earlier, despite El'tsin's intentions to promote relatively equitable economic conditions in the domestic market, the *grabbing-hand* model had kleptocracy conditions that increased the perceived risk towards Russian financial institutions and ultimately the greater economy. Due to this perception, there was mass capital flight as many Russians pulled their funding's, predominantly ruble and foreign-denominated assets, and transferred them to accounts in varying foreign banks.

Similarly, and paradoxically, those Russian citizens carried out a *run on the bank*, who either financed an improvement in their quality of life or sought to elevate their social standing by carrying actions at the crux of the *grabbing-hand* model. Similarly, this particular condition led to the Russian 1998 Financial Crisis, where the Russian Central Bank then defaulted on their debt and devalued the real exchange rate value of the ruble. In light of this movement, Russia faced a dragged-out credit crunch from 1998. Russia's major commercial lending banks, most of them being quasi-sovereign, added further to the capital flight, yet on a larger scale, while also transferring any remaining assets to their respective controlling organizations. During the early years of Yeltsin's administration, this opportunistic behavior soon led to a credit crunch years later in 1998, causing many borrowers and the Russian government to default as they did not have the means or lines of credit to meet the conditions of their loans.

---

<sup>122</sup> The Federation is the upper-house of the Russian Federal Assembly, while the Duma is the lower-house.

<sup>123</sup> Cash flow refers to the money held by the citizen or enterprise. More specifically, due to the uncertainty in Russia's transition, many wanted to pull their money from domestic Russian banks and divert their funds to foreign bank accounts.

*Sixthly*, notwithstanding the role of capital flows, private bank accounts were non-existent under El'tsin's administration due to the presented abilities of tax authorities. Following the collapse of the Soviet Union, the Russian Federation decentralized its tax legislation, allowing local and regional bureaucrats to establish their tax code. However, due to a rise in tax evasion, tightening the government's ability to carry out municipal projects, and targeted tax havens, the Yeltsin administration decentralized the nation's tax legislation under one universal code. Adding further to the exodus of capital flight, under this shift in taxation, many sovereign and taxation enterprises were able to pull money without the account holders' permission. Supported through El'tsin's conditionalities on taxation, my thesis argues that verbiage on *private bank accounts* was nothing but a fallacy, as various government organizations would pull funding from these accounts, adding further to the kleptocracy light that limited Russian economic growth under Yeltsin's regime. Complementing the already presented poor conditions towards worker's earnings, the *Seventh* and final example is that many private organizations and the Russian government often exercised the non-payment of wages. A complicated yet fundamental violation of conditions established in a standard market economy, many enterprises, and the government failed to pay employees on time. Through this combination of state kleptocracy and negligence to meet payment terms, the economic growth prospects of the Russian Federation under El'tsin were curbed, thus increasing the nation's domestic and internationally perceived risk premium.

During the dubious Yeltsin tenure, Russia saw a profound change in its underlying economic conditions. Ironically, the initial hopes for liberal market-oriented were not met. Instead, the economy of the Russian Federation mutated into a market economy with lingering Russian characteristics that curbed macroeconomic growth. This deadlock in development is due to primitive macroeconomic conditions and market standards. Instead, with increased poverty, corruption, inequality, and famine, the Russian economy saw amplified backwardness in its policy. Complementing the inherently adverse structure of the Russian economy resulting in a market growth vacuum, the IMF added further to Russian perceived risk premium and risk by calling for reduced inflationary pressures in the domestic economy from 1996 - 1998. However, the levels of inflation were relatively moderate, as quarterly changes in Russian inflation, proxied through reported CPI from

Q1-1996 through Q2-1998 decreased from 10.8% to 1.5%. When comparing Q1-1996 to Q2-1999, inflationary pressures slightly rose to 8.5%, attributed to such IMF pressures and the exit for Yeltsin.<sup>124</sup> In sum, with a domestic and foreign credit crunch, capital flight, primitive and regressive market conditions, corruption, and poor deficit financing, the economic collapse of the Russian Federation in 1998 was inevitable.

Soon after El'tsins "coming Russian boom," the Russian Default of 1998 was a speculative attack that resulted in a sovereign debt default and a devaluation in the ruble. Yet facing years of economic reform under Yeltsin, Russia saw limited success, favoring negligible social initiatives,<sup>125</sup> a slight recovery in outputs, narrowing exchange rate band relative to the U.S. dollar, and trade surplus.<sup>126</sup> Many discretionary-macro analysts projected a poised rebound in economic stability. With this adjustment in underlying macroeconomic market conditions, Russia soon joined the *Paris Club*<sup>127</sup> as they could meet the requirements to reschedule the payment of \$60 billion in outstanding Soviet sovereign debt and \$33 billion 23-year commercial repayments with the *London Club*.<sup>128</sup> Towards the end of 1997, 30% of short-term government debt, dating back to the Soviet Union, was repaid, improving the Russian Federations credit profile and perceived risk premium in the global economy. The Central Bank then issued ruble-denominated Russian government bonds to help finance their account deficit as non-inflationary securities.

Despite an increase in Russia's perceived risk in domestic macroeconomic conditions, like Argentina under Cavallo's *Convertibility Plan*, the ruble faced a speculative attack from international finance following the Asian Financial Crisis in 1997. Countries in the Asia-Pacific and Russia felt spillover from this regionally distant "domino effect" economic collapse. However, unlike Lula Brazil's countercyclical monetary moves, the Central Bank of Russia's move to defend the ruble failed, ultimately losing \$6 billion

---

<sup>124</sup> Pulled from the IMF's website, from 1995 to 1997, inflation fell from 131% to 11%, respectively.

<sup>125</sup> Due to the prevalence of *grabbing hand policy* and *Krysha*, equitable conditions in social, economic, and political settings were not feasible as Russian oligarchs had the means to "swing" things in their favor.

<sup>126</sup> This trade surplus was partly due to a resurgence in Russian oil trading at \$23 per barrel (on average, a relatively high price for 1997), where they soon controlled 45% of the world's oil market share.

<sup>127</sup> Established in 1956, the Paris Club is a cohort of globally recognized creditor nations, where they meet monthly to discuss solutions to various payment problems faced by borrower and/or debtor nations. Note, this club addresses borrowing between governments.

<sup>128</sup> Similar to the Paris Club, the London Club is a collection of private creditors, but are solely large commercial lenders. Note, it's major difference from the Paris Club is its borrowing from commercial lenders to sovereign countries.

in foreign-exchange reserves. Furthermore, foreign investors anticipated a depreciation in the ruble, as many regional currencies did, particularly in lower Asia. Under this speculation, investors holding ruble-denominated bonds met with the Russian Central Bank to hedge their risk exposure in Russia by using a forward contract<sup>129</sup> and swapping these bills from being denominated in ruble to another alternative foreign currency to protect against Russia volatile exchange rate risk, relative to the U.S. dollar. With many uncertainties in the Russian economy, extended-regional market health, and a rise in U.S. rates, this future contract allowed foreign investors to devalue the ruble further while limiting investment inflows into the country. This movement in the ruble off the back of changes in external market conditions drove an increase in the Russian risk premium, forcing Moscow to see the elevated cost of borrowing and tighter credit conditions. Equally important, during this period in 1998, crude oil reached its lowest levels since 1986,<sup>130</sup> sitting just under \$6.25 per barrel. With Russian gas and oil imports driving the ruble's value before 1998, following the global decline in gas, the ruble significantly depreciated. Shortly afterward, Russia's already tight credit market<sup>131</sup> squeezed even more, as the balance sheet of most commercial banks was "off-balance," as it was highly leveraged due to net obligations established by these forward contracts. Moreover, during this time in 1998, the IMF did not approve of the conditions for Russia's plan for economic austerity following the collapse of the Soviet Union. Despite that, months later, they approved of Yeltsin's plea for an emergency aid package, nominally \$4.8 billion adding further to the country's debt obligations.

Under extreme macroeconomic volatility, the Russian Federation's currency, bond, and the stock market collapsed<sup>132</sup> due to rising U.S. rates, foreign capital flight, a dying banking sector<sup>133</sup> and international finances amplified risk which increased Russia's perceived risk. Now in late 1998, the Russian banking sector was in total meltdown. Facing

---

<sup>129</sup> A forward contract is used to hedge against interest rate exposure and is paid upon a later date established by the two parties (i.e., Central Bank of Russia and investor). Due to the devaluation of the Ruble under the Asian Financial Crisis backdrop, many foreign investors settle on a set date.

<sup>130</sup> Adjusting for inflation, the price of crude oil was probably the lowest in a post-war period.

<sup>131</sup> Mentioned under point five.

<sup>132</sup> The Moscow Stock Exchange closed for 30 minutes, Russian stock lost 75% of the value of their stock proxied through pierce-to-earnings (P/E), and the yields of ruble-denominated bonds rose well over 200%.

<sup>133</sup> Sberbank, a state-owned commercial bank, took over the deposits held by the six largest banks.

external and domestic pressures, the Central Bank moved to a floating exchange rate, where in just three weeks, the ruble lost  $\frac{2}{3}$  of its value in the global market.<sup>134</sup> George Kogan most famously expressed the Russian 1998 collapse when he stated, “The whole system has just crashed. It will take years for their debtor Russia to recover” later saying, “We are so f-cked.” With Russia’s economy contracting by 5.3% and reported GDP reaching its lowest level since the fall of the Soviet Union, the country entered agreements with the IMF to restructure its debt. Facing harsh tailwinds from the Asian Financial Crisis and a decline in oil prices that once drove up an extremely levered ruble, “the legs” of the Russian economy collapsed, leading to an inevitable default.

After establishing their relationship in 1993, the IMF sought to “salvage a burning building,” rather than redesigning the building architecture. Consequently, issues like transitioning the Russian Central Bank model into a Federal Reserve, cleaning up the nation's tax regime legislation, or establishing some control over the country's monetary policy did not receive the needed attention to create successful scaffolding for the government to attain an equitable market economy. At the forefront of stable exchange rate conditions to curb runaway inflationary pressures and tight monetary policy, the IMF's suggestions brought down short-term inflation from 70% to 3% from 1995 to 1997. The IMF’s policy mix brought single-digit inflation off a strong ruble,<sup>135</sup> and high-interest rates prompted many commercial banks to go on a *borrowing binge*. Unconstrained by the Central Bank in conjunction with speculation of robust future inflows, Russian commercial banks then borrowed in ruble-denominated bonds and other securities denominated in regional securities. However, following the capital flight following the Asian Financial Crisis, these assets were worthless. Under speculative short-term profits, the Russian economy opened prematurely, as many enterprises, mainly commercial banks, had worthless assets on their balance sheet. As already presented, these assets were worthless due to the decline in regional currencies in Asia following the crash, and, if not even more detrimental, the rise in U.S. rates, adding further to the scope of myopic moves made by the FED.

---

<sup>134</sup> As a result, inflation from late 1998 to 1999 jumped from 27.6% to 85.7%. Similarly, unrest and protests grew as the price for food drastically increased

<sup>135</sup> As previously addressed, the strong value of the ruble came from robust growth in the Russian oil sector.

Equally harmful, the IMF could have reduced Russia's exposure to risk once it hit single-digits of inflation in 1995 - 1997. Instead, the IMF could have then pivoted their policy to a gradual inflationary approach over a sustained period of years. Likewise, the IMF should have assisted Central Banks by aiding a temporary control over fund outflows<sup>136</sup> while also selectively opening the economy. This "one size fits all" monetary prescription made by the IMF, can be attributed to the argument suggesting that the U.S. forcefully influences the IMF, coercing them to impose unattainable conditionalities. Paradoxically, the IMF does not formulate equitable economic policies to target market liberalization and macroeconomic stability. Ironically, the IMF's mismanagement is defended by George Soros, one of many blamed for the Asian Financial Crisis, when he says, "They push countries into recessions by forcing them to raise interest rates and cut budgets - exactly the opposite of what the US is doing in similar circumstances." Critiquing the IMF, Soros adds to my claim that the IMF's policy only amplifies the boom-and-bust cycles of many emerging market economies. The IMF's model is regularly built off specific conditions proposed by the U.S. – under U.S. interest the IMF will offer larger loans with tighter credit conditionalities. In sum, through the IMF, U.S. policymakers influence the direction of the organization's policy to pursue increased financial gain. U.S. manipulation over IMF lending and policymaking is addressed in Oatley et al. (2004), where he found U.S. foreign policy interest rates reflected the direction of the IMF's lending decision. Furthermore, the interest rates of commercial banks are strongly correlated with the IMF's lending policies, where the IMF offers countries with large balances larger loans. Guided by the FED's nearsighted policy targets and the account owed to commercial banks, the IMF provided the Russian Federation with a *one-rule-fits-all* model<sup>137</sup> rather than implementing a targeted mix of macroeconomic controls.

To the surprise of many, in all respects to a national leadership transformation, Russia saw a surge in positive growth under Vladimir Putin, following years of regressive economic conditions and a subsequent default in 1998. Reeling from the byproducts of the

---

<sup>136</sup> A temporary hold or limitation on drastic capital flight would have eased investor nerves on the speculative collapse and devaluation of the ruble following the Asian Financial Crisis.

<sup>137</sup> This model was very common in the IMF's policy model, as Yuri Dubini, former Soviet diplomat stated that during 1995 - 1998, "The top level IMF command team liked Russia. That was helpful. But it applied the same model in Russia as in other countries."



1998 collapse and lingering conditions dating back to the Soviet Union, Russia's economy leapfrogged previous structural conditions due to Putin's goal of economic liberalization with constraints on democracy. Boris Nemtsov, former Deputy Chairman of the Government, stated, "unfortunately he doesn't believe that Russia needs a democracy too," adding further that Stalin wanted a sustainable market economy. Despite Putin's rhetoric acknowledging his illiberal political intentions, the development fortunes of Russia turned. A considerable blow to the financial legitimacy of Russia in the international market, in hindsight, the 1998 collapse was beneficial to "prop up" the economy. Russia's favorable growth from 1999 to 2008 was due to increased interactions in the global economy.

Following the ruble's depreciation against the dollar, Russia cut its import inflows. It shifted focus towards domestic production, which allowed for the division of labor and improved the foundation of underdeveloped sectors<sup>138</sup>. Through increased domestic production and improvements, the thesis for Russian trade shifted their focus to domestic export goods, which then stabilized their account balance. *Goskomstat* reports that in U.S. billions, Russian exports from 1999 to 2008 jumped from \$75.5 billion to \$471.6 billion, a 525% increase in exports. Similarly, imports gradually increased by not on the same scale as exports.<sup>139</sup> Note, through this development initiative, Russia achieved relative financial stabilization by the end of 1999. Experiencing this trade surplus, Russia then saw an increase in its account balance, from \$24.6 billion to \$102.3 billion from 1999 to 2008. This much-needed improvement in international trade also contributed to Russia's development as the world's largest reserve holding, which as of 2008 was reported to sit north of \$427.1 billion. Surpassing domestic economic chaos, Russia restored its legitimacy in international trade. Another key objective for Putin's initiative to stabilize the economy was to rationalize government spending – complementing the improvements in trade surplus. Through tight fiscal policies, Putin's administration reined in government spending to maintain stable macroeconomic conditions, preventing runaway inflationary pressures and improving the nation's budget. Putin's prudent macroeconomic initiatives guided Russia to stabilize its fiscal balance in 2004. Once assuming office in 1999, the

---

<sup>138</sup> The most notable development came through the nation's merchandise sector, as its trade surplus jumped from \$36.0 billion to \$179.7 billion during 1999 - 2008.

<sup>139</sup> Imports jumped from 39.5 to 291.9 from 1999 to 2008.

Debt-to-GDP under Stalin was 4.2%, and soon government revenue shot up in the ensuing years from 12.6% to 22.6%, during 2000 through 2008. In conjunction with this increase, the government limited its spending initiatives to equal to or under 18.2% of GDP. The Russian government used the funds to partially pay the debt from the IMF, government pension funds, and the *Paris Club*. Putin's administration successfully monetized their domestic production, which improved their trade balance, allowing them to meet the repayment conditionalities of outstanding debt that led to the nation's early 1998 demise.

Under Stalin, the Russian Federation also saw improved structural economic reforms that brought relatively improved equitable corporate governance. One of the significant byproducts from El'tsins mutant market economy was the decentralized tax structure that increased the perceived risk of domestic and foreign investors. For instance, at one-point, Russian citizens and international and domestic enterprises were subject to 200 tax conditionalities.<sup>140</sup> Riddled with many inefficiencies, this consortium of taxes led to regional and federal claims battling each other to collect the funds. Without a centrally sound tax plan, there were delineating conditions regionally and federally, which brought corruption through tax delinquency. A byproduct of poor governance, many firms found a more significant net benefit to avoid paying tasks, taking on the possibility of getting caught. As a result, many firms did not accurately report their top-line revenue earnings among other capital streams. Holistically, this system hindered the government's ability to collect its total potential revenue. To adjust the conditions of the Russian Federation's tax collection, Putin centralized all aspects of the process into the tax ministry. In such a move, the tax ministry prevented the continued development of corrupt and abusive actions that many collection agencies once did. Putin's regime then turned to improving the efficacy of tax collection by reducing the number of taxes from 200 to 16, where 10 of them were Federal, and the remaining six were regional. President Putin's first term in office led to the improved Russian economic legitimacy proxied through structural reforms that enabled the Central Bank to elevate their austerity effects.

Through several social and economically targeted structural reforms, Russian president Vladimir Putin revised the nation's economy, which ultimately restored the

---

<sup>140</sup> Of these 200, 170 were regional and local conditions whereas the remaining 30 were federal requirements.

nation's legitimacy in the global economy and reduced the perceived risk associated with Russian investment. However, relative to the U.S. Western democracy, Putin is arguably the most politically targeted figure due to his illiberal rhetoric. That said, Putin's initiatives to increase government control in the market have allowed the nation's market economy to see robust growth, as many underlying sectors were able to scale their production which benefited their net revenue earning, and the account balance of the Russian Federation. Widely debated, without equivocation, my thesis argues that the FED's myopic changes in short-term rates to stabilize its own U.S. economy jointly with the IMF's fixed structural impaired El'tsin mutant market economy and further amplified the regional spillovers from the Asian Financial Crisis. Admittedly, Putin's political regime fills the caricature of previous authoritarian regimes, by supporting various state owned and quasi-sovereign firms, as well as improving the private sector landscape, developing undermined sectors, and repositioning the national oil industry, Putin's regime brought the Russian economy from "crash to cash," a form of successful rapid catch-up that forms the bedrock of his popularity among the masses. Managing the end of communism following the collapse of the Soviet Union, Yeltsin's economic tenure went up in flames due to lingering command economy regressive effects.<sup>141</sup> Analogous to the-Peronist-President of Argentina, Carlos Menem, Russia's political and monetary structural efficacy failed to address regional spillover<sup>142</sup> and U.S. short-term target changes. Notwithstanding the political operating model of Vladimir Putin's illiberal impetus, the liberal market economy ultimately prevailed from 1999 to 2008 – enabling Russia to pressure the U.S. hegemony.

### **5.1.2 Moscow's Economic Muscle Pounding U.S. Economic "Egoism"**

Elected as the third President of the Russian Federation, in his interview with *Itogi*<sup>143</sup> before the March 2nd, 2008 election, Dmitri Medvedev presented his intentions to

---

<sup>141</sup> There regressive effects are the twofold devolution of the ruble, sovereign debt default, domestic debt default, primitive market conditions, thin stock market, among others highlighted above.

<sup>142</sup> Note, as already discussed, Menem and subsequently Fernando de la Rúa struggled to address Mexico's "Tequila Crisis" in 1994 whereas Russia could not fend off speculative moves linked to the Asian Financial Crisis in 1997.

<sup>143</sup> Influential online Russian weekly magazine.

continue “Putin’s Plan”<sup>144</sup> for Russia when stating, “We want stability and continuation with the course that has been chosen. We do want disturbances of any kind.” Once in office, this was seen through his *The Concept of Long-term Socio-economic Development of the Russian Federation up to 2020*, which intended to modernize domestic markets and efficiency economically. Ironically having spoken too soon, the conditions of Russia’s newly achieved macroeconomic sustainability following the collapse of the U.S. housing market, the Russian economy was hit hard. On the surface, this economic collapse in 2008 seemed similar to the 1998 downfall due to the drop-in oil prices, external shocks, and short-term moves by the FED to protect underlying U.S. conditions. Nevertheless, this tertiary analysis does not hold. Russia had the monetary and fiscal collective means to spare the nation from an “even worse” punitive economic suffering through Putin’s targeted regime.

Principally vigorous in the early onset of the Global Financial Crisis, Russian domestic policy did not hesitate to acknowledge the Central Bank’s ability to guide the nation from another economic collapse<sup>145</sup> effectively. In so doing, Russia garnered confidence in the Russian ruble and domestic commercial financial system. When referring to confluences that drove the nation’s 1998 financial collapse, this move-in policy was to prevent a “run on the bank” or capital flight, and a credit crunch as Medvedev’s officials succeed in protecting the real value of the ruble and the balance sheet integrity of Russian commercial banks, in the short-run. Additionally, beneficial, the sound sovereign wealth funds, proxied through the *Stabilization Fund*,<sup>146</sup> and high levels of foreign reserves.

By early-2008, Russia was more prosperous than ever, but within a year, the targeted rhetoric to the West and strength in domestic institutions, along with “Putin’s Plan,” could not help Medvedev. Within seven months in office,<sup>147</sup> the Moscow Exchange

---

<sup>144</sup> Vladimir Putin was Medvedev’s longtime friend and mentor. With Medvedev’s subsequent win, Putin assumed the seat as Prime Minister. Moreover, “Putin’s Plan” was an popular, yet informal apropos

<sup>145</sup> While flexing the nation’s monetary ability, Russian policy makers also publicly critiqued the U.S. and called into question their own economic legitimacy.

<sup>146</sup> Under the guidance of Aleksei Kudrin, the then-Minister of Finance, the Stabilization Fund received \$157 billion in 2008. However, later in 2008, these funds were split into two separate entities, the *National Welfare Fund* holding \$142.6 billion, and the *Reserve Fund* with the remaining \$31.9 billion. Revenues from oil sales were allocated to these two funds. The *National Welfare Fund*’s intentions were to refinance the state’s pension fund whereas the *Reserve Fund* targeted investment in low-yielding foreign securities and other ventures.

<sup>147</sup> This period addresses June 2008 to January 2009.

dropped 70%. The ruble lost a  $\frac{1}{3}$  of its real exchange rate value when benchmarked to the U.S. dollar, despite the Central Bank's aggressive countercyclical measures to prop up such conditions. By mid-October 2008, the Central Bank, supported by the government, earmarked \$200 billion to contain and stabilize this decaying situation. These measures, through the *Stabilization Fund* and succeeding sub-fund,<sup>148</sup> the *Reserve Fund* stabilizing measures moved to purchase \$20 billion in outright plummeting stocks, provided recapitalization<sup>149</sup> initiatives for certain banks with highly leveraged balance sheets, and also channeled roughly \$50 billion to help Russian oligarchs owned companies raise funds before their respective end-of-quarter earnings calls.<sup>150</sup> In particular, Medvedev's administration offered \$36 billion to the two-largest Russian-owned banks, Vnesheconombank and Sberbank.<sup>151</sup> Commercial banks panicked in a similar yet smaller vein to the 1998 collapse, prompting them to limit their lending arm.

Interestingly, despite the Central Bank's countercyclical measures to cushion the market and improve investor confidence, many private enterprises saw rising debt levels as they struggled to meet repayment conditions. These three contingencies wore down Russia's national reserves<sup>152</sup> under the Global Financial Crisis backdrop and shrank Russia's reported GDP for the first time since Stalin assumed control. Likewise, due to his shift in international finance, the price for oil dropped significantly, guiding the Russian government to tighten its spending initiative. That said, despite seeing a credit tightening, by carrying out recapitalization projects targeted towards private enterprises and banks, Russia exercised the largest proposed bailout compared to other G-8 member countries.<sup>153</sup> Despite Russian economic advancements, relative to the conditions under El'tsin, the

---

<sup>148</sup> As mentioned above, due to the varying macroeconomic issues, the Central Bank decided to split up the *Stabilization Fund* into two separate funds that targeted the nations pension fund (*Welfare Fund*) and financial market agencies (*Reserve Fund*).

<sup>149</sup> Recapitalization is a method of restructuring debt through a mix of debt and equity. In this case, the *Reserve Fund* provided extra cash to help Russian enterprises balance their cash flows before their earnings call with respective domestic and foreign investors.

<sup>150</sup> I weigh both moves, government buy-backs of Russian securities and recapitalization, equally important as strong financials during the margin calls improve investor confidence. Moreover, this then helped the Moscow Exchange adjust and reach pre-2008 conditions. In sum, through this move, the *Reserve Fund* sought to target public and private market stabilization.

<sup>151</sup> Established in 2007, Vnesheconombank is a state-owned development corporation that provides funding to various commercial and state developments. Sberbank is a large savings bank in seven countries.

<sup>152</sup> By 2009, Russia had a budget deficit of \$77.5 billion.

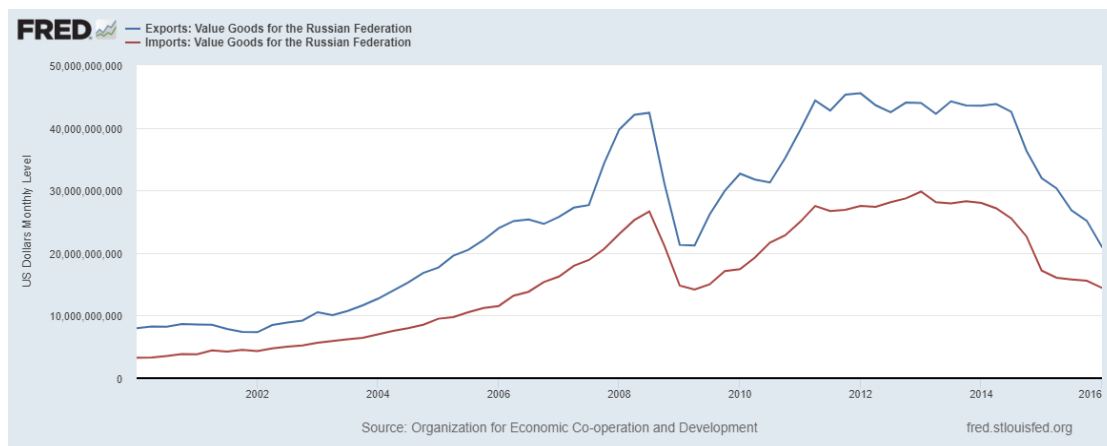
<sup>153</sup> In the end, the total for the proposed bailout equated to 13% of Russia's GDP; higher than the U.S. government's package which was only 5.5% of its own GDP (~ \$787 billion).

Medvedev administration underestimated the structural distance from the external shock, seen in the first months of the 2008 crash.

The *Anti-Crisis Programme of the Russian Government* was approved on June 19, 2009, to implement targeted systemic measures to help improve the non-financial sector<sup>154</sup> and remedy the nation's economic decline. However, of these sector targets, the automotive, pharmaceutical, construction, agricultural, and light textile industries focused explicitly on catalyzing domestic demand and import substitution industrialization. This anti-crisis measure forced Russia to gradually remove its independence from importing foreign goods and strengthen domestic industries. Complementing this focus on domestic production to maintain a trade surplus, in Q2-2009, Medvedev introduced a collection of tariffs and subsidies towards the mentioned industries. Verbalized as "softening the crisis" by the Central Bank, this two-fold anti-crisis targeted economic policy protected domestic customers', producers, and the government's budget. Russia's unilateral protective tariffs helped increase its domestic production recovery. Complementing this growing strength in scales of Russian market production, off the back of a depreciation in the ruble, Russian imports continued to thrive whereas exports contracted. Despite hemorrhaging in the ruble's real exchange rate in the global market, the Central Bank refrained from imposing exchange controls to prevent an outflow of the U.S. dollar. Through this, the government curbed the nation's U.S. dollar-denominated capital flight and added a protective layer to their reserve ratios.

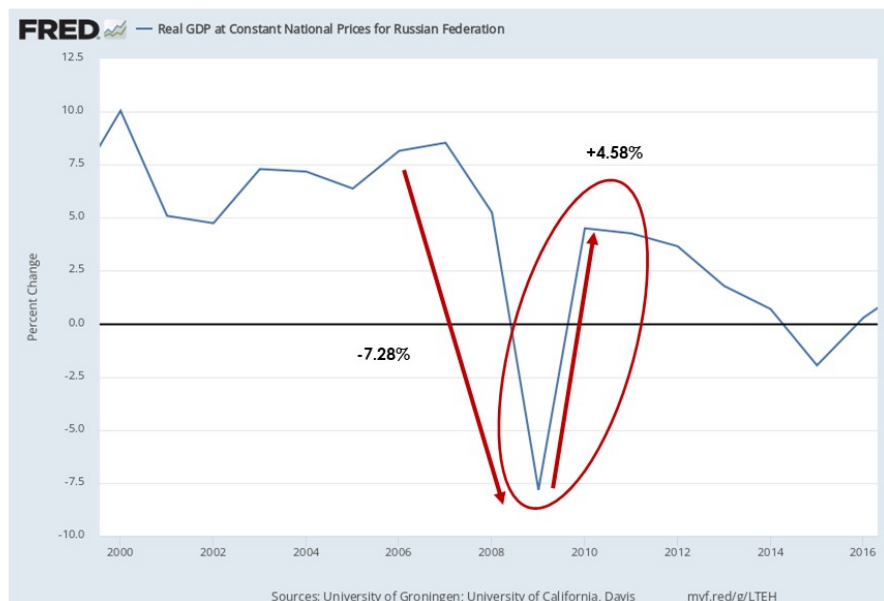
---

<sup>154</sup> The industries within this non-financial sector are but not limited to: metallurgical, agricultural, automotive, forestry, transport, defense, and transportation.

**Figure 12: Co-movement of Russian Exports & Imports**

**Source: St. Louis Federal Reserve Database**

Thus, in 2010, the following fiscal year, the Russian Federation's economic situation improved, seeing a 4.58% rebound in reported real GDP when referring to Figure 2. Two years following the global financial collapse in 2008, the price of oil soon stabilized, which improved Russia's reported exports, rebalancing the nation's account balance. Like the increase in oil prices, other commodities including gas, precious metals, oil, and others improved Russian exports further. As alluded to in the Central Banks report for 2010, due to the diversification of the economy and stable grounds in the Russian specialization in oil, the newly modernized market economy under Stalin pushed Russia over the 2008 economic collapse - just two years later. However, despite facing robust market growth, Putin's political prerogative was still extremely illiberal condemning many actions of Western democratic countries. Moreover, from 2010, the price for oil was relatively stable and brought the Russian government a stable balance. As presented earlier, fundamentally the rise in the price of crude oil suggests improving macroeconomic conditions within Russia. With increased domestic production and demand protected off the back of import tariff measures, Russian legislation for imports was that of a pendulum swinging back and forth – both liberalizing and discriminatory.

**Figure 13:** Russian Federation's Reported Real GDP, *post-2008*

**Source: St. Louis Federal Reserve Database**

In 2008, Medvedev's Russia was on sufficient economic grounds due to the nation's domestic markets undertaking structural reforms. Having realized the lagged economic development following the 1998 collapse, Putin developed Moscow's sound financial muscle to protect the nation's underlying macroeconomic conditions from volatile tailwinds in the international market amplified from the collapse of the U.S. mortgage sector. Putin's economic pseudo-market financial scaffolding fueled off soaring prices for Russian gas and oil exports, allowing Medvedev to combat U.S. monetary egoism that ravaged the international markets effectively in late 2008. Over and above that, guiding the Kremlin's response plan to adjust domestic conditions, the Russian leader thereafter liberalized Russia's domestic gas sector while also lowering taxes on its oil which subsequently allowed the global energy market to reach pre-2008 levels.

Russian technocrats in the Central Bank and Ministry of Finance helped guide the nation through the U.S. egotistical global collapse through the market-oriented exchange rate monetary and budgetary policies. In sum, Moscow leadership's market-driven system enabled the state to alleviate itself from an increase in perceived risk premium from a heavily concentrated top-down approach as domestic macroeconomic conditions saw improvements in austerity measures – improving the perception of Russian legitimacy.



### 5.1.3 Erratic Policy & Sound Macroeconomic Conditions: Russia Regression

As mentioned earlier, the market economy of Russia is particularly fascinating given Putin's illiberal rhetoric. Despite being categorized as a polyarchy, the Russian Federation paradoxically sees sustained inflows of foreign investment, stable account balances, robust market growth, and an increase in their regional and global sphere of influence. Widely recognized, countries who are less democratic, or in this case, show more traits pushing the agenda of a polyarchy or autocracy, will see a higher cost of borrowing when issuing in the global credit market. This assumption is driven by the conditions that political structures of polyarchy are top-heavy, favoring a select few, while also seeing increasing corruption and social burdens due to limitations on the growth of an equitable landscape. Robert Dahl, among other political theorists, adds further suggesting that under a polyarchy, the "tyranny of the minority" does not promote greater social justice, instead with traits to that of political bargaining, their limitations on the citizen's autonomy. These traits bottleneck economic growth and drive up the country's risk premium. As such, it would be assumed that Russia, like most polyarchies and autocratic regimes, will see an increase in its risk premium. This universal political-macroeconomic condition can be best seen through South Africa, as they were a widespread case of a "competitive oligarchy" before 1994.<sup>155</sup> Many of its population were disenfranchised before the nation's political transition, still seeing lingering violence and political intimidation today. When referencing the graph below, it is clear the rise in the cost of borrowing under volatile domestic conditions. Most notable, in the 1980s, seen below, the South African economy faced external boycotts due to their Apartheid which amplified the decline of their underlying economy. In sum, with the work of Dahl and analyzing countries like South Africa,<sup>156</sup> which once was a "competitive" polyarchy – countries who lack liberal democratic conditions, proxied through their V-Dem Institute, will see an increase in the cost of

---

<sup>155</sup> In 1994, all citizens in South Africa were allowed to vote under the birth of the National Party government.

<sup>156</sup> Note, wanting to stay in the scope of my thesis, I am limiting my analysis of South Africa as the nation's political and economic development deserves its own chapter.

borrowing. Conversely, this is not the case, as seen in the aggregated fixed effect regression results and Russian Federation country-specific model.

**Table 14:** South Africa Long-Term Rates Benchmarked to U.S. 10-Year



**Source: St. Louis Federal Reserve Database**

Similar to the aggregated results presented in my results section, this section solely focuses on Russia from 2000 through 2020 using a fixed-effect model. A fixed-effect model best illustrates the correlation of variable change over time regressed on the dependent variable. In this case, this model complements my qualitative assessment, as this regression, for the most part, holds a similar premise to the legitimacy of the Russian Federation.

**Table 11** Russia Fixed Effect Model from 2000 to 2020

Dependent variable:				
	nominalspread			
	(1)	(2)	(3)	(4)
US_2yr	2.107* (1.251)			
VIX	0.040 (0.063)			0.032 (0.065)
LIBOR	-2.212** (1.037)	-0.558** (0.259)	-0.244 (0.263)	
spot	0.044 (0.074)			0.322*** (0.054)
inflation	0.262*** (0.051)	0.293*** (0.028)	0.288*** (0.029)	
ab	-0.0001 (0.0001)			
vul	-21.931*** (8.147)	-16.158** (7.105)		
regime	373.903*** (46.266)	404.938*** (29.266)	378.374*** (28.673)	219.809*** (27.160)
fdi	0.0002 (0.0002)			0.0002 (0.0001)
Observations	70	70	74	74
R2	0.807	0.790	0.753	0.636
Adjusted R2	0.778	0.777	0.742	0.615
F Statistic	27.806*** (df = 9; 60)	61.069*** (df = 4; 65)	71.103*** (df = 3; 70)	30.164*** (df = 4; 69)
Note: *p<0.1; **p<0.05; ***p<0.01				

Table 11 has four regressions, looking at the relationship between Russian political and economic conditions on the nation's nominal spread, proxying its cost of borrowing. Note, as addressed in the Methodology and Data section, the nominal spread is benchmarked to the U.S. 10-Year to gauge the risk premium off movements in the FEDs watershed short-term rate. The coefficients and standard error fluctuate across each regression, highlighting the effects and correlation of variable pairing when being regressed on the dependent variable. Inflation has a positive and significant relationship with nominal spread, suggesting that with a one-unit increase of domestic inflation, the Russian Federation will see an increase in the cost of borrowing. With these two constraints, with runaway inflationary pressures, it is increasingly more challenging for the citizens and firms to meet various conditions as the real value of the ruble is decreasing. In sum, they are making it harder for the Central Bank to meet the conditionalities of the risk

premium due to limitations on their purchasing power. This complements my original thesis, as heightened inflationary pressures tighten the Russian Central Bank's monetary efforts and curb the domestic circulation of capital.

Two surprises are that the Russian Political Regime is positively correlated with an increase in the cost of borrowing while its political vulnerability is negatively correlated. This result suggests that holding everything constant, with a one-unit increase in Russia's V-Dem liberal democratic score, meaning they are moving away from a polyarchy, they see an increase of 373.903 in their cost of borrowing, on average. Conversely, as the Russian Federation sees a one-unit increase in their political vulnerability, their cost of borrowing goes down by 21.91%. My thesis initially thought the political regime would negatively correlate with nominal spread, suggesting a decline in the cost of borrowing as Russia becomes more "Democratic," however the two have a positive correlation. Russia has benefited from its vast natural resources and collection of oligarchs that help finance the nation's account deficit during their 1998 collapse and brief downturn following 2008. Equally important, despite publicly pushing illiberal sentiments and shifting the global landscape through their foreign policy with regional and international counterparts, investors still seek our Russian issuances. This result can be partly attributed to the nation's substantial oil reserves, making them one of the global focal points, but Russia has one of the largest Foreign currency reserves. But, more importantly, the Kremlin's sound macroeconomic strength and ability to meet coercive conditionalities in the global credit cycle.

Moreover, with quasi-sovereign Russian firms, the most notable being Gazprom and Sberbank, Moscow has highly sought-after assets that churn strong revenue margins, which add further to the nation's financing ability<sup>157</sup> and attractive credit profile. Likewise, Russia has increased its sphere of influence through various financing initiatives by providing streams of liquidity and bailouts to countries such as Venezuela, Iceland, Ukraine, Cyprus, and, more importantly, a burgeoning Sino-Russian alliance. Correspondingly, Russian enterprises are expanding their scales of operations to Latin America and Africa, all of which improve Russian legitimacy in the global markets.

---

<sup>157</sup> In September 2021, Gazprom reported \$2.37 Trillion in revenue and Sberbank at \$587.7 billion in revenue.

Despite the nation showing more conditions aligning to that of autocracy<sup>158</sup>, Moscow's strong flows of revenue from quasi-sovereign assets, vast reserves of oil and natural resources, and growing sphere of influence have strengthened the nation's legitimacy in international financial markets. Correspondingly, Russia's improving macroeconomic legitimacy works similar to the nation's correlation with increased vulnerability. Despite increased volatile political conditions, due to the nation's well-positioned financial ability, the global market feels confident in the Central Bank of Russia's ability to meet the repayment conditions.

Additionally, universally known and seen through the nation's V-Dem score, Russia is riddled with corruption, which many accounts for as presented in Zakharov (2019). Zakharov (2013) found that increasing corruption led to a 15% decline in national investment in 2013 but takes into account the rise in policy targeting corruption stating future inflows of investment will increase. In short, through these developments, the political agenda of Russia seems not to faze institutional investors. Furthermore, the political landscape of Russia can be viewed as negligible in the eyes of global finance as the direction of Moscow's agenda is driven by the nation's vast financial position.

Interestingly, the remaining variables were not statistically significant, suggesting they did not affect the emerging market risk premium from 2000 to 2020. When considering Russia's economic and political strength, these results indicate that the US\_2yr and VIX do not influence the nation's cost of borrowing. Arguably most demonstrative results addressing the influence of FED policy and U.S. market conditions, it can be seen, through both the qualitative and quantitative analysis, that the Russian Federation has the macroeconomic brawn to maintain its financial legitimacy suggesting that the direction of U.S. conditions does not influence their risk premium. Instead, through the nation's growing sphere of influence coupled with its large reserves and financially sound domestic firms, international finance does not subscribe to Russia the trait of easing risk premium under improving Democratic conditions, nor does U.S. economic health. While many perceive Moscow's policy to be erratic, its macroeconomic policy management is entirely orthodox, allowing them to be relatively removed from U.S. spillover. However, the

---

<sup>158</sup> This is contested by many, as some suggest Russia is an anocracy. However, my thesis argues it is an autocracy.

nation's rise in the cost of borrowing can be linked to such erratic policy as they continue to test the willingness of Washington deterrence efforts. Russia's macroeconomic legitimacy and power to act autonomously against FED policy changes, among other global conditions, challenges the U.S. hegemony stronghold of international finance. When considering the current geopolitical landscape, U.S. political-military hegemony, proxied through the U.S Federal Reserve, continues to influence conditions domestically in Russia. But, unlike its developing counterparts, Russia's macroeconomic grandeur enables them to be relatively protected from drastic spillover.

## 5.2 Turkey

During the late 1990s and early 2000s, Turkey's mixed economy saw back-to-back economic and financial crises. Successive long and deep recessions succeeded one another, wherein 2001, the Turkish economy reached its lowest point. Since then, the U.S. economic hegemony has only grown, whereas European influence has some sway towards Turkish development. This section provides an overview of the seldom-addressed financial puzzle of the Turkish economy. Touted by many Turkish technocrats, Turkey's economic operating model is immune to stop-go cycles that characterize much of the 20th and early 21st century.

This section will present the influence both the IMF and World Bank had on the shift in the economy's structure, which only worsened the nation's operating model leading to its subsequent collapse in 2001. However, following the rebound in the lira paired in conjunction with the rise of "Anatolian Tiger" cities, inflows of foreign investment allowed the nations to enjoy five years of rapid and robust recovery following the 2001 economic collapse. Equally important, with improvements in scales of production and industrialization, the *Justice and Development Party*, and Central Bank officials, were able to successfully guide Turkey from the collapse of the global financial system in 2008. Additionally, this section presents yielding results from my Turkish specific fixed-effect regression model to best illustrate the role country-specific conditions have on the nation's risk premium, or cost of borrowing. With these results, there is clear overlap of presented monetary and political conditions, along with common emerging market conditions. Interestingly, various regressed results contest my original beliefs. By examining the

government's monetary and fiscal policy moves during two periods of economic crises, this chapter complements existing narratives addressing Ankara's successful moves to address amplified spillover, thus protecting the nation's economic conditions following the collapse in international finance.

### 5.2.1 Turkish Monetary Policy: *Ever-Changing Structural Reforms*

Positioned on the corner of Europe, the Turkish economy has gone through all phases of market development, from a liberalized capital account to ensuing boom-bust cycles to substitutions and inflation targeting.<sup>159</sup> Narrowing the scope of Turkish monetary stability, the Central Bank of Turkey recorded relatively stable economic growth off the back of severe debt crises in Latin America and domestic political reforms. Namely, yearly domestic gross national production oscillated to an average high of 10% and a low of 4.6%, whereas the average sat comfortably at 5% from 1981 through to 1990.<sup>160</sup> Addressing its inability to effectively manage its acceleration in runaway domestic inflation and balance of payments growing pain, Turkey introduced the *Stabilization and Structural Adjustment Program* (SSAP) in collaboration with the World Bank and IMF. The 1980 stabilization program targeted export-led growth, pushing the Turkish economic model out of the decaying conditions of substitution-based development<sup>161</sup>. This program had five objectives<sup>162</sup>:

1. Reduce inflation and attain price stability
2. Break inflationary “spiral” and remove disequilibria in major markets
3. Address immediate pressures on the balance of payments

---

<sup>159</sup> Note, the order in which these economic cycles were presented does not reflect the true movement of Turkey's economy. Rather, it shows the volatile variance in the nation's monetary history.

<sup>160</sup> This data is reported from the Turkish Statistical Institute (Turkstat), the nation's official statistical agency.

<sup>161</sup> With improving conditions in international finance, I, like many others, argue that Turkey among other developing countries needed to improve their interconnectedness in the market rather than pushing itself away from trade. In so doing, Turkey, being riddled with sound scales of production, would increase and then adjust its current account balance; which it did, reaching 2.1% of the nation's GNP in 1988, while it was -5.8% in 1980.

<sup>162</sup> The first three target market stabilizations while the last two at structural adjustments.

4. Through improved confidence in market forces, increase privatization targets by targeting the idea of removing state intervention
5. Reach a stable balance of payments levels and integrate the Turkish economy in the global market through export-oriented industrialization and liberalization of international trade.

Hailed as a success, the stabilization's overriding goal was to strategically shift the nation's archetypal import-substitution operating model towards a more emphasized market-oriented thesis that penetrated the global exports market. My thesis argues that the stabilization initiative represents one of the first radical yet successful transformations in Turkish policies and institutions. At this time, marketization and improvements in the Central Bank's macro-management abilities eased the nation's credit cycle and deposit rate settlements as it was left to the market forces. Equally important, the Istanbul Stock Exchange, *Borsa İstanbul*, was established, adding further to Turkey's developing connections to the global economy. The stabilization program's efforts can be viewed through three broad macroeconomic headings.

First, viewed on its macroeconomic performance, Turkey reached high growth rates under this IMF-supported program. Shortly after that, except for negative growth in mining<sup>163</sup> and slow growth construction, most sectors of the economy reported strong development. Manufacturing and energy reported the highest growth, which fell in line with the stabilization conditions of industrialization and increased scales of production in developing markets. Conversely, but negligible to the goals of this 1980 economic reform,<sup>164</sup> the agricultural sector saw robust aggregated growth from each year, which can be attributed to the seasonal production. With improved domestic scales of production across industries coupled with steady increasing inflows of private investment, two significant drivers of growth also eased inflationary pressures.

---

<sup>163</sup> Note, negative growth only lasted one fiscal year from 1981 - 1982. There is no definitive reason why mining did not see immediate sustained growth like other sectors, but it can be linked to the innate sunk costs and operating expenses with this commodities oriented space.

<sup>164</sup> One pillar of the stabilization program that sought to catalyze growth was industrialization efforts. Considering the importance of the agrarian sector, my thesis considers this variation in growth to be negligible as the Turkish agricultural sector was relatively established, but was not addressed in the original goals as other sectors were of importance.



Furthermore, the Turkish balance of payments improved as the current account deficit to GNP ratio lowered in the program's early years and remained at low levels till 1987. More importantly, from 1998 through 1989, this ratio transformed to surplus, highlighting improved conditions for trade in later years. Secondly, this policy increased trade liberalization, which led to market and product diversification. This can be seen holistically, where, as reported by the Turkish Statistical Institute, the national volume of exports increased from \$2.3 billion to \$11.7 billion just between 1979 to 1988. As addressed above, the macroeconomic thesis of the Turkish Central Bank shifted focus towards industrialization, which was driven off the nation's manufactured goods sector where total exports rose from 28.8% to 69.1% from 1980 through to 1988.<sup>165</sup> These impressive developments in Turkey's "more industrialized" sectors were even more pronounced when considering the discretionary macroeconomic conditions of stagnant market growth by many of their trading partners and a decaying U.S. economy during the 1980s recession.<sup>166</sup>

Additionally, during this time, the landscape of international finance struggled to reach stable levels as Europe struggled to create its single currency while Argentina, Brazil, and Mexico all were facing debt crises, adding further external pressures on Turkish liberal efforts in market adjustment. Turkey's 1980 stabilization and structural reforms were instrumental in increasing domestic confidence towards becoming export-oriented and further improving the nation's perceived risk premium. In sum, using this program as a yardstick, led to significant and robust economic progress across all sectors of the economy. Although the nation saw reasonably slow progress towards a liberalized economy, the underlying macroeconomic conditions of the economy improved as Turkey shifted towards improved democratic conditions.

As Turkey pivoted to the 1990s, the nation reported its worst economic performance. The performance in average growth was its worst since the 1930s, just sitting below 4%. From 1991 to 2001, Turkey's reported GDP swung from -6% in 1994 to -5% in 2001, prompting many market commentators to title this period in Turkish economic

---

<sup>165</sup> Interestingly, roughly ~35-42% of exports were being sent to Middle Eastern countries.

<sup>166</sup> Off the back of the 1979 oil crisis and the FED's contractionary monetary policy, the U.S. saw record levels of inflation and unemployment reaching a high of ~10.7%. Likewise, the decline in oil prices threatened the economic health of many Middle Eastern countries.

history as the *Lost Decade*. Despite these poor reports in economic growth, hyper-inflation never became a pressure concern to the stability of the Turkish economy. Short of hyperinflation, this period of continued high inflation levels may be attributed to the absence of financial deepening<sup>167</sup> due to the removal of dollarization of assets and liabilities under capital flight among growing capital controls. During this period of lost growth, Turkstat reported that inflation reached an average of 76%, and Turkey's account balance is now seeing structural deficits. Equally detrimental, the real spot exchange rate for the lira to the dollar further depreciated, while domestic debt only grew to average around \$43,433 million. The depreciation of the lira and the once successful stabilization program destroyed the well-being of the Turkish economy as in 1994, the nation had an unsustainable fiscal balance with a poor primary surplus<sup>168</sup> that prevented the Central Bank from dealing with their growing debt load. With the lira depreciating, Turkey faced twin deficits in both current accounts and budget deficits, fundamentally suggesting that the government is spending more than it is generating and is importing more than it is exporting. Adding further to the nation's poor economic conditions, local elections and market uncertainty with these political events increased the perceived risk in Turkish markets. In desperate need of an economic recovery package, the Turkish Treasury issued bonds at maturity of 3-months with an interest rate of 50%, which helped ease the domestic financial landscape.

Under poor structural conditions and weighted financial deepening favoring the financial sector, the long-standing IMF relationship came front and center in 1999. To guide the Turkish economy back to its projected sustainable growth prospects, the IMF assisted the Central Bank to increase the oversight on financial stability through regulatory and supervisory agencies. Through this IMF-support program, privatization was of most importance; however, this support would not have been sufficient in preventing further market stress in 2000. However, it is worth mentioning that this oversight program failed as many commercial banks increased their exposure to risk as they did not stress test their

---

<sup>167</sup> Financial deepening encompasses improved ratios of the nation's assets to GDP. However, as presented, this was not the case in Turkey as the government proxied through the Central Bank enforced capital controls which limited the austerity of individuals and enterprises from freely moving their money.

<sup>168</sup> Primary surplus is a macroeconomic condition that proxies the government's reported top-line revenue over non-interest spending. The metric illustrates the government's ability to pay off sovereign debt.

balance sheet.<sup>169</sup> Instead, with further depreciation in the lira, the Central Bank changed their exchange rate regime to a floating system,<sup>170</sup> which paradoxically increased the depreciation of the lira.<sup>171</sup> However, despite the lira following a floating exchange rate, geared off market conditions, the Central Bank announced its intentions to intervene in the exchange market to “prevent excessive volatility” to maintain investor confidence towards the lira.

Similarly, with increasing inflation and a devaluation in the Lira, many commercial banks were facing bankruptcy as many borrowers defaulted on the conditions of their loans. Once in 2001, Turkey entered an economic crisis, leaving no other mode to reach financial stability except reaching another deal with the IMF. Through poor macro-management, only amplified by the IMF's programs, Turkey's *lost years* caused the nation's most costly financial collapse in 2001. Notwithstanding the political landscape of Turkey during this time following the 1980s coup d'état, the nation's economy did succeed in improving its role globally by shifting its economic thesis towards more industrialized scales of production. Following the nation's post-liberalization crisis in 1994, economic conditions in Turkey worsened due to amplified spillover from the 1997 Asian Financial Crisis and 1998 Russia Crisis, ultimately protracted a severe collapse of financial conditions in 2001.

Despite seeing its worst economic period in 2001, five years following the collapse of Turkish markets, the nation experienced a high-quality and solid growth phase. Turkey's reported economic conditions best tell the story. In sharp contrast to economic conditions preceding 2001, the Turkish economy grew 6% from 2002 to 2006, the fastest rebound in growth since the 1960s. Correspondingly, during this five-year period following the collapse in 2001, private investment as a percentage of GDP jumped to 22%, driven by significant inflows of capital towards the manufacturing sector. Under a rebound in GDP coupled with increased inflows on foreign investment into the private space, the market

---

<sup>169</sup> A stress-test common method of analysis to determine the ability to deal with economic crises. Common among many lending institutions, these banks offered loans and did not account for the ever-changing qualities in their domestic macroeconomic conditions. In sum, the IMF-supported program failed to impose proper oversight which helped catalyze the nation's economic collapse in 2001.

<sup>170</sup> Prior to their transition to a floating exchange rate, the Turkish Central Bank used a crawling-peg system.

<sup>171</sup> This depreciation in the Lira can be associated with an appreciating U.S. dollar, where following the 1997 Asian Financial Crisis and just before the Dotcom Bubble, the dollar gained strength relative to other international currencies.

share of manufacturing to Turkish GDP jumped to roughly 24% in 2007. Widely recognized as a private-sector-led market boom, inflation that sat north of 80% in the 1990s now dropped comfortably to single digit numbers, while public sector debt dropped to 35% of GDP.<sup>172</sup> Spearheaded by this private-sector boom, many cities saw investment inflows and improved living standards as global conglomerates moved their operations to these respective industrial hubs. It is worth highlighting the economic success of non-Tiger municipalities, the most famous of which is Istanbul and Ankara, which helped constitute robust economic growth throughout many Turkish cities. These two collections of cities enabled private enterprises to improve their operating scales and further help promote macro-oriented development through all provinces in Turkey. In this convergence of living standards and scales of production came the birth of “Anatolian Tiger”<sup>173</sup> cities reported the most significant growth figures due to this rise of prominent enterprises. Not directly linked to the rise of private enterprises through these Tiger cities, but correlated nonetheless, proxied through the Gini coefficient, income inequality dropped from 42% to 38% from 2003 through 2008. Through increased employment opportunities, there were improvements in wage growth and the implementation of sustainable working opportunities. Holding equal importance, the *Justice and Development Party* (AK) shifted the government's spending priorities to allocate funding to less advantaged provincial towns and suburbs of major cities. In sum, following the industrialized birth of Anatolian Tiger cities, supported by improvements in the nation's equitable conditions, following its collapse in 2001, posting robust growth in almost all macroeconomic aspects. Moreover, from 2002 through 2007, Turkey's perceived risk premium decreased<sup>174</sup> due to improvements in monetary austerity measures, social conditions, and well-deserved structural reforms through the AK party's deep-rooted reform targets.

---

<sup>172</sup> Note, public debt as a percentage of GDP reached its peak during 2001, reported at 75% of GDP.

<sup>173</sup> The most notable of these Anatolian Tiger cities are but not limited to: Denizli, Gaziantep, Kayseri, Balıkesir, Konya, Kahramanmaraş, Bursa, and Kocaeli.

<sup>174</sup> Along with the nation's improved economic conditions, domestic corruption, proxied through the Transparency International Index, improved where by 2003, there were in the low 50s. This improvement was driven off improved institutional transparency and the AK parties sound political prerogative.

### 5.2.2 The Turkish Smoking Gun: Successful Structural Changes Post-2001

To effectively address the byproducts of the Global Financial Crisis, the Turkish Central Bank modified its existing framework of inflation targeting through emphasizing focus toward stability in financial conditions. Turkish technocrats realized the uncertainty and volatility in the global economy and learned about the natural impotence and most market economies through the lens of current discretionary macroeconomic conditions. As addressed above, through the forceful imposition of U.S. economic conditions as the benchmark for international finance, market economies in emerging countries, and developed countries, fail to remedy such external shocks effectively. Under such circumstances, the Central Bank believed strategic government intervention would best “soften” the landing and subsequent rebalancing of the nation’s domestic economy while protecting the Turkish lira stability efforts. To attain this goal, the intermediate goals of Turkish officials were to preserve growth targets in domestic credit markets and ward off short-term inflows of foreign capital. Realizing that the latter goal may lead to the real possibility of a credit crunch, to supplement the absence of foreign inflows, the Central Bank of Turkey turned to macroprudential measures. Of these Immediate monetary measures to prevent further amplification, the Central Bank did the following:

1. Provide needed liquidity to the banking system to prevent a credit crunch;
2. From November 2008 to September 2009, they cut overnight rates<sup>175</sup> eleven times from 16.75% to 7.25%;
3. The Banks dividends were restricted to improve and strengthen their capital structures;
4. Measures were put in place to ease export financing.<sup>176</sup>

---

<sup>175</sup> Overnight rates are the set interest rates of borrowing between financial institutions. In practice when these rates increase, interest rates rise as well, suggesting that borrowers have to borrow at a higher cost which in-turn generates more returns for the banks. In this case, the Central Bank wanted to prevent a credit crunch and prompt its citizens to borrow more.

<sup>176</sup> Some of these measures were but not limited to: zero interest loans to manufacturers, reduction in the interest of loans for SME construction, stimulus packages where 35% of risk was taken on by the bank.

Like most emerging market economies, Turkey shifted its national efforts to contain and mitigate against amplified adverse spillover onto its economy following the 2008 Global Financial Crisis. With no exception, Turkish Central Bank technocrats delivered on robust policy easing through relatively stable sovereign risk measures and pre-crisis macroeconomic policy standards. By front-loading cuts in Turkish benchmark rates,<sup>177</sup> and countercyclical liquidity initiatives, the Central Bank created a sound foundation for the country to revive its credit and money market, which eased the perceived risk premium of domestic and international sentiment. Through these targeted efforts, the Central Bank of Turkey positioned itself for a swift and convincing recovery.

Interestingly, following the nation's structural reform following 2001, many technocrats in Ankara believed that the Central Bank did not need to take additional measures once the 2008 Global Financial Crisis hit Turkey. Furthermore, and in an ironic display, despite posting negative performances in varying subsectors, the government projected a 4% economic growth rate in 2009. With building pressures from domestic and international enterprises focused on major cities and significant Tiger cities, the forecast target changed to -3.4% by mid-April 2009. Accounting for lingering macroeconomic tailwinds, the Central Bank issued new fiscal measures.

To ensure stable conditions in the domestic economy, these fiscal policies were targeted to promote market legitimacy under the ever-changing backdrop following the collapse of the U.S. housing market. The first move to protect domestic economic conditions were targeted reductions in value-added taxes and special consumption taxes, which were cut for the first three months in March 2008, then till 2009. In particular, these targeted tax breaks in consumption can be seen through encouraged sales in furniture, white goods,<sup>178</sup> and automobiles. However, this fiscal move soon lost its effects as the consumers' deferred consumption was already made in the tax regime's early months, and then the tax reductions were narrowed down further. Despite seeing increased consumption and substantial capital flows immediately after implementing this tax regime, it could not be

---

<sup>177</sup> This cut in Turkish rates varied, but the largest in the rate cut hike was 1025 basis points.

<sup>178</sup> White goods encompass large household appliances that are powered on gas, electricity or some form of fuel. These can be washers, dryers, freezers, refrigerators, amongst other appliances found in households.

sustained over a long period. It can be viewed as a one-shot measure. Paradoxically, intending to elevate domestic sales, imports on foreign products increased where domestic consumption of goods decreased. This shift holds especially in the automobile and technology industries, where 70% of net new demand went to imported goods.

Similarly, technocrats in Ankara reduced social security allowances and premiums shortly after the 2008 collapse to promote sustained employment. During this respective period, there was a rise in contracted short-term working contracts, which helps limit the rise in unemployment layoffs. Instead, to address the nation's increase in unemployment, introduced training schemes to help improve the working human capital of Turkish nationals seeking employment.

However, despite adjustments in underlying macroeconomic conditions, the lingering effects of the 2008 global financial crisis altered Turkey's political landscape. As inflationary pressures and trade deficit grew, so did the growing dissatisfaction of the Turkish middle-class. Such social anger can be seen in May 2013, where demonstrations in Istanbul's Taksim Gezi Park had to be put down with police force – a similar movement to Argentina's *Corralito* in 2001. With this decline in social equitability, Recep Tayyip Erdoğan of the Justice and Development party won the 2014 election and immediately altered the nation's constitution shifting power to the President of the Turkish Republic. Furthermore, he then attacked the nation's media sector by imprisoning journalists and shifted fines on the Doğan Holding, one of the nation's largest conglomerates well-positioned in the media space. Adding further to Erdoğan swift oppressive prerogative, he then targeted various leaders of opposition parties, most notably the *Kurdish People's Democratic Party*. For example, Selahattin Demirtaş was accused of being linked with the PKK terrorist organization, where he imprisoned from 2016 to 2020<sup>179</sup>. Due to Erdoğan oppression on Kurdish and other ethnic factions, there was a subsequent coup d'état led by the *Peace At Home Council*<sup>180</sup> and Kemalists<sup>181</sup>.

---

<sup>179</sup> Erdoğan was seeking to imprison Demirtaş for roughly 142 years, on the basis that he provoked Kurdish cohorts to protest. Interestingly, from the record I found, the allegations vary and have yet to find a solid base that accused him.

<sup>180</sup> The coup was led by officials from elements and factions of the Gülen, an Islamist movement, and Turkish special forces, second guard, third army. Moreover, per leaked emails, it is believed that this coup was supported by officials from Egypt and the United Arab Emirates.

<sup>181</sup> A Turkish group that aligns themselves with Turkic socialist conditions to nationalize the country.

The failed coup of the Kemalists and Gülen's allowed Erdoğan to successfully remove all opposition that threatened his agenda. Erdoğan called this failed attempt as "a gift from god" prompting him to fully remove these factions, purging opposition leaders in the military, courts, press, higher academia and civil service organizations. So thereafter, Erdoğan created his "super-presidential" structure in 2017, by a close margin of 51% to 49%. Pivoting the political structure of Turkey, the President can now declare a state of emergency where he would assume total power, appoint prosecutors and judges, choose 12 out of 15 members of the Constitutional Court, and power over the Council of Ministers. The totalitarian leader then had the ability to jail many while also removing the Kurdish DHP from the Constitutional Court driven on the claim that they were a terrorist organization. Following these events, many Turks practicing Islam and even those who do not fled the nation seeking asylum elsewhere. Sir Peter Westmacott, former British diplomat to Turkey stated, "The remarkable degree of national solidarity sparked by anger at the effrontery of the (July 2016) coup plotters provided an opportunity to bring the country together, not to drive people apart; to regain the momentum of reforms and modernization it had enjoyed under the AKP a decade earlier. But it was not to be." Following the 2008 global financial collapse, Turkey struggled to address lingering economic constraints, curbing equitable economic conditions for the middle-class. In sum, due to the 2008 collapse, the Ankara technocrats then allowed the rise of Erdoğan's AKP party. Following the development of Erdoğan's tyrannical regime, Turkey's political agenda transitioned to one of an illiberal democracy which has driven the nation's perceived risk premium.

Through corporate negligence in the U.S. housing market, Turkish technocrats were able to guide its economy through structural reforms that took shape following their economic collapse in 2001. Despite poor moves by the U.S. in 2008, Turkey was able to protect itself from an elevated perception of risk premium through the nation's previous changes in its economic structure. However, this collapse led to the rise of the illiberal democratic regime of Recep Tayyip Erdoğan, where he has limited the nation's economic growth prospects due to his own targeted agenda. Since then, Erdoğan's autocratic regime has limited the nation's Central Bank from making sound orthodox policy which subsequently elevates the government's risk premium.



### 5.2.3 Turkish Idiosyncratic Risk: Fixed Effect Regression 2000 to 2020

Accounting quarterly developments of the Turkish economy, this section complements the qualitative assessment with a fixed-effect regression model from 2000 to 2020. The results are similar but not as extreme as the relationship presented in the Russian fixed-effects model.

**Table 12** Turkey Fixed Effect Regression 2000 to 2020

	Dependent variable:			
	nominalspread			
	(1)	(2)	(3)	(4)
US_2yr	-5.764*** (1.441)	-6.607*** (1.310)		
VIX	0.075 (0.062)		0.170* (0.089)	0.140 (0.113)
LIBOR	5.765*** (1.152)	6.199*** (1.093)		
spot	7.517*** (2.080)	9.926*** (1.370)		0.083 (1.057)
inflation	-0.510*** (0.107)	-0.640*** (0.063)		
ab	0.0003** (0.0001)	0.0003*** (0.0001)	0.001*** (0.0002)	
vul	-25.481*** (9.477)	-15.296*** (5.467)	-75.600*** (10.889)	
regime	18.537 (14.694)		128.699*** (11.551)	55.038*** (11.390)
fdi	-0.003*** (0.0005)	-0.003*** (0.0005)		-0.006*** (0.001)
Observations	80	80	80	84
R2	0.936	0.934	0.805	0.748
Adjusted R2	0.928	0.928	0.794	0.735
F Statistic	114.564*** (df = 9; 70)	145.583*** (df = 7; 72)	77.291*** (df = 4; 75)	58.611*** (df = 4; 79)
Note: *p<0.1; **p<0.05; ***p<0.01				

Table 12 has four different regression models, analyzing Turkey's country-specific variables and U.S. conditions regressed on their risk premium. Akin to the results presented in the Russian fixed effects model, the CBOE VIX, proxying U.S. market volatility, has no significant correlation with the direction of Turkish risk premium. Despite this result, I find it relatively interesting as my original hypothesis thought that increasing volatility and pressures on the S&P 500 would positively affect Turkey's cost of borrowing. This hypothesis is driven by the assumption that the U.S. hegemony's decaying conditions

would spill over onto Turkey and tighten their credit profile. However, the results proved to be negligible in the three regressions. This result can be attributed to the nation's geographic distance and strong trade relations with the European Union. This assumption is based on the strong results presented in LIBORs correlation.

Interestingly, LIBOR has a positive and significant causal relationship with Turkey's nominal credit spread. This outcome makes sense when looking further into this result given Turkey's relationship with many European countries. Although not an officially recognized member of the European Union, Turkey is the EU's leading partner solidified through the *European Union-Turkey Custom Union*. As of 2020, this agreement has outpaced the original *Ankara Agreement*, boosting trade by roughly 55% to 65% between the European Union and Turkey. Moreover, the bilateral relationship has improved Turkish trade by imposing external tariffs on other goods. In sum, with LIBOR being a popular lending rate for European and global financial institutions, and Turkey's strong relationship with the EU positioning them as the focal point of European production, Turkish risk premium co-movement with an increase in LIBOR makes sense. With a one-unit increase in LIBOR, Turkey's cost of borrowing rises by 5.765%.

Showing more illiberal democratic conditions than most European countries, when the nation has a one-unit increase in the political regime, suggesting improved democratic conditions, they see a rise in the cost of borrowing. As presented in the Russian regression analysis, my thesis argues that due to Turkey's importance to regional European trade, proxied through the *European Union-Turkey Custom Union*, domestic and political tensions are viewed as negligible to participants in the global market. In that, despite heightened ethnic tensions targeting Kurdish factions, the direction of the political system would not matter in the eyes in regard to the cost of borrowing. In principle, if the nation does not have more democratic conditions, it is assumed there will be a decline in the cost of borrowing through this regression. Contradicting widely accepted conditions that democratic standards lead to lower risk premiums, as seen through both Turkey and Russia, the nation's macroeconomic conditions will surpass policy initiatives. The weighted importance of macroeconomic conditions is seen through the statistical significance of Turkey's FDI inflows, whereas increasing streams of foreign capital lower Turkey's cost

of borrowing. This relation of increased inflows suggests expanding market opportunities in the nation, as FDI proxy's investment sentiment.

Despite certain conditionalities that arise with inflows of FDI, as Turkey sees this increase, there is a decline in their cost of borrowing, which suggests improved economic conditions. However, the two results of inflation suggest that the cost of borrowing decreases as inflation increases. Since July 2021, Turkey's year-over-year inflation reached 18.9% surpassing 17% in 2020, emphasizing the rapid deterioration of the Turkish economy. Turkish inflationary pressures grew and continues to rise as Erdoğan continues to deploy procyclical policy through keeping rates low, which has catalyzed the nation's runaway inflation<sup>182</sup>. However, with the results presented in the regression, despite runaway inflationary levels, *ceteris paribus*, the cost of borrowing decreases with increased inflation levels. Despite a rise in inflation, this decline in the cost of borrowing can be attributed to the nation's sound macroeconomic fundamentals and long-standing history of timely payments of conditionalities<sup>183</sup> in the 21st Century – strengthening their credit profile.

Interestingly, both the US\_2yr and Political Vulnerability index yield a negative and statistically significant relationship with Turkey's nominal credit spread. This result suggests when the US\_2yr rises by 1%, the cost of borrowing goes down by -5.76%. This result is fascinating as the US\_2yr is not commonly used to benchmark long-term interest rates. That being said, when the US\_2yr rises, proxying improved macroeconomic conditions in the U.S., this will then amplify over to the financial stability of Turkey. Notwithstanding this, I do not look into this result with other variables as the US\_2yr is not a widely used benchmark. However, these results support the claim that improving U.S. conditions lead to positive developments in emerging market economies. Likewise, when there is a one-unit increase in Turkish political vulnerability, nominal spreads decrease by 25.48. As mentioned above, I believe this negatively significant relationship is based on Turkey's importance to regional economic austerity and development. Of equal

---

<sup>182</sup> This move is more prevalent in 2021 and given the scope of my thesis, it will not be further analyzed.

<sup>183</sup> From IMF and Bloomberg documentation, the last time Turkey defaulted on a sovereign issue was in 1982. This improves Turkish economic legitimacy and for that reason strengthens their credit profile.

importance, holding everything constant, when Turkey has a one-unit increase in their account balance, there is an increase in their cost of borrowing.

Given that sovereign issuances are used to either refinance existing debt or address targeted development plans, the result is significant. It is a base to determine a country's ability to meet conditionalities. With improving their account balance, they cannot pay at higher levels. Like the relationship presented in the regime result, I was surprised as my original hypothesis assumed that an improved account balance would have a negative relationship with the nominal spread, suggesting a lowered cost of borrowing. When considering the policy development of the Turkish economy during times of heightened uncertainty in domestic and international markets coupled with the results presented in Turkish fixed effect regression – Ankara's despot policy is erratic. Still it has but has issued relatively orthodox monetary policies from 2000 to 2020.<sup>184</sup> Through the Central Bank's improved economic austerity, Turkey is well-positioned to brace spillover, but as expected, it is not entirely removed from myopic U.S. short-term policy moves.

## **6. Issues For Evaluation: Shortsighted FED Policy**

This chapter seeks to better understand the conditions that have guided the U.S. Federal Reserve's policy during the period under review. Based on this critique, this chapter calls upon relevant lessons, highlighting how the U.S. can improve its procedures and policies to promote more equitable conditions in international finance. Equally important, this chapter draws on the work of Robert Reich, Joseph Stiglitz, as on current trends within international finance to illustrate how the shortsighted changes by Washington technocrats further worsen the global conditions, ultimately spilling back onto the U.S. in the near future. Such deteriorating macroeconomic conditions may lead to a decline of the U.S. sphere of influence. If not adequately remedied, U.S. policy-makers may likely lose their hegemonic status

Furthermore, this chapter uses the FEDs published and internal documents to gauge the evaluation used in its policy-making process, views, and targets to adjust domestic

---

<sup>184</sup> Note, during the height of the novel COVID-19 pandemic, Erdoğan used a procyclical policy which was unorthodox as he did raise rates to combat inflation. Instead, he has fired three Central Bank governors as they defied his intentions.

market conditions. These documents supplement the geopolitical, macro management, and social research.<sup>185</sup> To attain a broader perspective on the matter, this chapter addresses the role of the FED in global credit cycles, as well as other critical decisions made by Central Bank technocrats, private-sector, academic experts, shareholder private agents, and government officials.

Emerging market economies are exposed to the FEDs changes in the short-term. Even though the U.S. FED aims to improve domestic macroeconomic conditions and to promote equitable market conditions, FED's officials fail to consider potential spillover onto the economic austerity of emerging market economies and international finance, making their policy moves myopic.

Since its creation in 1913, the U.S. Federal Reserve and its congressional appointees set to reach its goal of promoting domestic economic stability. However, taking into account the establishment of U.S. hegemony in 1944, changes in the FEDs targets, under the dual mandate, have eroded the autonomy and austerity of most economics in international financial markets. While the U.S. adjusts its own economic well-being through changes in short-term targets

In what follows, much of this chapter examines shortsighted moves made by U.S. policymakers, which risks leading to further decay of macroeconomic economic conditions in international financial markets if not adequately addressed.

## **6.1 In a globalizing world, *no country is an island***

Many emerging market economies achieved tremendous economic success through well-planned policies that improved domestic consumption, FDI, and trade liberalization. With a large population base in these countries came huge and robust upside for domestic and foreign producers. Many macroeconomic economists expected that due to the growth prospects of these emerging market economies, they would then become less exposed to changes in the global economic cycle. This common misconception jeopardizes the

---

<sup>185</sup> This analysis encompasses the qualitative country-specific case studies as well as the quantitative regressions presented addressing the impact of U.S., discretionary macro and country-specific variables influence the perceived risk premium of these emerging market countries, proxied through their nominal credit spread.

foundation of many smaller nations. However, then came the Global Financial Crisis of 2007 - 2008. Engulfing both developing and developed countries, the U.S. housing market crash raised the specter of social unrest and market panic<sup>186</sup> highlighting the significance of Washington's influence on the economic scaffolding of international financial markets.

Interestingly, many emerging market nations, particularly Brazil, China, India, and Russia (BRICS), reported strong economic solid figures following the collapse of the U.S. housing market. Their aggregated growth rates were expected to outpace established industrial countries of the U.S., Japan, and Europe.<sup>187</sup> Countries within the Latin American region faced heterogeneous experiences, as some faced a slight contraction while other countries did not experience drastic contraction at all.<sup>188</sup> The world faced an economic downturn that dragged the global financial system and the U.S. into a deep economic depression. It is worth emphasizing the reality that this regional downturn did not stem from country-specific economic conditions or events, as did in the previous event. Instead, it spilled over from the U.S. fast-and-loose mortgage lending by private U.S. institutions, the natural byproducts of the 2007 - 2008 crash exposes the limitations and scale of contemporary economic globalization. Correspondingly, countries were interconnected by a tattered system of banks and loans that had toxic U.S. assets on their balance sheet. Many emerging market countries became collaterally damaged during the Global Financial Crisis, which began in the U.S. subprime market. During this time, many private banks and hedge-funds created mortgage-backed securities (MBS) sold as investment tranches. These tranches were pooled, or a collection of loans traded, which further drove down interest rates. However, these loans were offered to consumers who feasibly could not repay and meet the conditions of these loans, subsequently causing many to default on these payments, which in turn led to the 2007 - 2008 housing bubble that this chapter is addressing. These mortgage-backed securities are the "toxic" assets that many emerging market economies had, making them collateral damage as these assets were effectively worthless in real value following the housing market's demise. Economists and political

---

<sup>186</sup> Interestingly, in the run up to the Global Financial Crisis, many developed and emerging market economies saw strong cross-border inflows of capital (Figure 2)

<sup>187</sup> You can see this where from 2002 through till 2008, China's economy on average grew 10% per year and India's 8% per year, respectively. 4 Brazil (as alluded to in the BRIC explanation), Colombia, and the Dominican Republic saw a slight contraction.

<sup>188</sup> Bolivia, Panama, Peru, and Uruguay did not experience contractions.

commentators in all corners of the globe “missed the boat” when it came to this financial crisis. Fifteen years later, no analyst could correctly tell the time, breadth, and extent of the collapse.

The U.S. wanton mortgage lending power was too self-destructive, making market correction unfeasible for neoclassical laissez-faire policy to take shape. Practically, this collapse, the largest since the Great Depression, was due to institutional malpractice, negligence, and overall greed. In that, borrowers were lent credit, despite not being able to repay the loan on time. With the cooperation of banks, rating agencies, insurance groups, amongst other financially-driven private interests, these loans are packaged together and then sold as securities. More shocking, many of these commercial lenders knew the borrowers could not feasibly meet the conditionalities as their credit profiles were poorly ranked. However, as previously mentioned, once U.S. rates rose and the housing market became saturated, these borrowers defaulted on their loans leading to the collapse of the American housing market and subsequent Global Financial Crisis. Institutionally flawed at the time, and even to this day, fundamentally sound recovery for emerging market economies was challenging due to political, social, and economic malpractice found throughout the U.S. and private corporate interests.

During this time, emerging market stalwarts, among many other fast-growing economies, relied heavily on money from private Western banks to expand their domestic operations, drive economic growth, and export goods to the U.S. and Europe. When global financial institutions halt their credit lending efforts and the flow of money inevitably dries up, as it did during this time, the scaffolding of many economies collapsed, and investor confidence subsided. Emerging market economies then found themselves in an unfavorable crisis.

During normalcy, complications in the economy fundamentally led to problems in the financial markets as many market participants subsequently became hard-pressed to repay and address the terms of their loans. Conversely, the underlying institutional issues of the financial system slowed down the economy during the 2007 economic collapse. Further, the U.S. housing market collapse triggered a profound liquidity crunch across different asset classes. The European Commission published a special report that examines the global financial crisis economic landscape, stating:

“ The crisis was preceded by a long period of rapid credit growth, low risk premiums, abundant availability of liquidity, strong leveraging, soaring asset prices and the development of bubbles in the real estate sector. Overstretched leveraging positions rendered financial institutions extremely vulnerable to corrections in asset markets. As a result, a turnaround in a relatively small corner of the financial system (the U.S. subprime market) was sufficient to topple the whole structure “ (2009, 1).

Due to a lack of liquidity, the Global Financial Crisis caused many emerging market central banks and policymakers to deploy a wide array of defensive strategies, shifts in short-term monetary targets, currency debasement, and other actions to promote economic stability. Phrased differently; many countries began dousing fires on their own. Unfortunately, there were minor prospects of global financial cooperation, as there is no natural global economic constituency. The unprecedented liquidity crunch of the 2007 - 2008 crisis manifested into the destruction of capital and either curbed or tarnished favorable economic prospects of many emerging market economies.

Although to this day, many analysts and commentators contend over the root catalyst of the 2007 Global crisis, it is universally acknowledged that the proximate cause stemmed from the U.S. subprime mortgage market and the negligible moves by many U.S. banks. What started first as a bullish and subsequent bubble in the U.S. housing market then into a global banking crisis snowballed into a worldwide economic crisis. Through international finance's dependence on the U.S. dollar and rate environment, many countries faced amplified spillovers from the subsequent housing market collapse. The 2007 - 2008 subprime mortgage crisis certainly demonstrates how the economic conditions of many countries, particularly emerging market countries, depend on the health of the U.S. economy. Without equivocation, my Senior Thesis adamantly works off the claim that the U.S. caused the Global Financial Crisis due to manipulation of domestic and global economic conditions driven on neoliberal capitalism coercive measures.

The grandeur of the 2007 Global Financial Crisis demonstrates that no country can be an island in a globally interconnected financial system, as disruptions in one country's economy can impact any country. Following is a detailed exposition of the 2007 collapse related to my selected Latin American and Eastern Hemisphere countries that were, until then, widely viewed as good nations poised to benefit from robust economic stability and



growth. Albeit, Brazil has seen robust economic growth, but the U.S. political-military hegemony, in the context of U.S Federal Reserve, continues to fail to acknowledge its spillover and decaying effect on international financial markets. This must be addressed to remedy current market functions and protect the long-term sustainability of the global economy as verbalized by Brown (2015).

## 6.2 U.S Federal Reserve Short-Sightedness

In very holistic terms, the central bank, or the Federal Reserve's goals are to promote social welfare and foster economic prosperity in the United States. More specifically, two watershed objectives established by the government are guided by the *Dual Mandate* amended in the *Federal Reserve Act of 1977*. This 1977 amendment to the *Federal Reserve Act from 1913*<sup>189</sup> states:

“The Board of Governors of the Federal Reserve System and the Federal Open Market Committee shall maintain long run growth of the monetary and credit aggregates commensurate with the economy's long run potential to increase production, so as to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates.”

The phrase “...maximum employment and stable prices” interprets the dual mandate.<sup>190</sup> Concerning the objective of the first target, “maximum employment,” is relatively straightforward. High levels of unemployment increase human misery<sup>191</sup> and lower living standards.<sup>192</sup> The reasoning behind the dual mandate follows the fundamental premise that

---

<sup>189</sup> Prior to its amendment in 1977, the *Federal Reserve Act of 1913*, provided a statutory base for monetary policy. Interestingly, the original language was, “. . . to furnish an elastic currency, to afford means of rediscounting commercial paper, to establish more effective supervision of banking in the United States, and for other purposes.” This act established the FED, but given its early implementation, the rhetoric used had a lot of gray area when addressing varying issues revolving monetary policy.

<sup>190</sup> In conjunction with guiding the nation's monetary policy, Congress granted the FED the role to maintain stable conditions in the U.S. financial system, while also promoting safe and equitable conditions in payments & settlements; community development; consumer protection.

<sup>191</sup> Note, in economics, human conditions or happiness is proxied through a large spectrum between “happy” and “misery”; the condition presented above. Misery typically falls in-line with high unemployment, borrowing costs, inflation, among other costs. Furthermore, it is fair to assume that under these conditions of “misery” the market participant, or U.S. citizen has a low quality of life.

<sup>192</sup> Lowered livings standards are but not limited to, increased poverty, violence, suicide, and even divorce.

in an economy with stable price levels<sup>193</sup> individuals looking for jobs are likely to find one quickly. While there is no fixed way for the FED to reach maximum employment levels, this goal is based on various indicators that help policy decisions be the most informed. Thus, the main task consists of creating a framework to guide interest rates to stay at moderate levels.

Additionally, under high levels of unemployment, the economy sees reduced levels of production and income as many workers and factories sit idle. When factories remain idle, inflows of investment capital dry up, which ultimately adversely affects economic growth. Despite fading away in recent economic studies, this ripple effect can be best understood when examining the 1930s Great Depression. If not very painful during the recent economic downfalls, this association can also be seen during the 2008 Global Financial Crisis and the outbreak of the novel Coronavirus.<sup>194</sup> Monetary policy-making, let alone policy-making in general, does not have the foresight to secure the “dual mandate” goals. Rather, it uses previously reported conditions to then guide such projections. Still, my study suggests that FED policy-makers should also consider negative amplified spillovers onto various domestic and international conditions, which so far seem to be mostly ignored.

Concerning the latter objective, price stability, it is widely accepted among U.S. policy-makers, economists, and the greater public, to maintain stable and low inflationary pressures to promote long-term economic stability. Particularly, predictable and low inflation encourages improved social welfare by easing restrictions on investment and production decisions in the private market and improving the lending conditions in the credit facilities. Equally important, stable price levels help improve U.S. market efficiency by reducing price variability and distortion in watershed underlying macroeconomic variables.<sup>195</sup> Further, price stability will maintain equitable conditions, as elevated

---

<sup>193</sup> When referring to stable price levels, this metric in general means that the level of prices in the domestic market do not fluctuate significantly, rather they do not dip or rise drastically in major indices such as the *Consumer Price Index* or *Harmonized Index of Consumer Prices*.

<sup>194</sup> Interestingly, unlike past economic crises, the downturn under the pandemic backdrop saw tightening in the goods sector rather than the services side. Whereas previous periods, most recently the 2008 crisis among others, saw pressures on the services side over the goods.

<sup>195</sup> Given that tax systems are not indexed to movements in inflation, this is where the ‘said’ distortion may take place. If tax legislation does not properly comove with changes in inflation, then the government will see a negative current account balance due to strains on its spending initiatives.

inflationary pressures hurt pernicious cohorts as they do not have access<sup>196</sup> to protect themselves from such influences. In sum, the conditionality of the dual mandate is not a theoretical guideline, as the macroeconomic volatility faced by the U.S. and many other countries during the 1970s saw the effects that high inflation hinders economic growth and lowers the quality of life and political stability. Fundamentally, the conditions of the dual mandate, in practice, complement each other.

Notwithstanding the macroeconomic targets of the dual mandate, the most pressing challenge for the FED is interpreting this policy under each respective economic condition or cycle. Policy moves used for one previous event may not be appropriate or enough for succeeding collapses, discrediting the adage and commonly used framework of the IMF, “one size fits all” approach. Moreover, this interpretation does not suggest that attaining maximum employment is a scenario where the total working population is employed, having universally long hour work weeks. If this were the case, the FED and similar agencies would have to discourage senior citizens from working and younger citizens from going to college instead of joining the labor force. Additionally, as a result of U.S. influential spillover, as is common among all categories of economic development, the country will see “frictional” unemployment, which encompasses workers in the labor force who are laid off and are transitioning or searching for a new role. In part, for this reason, FED officials title the goal of this aspect as - achieving *sustainable* employment.<sup>197</sup> Sustainable employment assumes more eligible workers are working or those seeking work find it in due time. With this trait, the market economy will see inflationary levels and the real exchange value of the dollar reach their optimal levels. Akin to that employment targets, FED technocrats do not aim for constant price levels as it is not feasible given the uncertainties of internal and external shocks to the market.<sup>198</sup> Instead, policy-makers will pursue targets that seek to reach low and stable inflation digits. Former FED Chairman Alan Greenspan verbalizes this condition during

---

<sup>196</sup> The verbiage of access encompasses financial vehicles that help market participants address such financial pressures. Most notably, this is best seen through tight lines of credit as these “poor” cohorts, on average, do not meet the conditions or take out loans to build up their FICO which would ease against inflationary pressures.

<sup>197</sup> Consider the weighted emphasis towards sustainability.

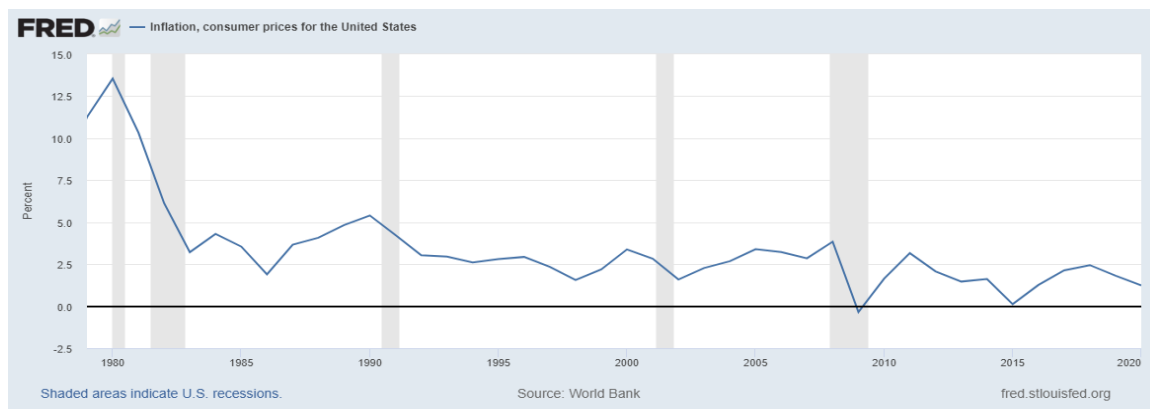
<sup>198</sup> These uncertain shocks can be seen in the spread of diseases (SARs, COVID, EBOLA, etc.), abrupt social upheaval, market malpractice, etc. In short, there is market oversight, but the world is innately uncertain as seen through the previous years.

a 1988 Congressional hearing by stating that businesses and households “can safely ignore the possibility of sustained, generalized price increases or decreases” when deciding their goals of investments or savings.<sup>199</sup> Since 1977, the challenge concerning effect and correct policy implementation of the dual mandate – to achieve stable market conditions – has continued due to the natural backward looking nature of policy making.

When considering the ever-changing movement of economic health, the most complex practical monetary policy challenge under the dual mandate is committing to the *nominal anchor* – sustained and low inflation. The two goals are price stability and the sustainable level of maximum employment. Since the amendment in 1977, the FED has brought low domestic inflationary pressures from double-digit figures to around 2% from the 1980s to the 1990s and the preceding decade, see Figure 16. Interestingly, when referring to the graph below, once inflation reaches ~1%, the Federal Open Market Committee stated that any reported level below this threshold would be “welcomed” as it may lead to a decline in price levels, disrupting economic growth, and employment levels. Fundamentally, as the FED adjusts policy to ensure the nominal anchor is met, this helps stabilize inflation in domestic markets; oscillation of inflation, on average, is correlated with economic slack where stable inflation levels bring sustainable macroeconomic levels. In recent years, despite the current pandemic backdrop and lingering effects from the 2008 crisis, the FED successfully sustained this nominal anchor throughout most of the 21st Century.

---

<sup>199</sup> Alan Greenspan’s statement before the *Committee on Banking, Finance, and Urban Affairs*, U.S. Senate, July 13, 1988.

**Figure 16: U.S. Inflation from 1979 to 2020**

**Source: St. Louis Federal Reserve Database**

In relation to the *dual mandate*, consider the following thought experiment. There has been a negative shock<sup>200</sup> to U.S. consumer demand, caused by a decline in confidence, thus prompting consumers to increase their savings and cut their spending.<sup>201</sup> Note this scenario considers rational decisions on individuals. However, this will lead to tremendous decay in underlying macroeconomic conditions and market earnings when aggregated. A negative shift in consumer sentiment, in turn, leads to a decrease in demand. While consumers have a lower demand, this correspondingly lowers the reported output of production relative to its projected potential – that is, the outproduced at the reported *sustainable* level of maximum employment. This influential co-movement highlights how consumer sentiment and demand can ripple onto the efficiency of the production cycle – damaging the overall macro fundamentals of the economy.

Moreover, future inflationary levels will fall well below the appropriate level of price stability, prompting the FED to seek out expansionary policy<sup>202</sup> relative to the dual mandate, to prevent elevated financial pressures. The FED will then look to cut taxes,

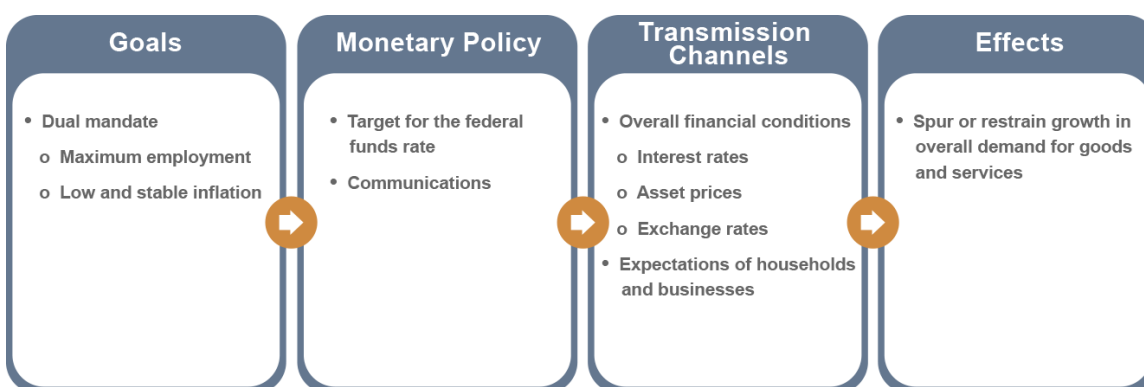
<sup>200</sup> The most common negative shocks are but not limited to natural disaster, terrorist attacks, global pandemic, and a market crash.

<sup>201</sup> This assumption is based on the premise that, during times of negative demand shocks, market participants are not willing to take on risks, spend more, and or seek out education – all vital aspects that drive economic growth.

<sup>202</sup> Expansionary monetary policy seeks to expand the circulation and supply of money at a faster rate. Additionally, the FED will also lower short-term rates, increase their reserves, buy-back government securities, and reduce the reserve requirements for banks. In so doing, expansionary policy seeks to lower the cost of borrowing and prompt consumers to spend more.

lower short-term rates, buy-back government securities, or increase its spending to reverse the negative spiral to remedy this negative shock. To protect the U.S. economy from further economic collapse, the FED will improve the credit conditions and improve the perceived risk towards investment by introducing a positive demand. Indeed, during the *Early 2000s Recession*,<sup>203</sup> the FED lowered the federal funds rates by 5.5% points, helping stimulate the credit cycle by improving conditions for U.S. consumers to increase the circulation of the money, while also curbing further decline of inflation. However, the responses by the FED are not the same across all economic crises; rather, it is a case-by-case process. Rather than expansionary monetary policy, the FED can also deploy contractionary policy, or monetary “tightening,” where the FED will raise rates to prevent hyperinflation and “overheating” economic activity. In brief, to avoid undesirable boom-bust employment cycles or spurts of volatile inflation, the FED will seek to maintain its dual mandate targets given the presented shocks to the economy – follow the policy – making road map referenced in Figure 17 below. Further, in poor economic developments, the Federal Open Market Committee will either *tighten* or *ease* its policies to achieve sustainable levels. The rhetoric in all aspects of the policy outline, particularly the “effects” section never explicitly mentions the potential analysis of spillover or regional effect. This process is seen below:

**Figure 17:** The Transmission of U.S. Monetary Policy



Source: U.S. Federal Reserve

<sup>203</sup> Prior to this collapse, the U.S. reported its largest economic growth during the 1990s. However, the collapse occurred due to the September 11th terrorist attacks and the dot-com bubble.

To sustain healthy levels of economic growth, the FED acts aggressively to meet the conditions of the dual governing mandate. Apolitical, FED technocrats are legally obliged to meet the ‘said’ dual mandate requirements. From March 2015, the Federal Open Market Committee states that “with appropriate policy accommodation, economic activity will expand at a moderate pace, with labor market indicators continuing to move toward levels the Committee judges consistent with its dual mandate.” With this rhetoric in mind, it is worth reiterating that monetary policy directly cannot affect inflation or employment – the two ultimate objectives of the dual mandate. Instead, monetary policy can affect U.S. credit flows in the market, thus swaying its financial conditions. Arguably the most demonstrative condition of sound economic health is sustainable flows of capital, as it can affect economic activity and the aggregate demand, as alluded to above in the presented thought experiments. In light of this, accommodation provided by the FED is when they offer more credit at a lower cost, which boosts consumer demand and spending, of which economic stimulus adjusts price stability. Given the macro-environment facing the U.S. economy, the FED will decide to either tighten or ease their policy by selecting the appropriate operating or intermediate targets.<sup>204</sup> To reach stability, the FED, as presented in many of their transcripts, commits to a nominal anchor to maintain employment at maximum sustainable levels and promote stable price conditions. The FED will take these actions to maintain its credibility in its domestic market and have done so following various ebb and flows.

At the crux of the FEDs dual mandate is the commitment to stable prices, preventing drastic changes in reported output levels and employment. Under unforeseen circumstances, the FED may see a tradeoff between the dual mandates and two guiding elements. Considering the following thought experiment – there has been an adverse supply shock,<sup>205</sup> which typically results in inflation levels above the market's preferred price stability. At the same time, employment figures suggest it is slowing down relative to the maximum sustainable level. In this thought experiment, if the FED adjusts inflation levels through aggressive expansionary monetary policy too quickly to price stability

---

<sup>204</sup> A *good* target is an effective policy influencing the flow of credit which can be controlled by the FED. The most common of these are moving short-term rates, exchange rates, money aggregates, among others.

<sup>205</sup> This adverse shock could be a natural disaster, political collapse, social upheaval, among other possible scenarios.

levels, this might adversely affect the economy exacerbating macroeconomic weakness. An unprecedented event given the uncertainty of the novel 2020 COVID-19 pandemic,<sup>206</sup> this relationship be seen contemporarily, as the FED aggressively acted lowering short-term rates,<sup>207</sup> which saw accelerated inflation, reaching 7.5% in Q1-2022; well above the markets forecast 7.3% and the highest reported figure since 1982. Despite lowering rates to ease potential inflationary pressures, the FED in the provided scenario, also supplemented in the recent pandemic, acted too quickly and therefore should move at a sustained pace that leads to undue harm on the economy.

Equally important, due to the influence of the U.S. hegemony, the 10-Year is a universal benchmark guiding international finance, and it is for such a reason that my thesis uses this rate to proxy the agenda of Washington monetary policy. The 10-Year benchmark became a watershed rate following the Bretton Woods Conference, establishing the economic dimension and legitimacy of the U.S. military-political hegemony. Preceding the collapse of Europe following World War II, the U.S. propelled itself as the focal point of international finance of the legislative acts enacted in 1944. With this status and recalling the U.S.-oriented adjustment of Klemens von Metternich's state, "When Paris sneezes, Europe catches a cold," when the U.S. faces economic collapse, so does international finance.

The direction of U.S. monetary policy compromises the economic austerity of countries heavily concentrated in the global market. Since 1944, the U.S. political-military hegemony has guided the conditionalities of international finance off its own domestic macroeconomic variables and market health. The U.S. stronghold over the global market is best seen in the currency market, where many countries struggle to effectively address U.S. major financial conditions. For example, following the 1994 peso crisis in Mexico, the Argentina peso struggled to adjust its real exchange rate to the U.S. dollar. Albeit, leaving a fixed hard pegged system to a floating exchange rate, the peso could not adjust its levels to an appropriate real exchange rate, as local currencies, particularly the

---

<sup>206</sup> As addressed above, there were restrictions on the services space and increased prices of oil made it even harder for the global economy to navigate this uncertainty.

<sup>207</sup> Following several drops in the global market in March 2020, there was *Black Monday II* where the global market dropped -12.93%. To ease this drop, the FED lowered the U.S. 10-Year Treasury to .65% in Q3-2020.

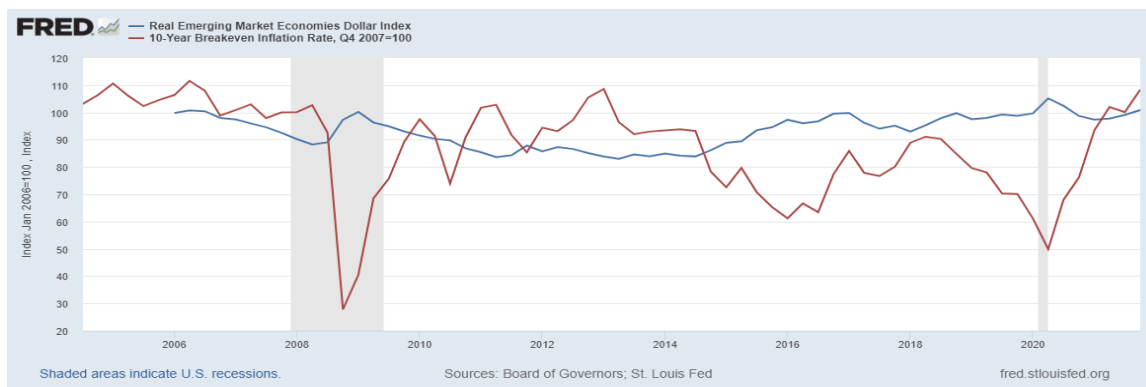


Brazilian real, added further pressure. Similar currency adjustments were seen in 1998 with the ruble, and the 1997 Asian Financial Crisis. This erosion can be seen in the rise in the risk premium or the cost of borrowing of the eight selected countries best defended through the regression results and narrative presented in the case studies. Additionally, these changes in U.S. policy amplify over onto other country-specific political and economic variables. As seen below in Figure 18, with the shaded area representing both the 2008 Global Financial Crisis and the recent novel Coronavirus pandemic in 2020, the U.S. FED turned to expansionary monetary policy. It lowered short-term rates where they decreased rates to ease credit conditions (red line).

U.S. market manipulation is seen through the 2008 subprime mortgage crisis. However, when the U.S. has improved conditions, so do other countries. In sum, following 1944, the U.S. financial conditions drive the direction of the global economy, where many participants opt to use U.S. rates and currencies. This co-movement of international finance to the U.S. economy is presented in Figure 18 below. Indexed in U.S. dollars, the Real Emerging Market Index reflects market conditions in emerging markets economies (blue line). This movement is seen in the empirical results, where the movement of the U.S. 10-Year, like the U.S. 2-Year, impacts the cost of borrowing in emerging market economies. When U.S. rates lower to boost consumer confidence in its domestic market, emerging market health will increase as the perceived risk will lower, thus making the nominal credit spread larger. This larger spread suggests a higher cost of borrowing, alluding to the claim that there is more risk when investing due to elevated economic conditions in the country. This divergence between U.S. rates and emerging market nominal spreads shows that as the U.S. lowers its rates to combat volatile domestic conditions, the sovereign spreads of emerging market countries rise, increasing the cost of borrowing or risk premium. That being said, taking into account targets of the dual mandate and the process in Figure 17, when the FED adjusts its targets to “rein in” its economy, they do not consider the possibility of impacting other countries. As seen in Figure 18 below, shortly after 2008, when the U.S. raises the 10-Year, or the red line, the conditions of emerging markets increase – this is the clearest from 2010 through to 2014 where the U.S. improved their macroeconomic conditions. This rise in U.S. rates fundamentally suggests improving domestic conditions, which then amplified to a lower

risk premium or borrowing cost. The same, when addressing the case study of Argentina and Russia, following the Tequila Crisis in 1994 and the Asian Financial Crisis in 1997, the already decaying conditions in these economies were amplified under changes in U.S. macroeconomic targets. This result can be seen with Argentina following Mexico's collapse in 1994 and Russia with the Asian Financial Crisis in 1997. Both countries felt deteriorating conditions due to their fall of watershed regional counterparts. But, during this time, the FED raised the reach exchange rate value of the U.S. dollar and increased short-term rates which exacerbated their failing economy. By solely considering the conditions within the U.S., the FEDs policy making process omits taking into account the global consequence of its policies. Drastic oscillation in U.S. rates increases global market risk. After their forceful establishment of the U.S. political-military hegemony, the U.S. continues to erode the economic autonomy and austerity of many countries in the global economy. The fixed effect regression analysis and qualitative case studies defended the collapse of equitable conditions in international finance. In practice, the *dual mandate* solely focuses on domestic conditions and neglects to consider its implications on other economies or the possibility of compromising the autonomy of Central Bank policymaking. Furthermore, the governments of these countries face downward pressure on their macroeconomic conditions, hindering their ability to benefit from robust financial growth.

**Figure 18:** Co-movement Between Emerging Market Index & U.S. 10-Year



Source: St. Louis Federal Reserve Database

### 6.3 Spillover Back onto the U.S.

As the world has become more globalized, many nations, particularly emerging market economies, have become more dependent on the U.S. and its changes in monetary policy. As Reich (2007) states, the framework of democracy and capitalism are a “match made in heaven” as the two have similar pillars that bring unprecedented growth and freedom. Albeit, riddled with top-heavy manipulation in the U.S., this pairing in its core essence drives such growth – but it is deterred due to private interest. Brown (2015) is an extension of Reich (2007) as she argues that free-market neoliberalism has been corrupted due to the private interest of the white male, and even in certain cases female. Brown adds further that the global market today, particularly pertinent in the U.S., has neoliberal capitalism which has prevented equitable dispersion across all markets. In much the same way, Reich (2007) emphasizes that the core purpose of democratic intentions, both politically and economically, is to reach ends that one could not achieve independently. Yet, the goal to promote democratic or equitable conditions is not explicitly present in Washington’s economic policy. Reich (1983) states that “The American interest lies in promoting rapid transformation of all nations’ industrial bases...while discouraging zero-sum efforts to preserve the status quo.” Likewise, Reich (1983) highlights that U.S. technocrats promote trade policies that “had just the opposite effect, discouraging positive adjustments at home and abroad.” As Reich states, the U.S. fails to implement appropriate and effective policy effects when entering conditional negotiations with sovereign countries. Stiglitz (2010) complements Reich’s commentary wherein his memoir he writes that U.S. policy-makers:

“had departed from the mission for which they had been founded, under intellectual guidance for Keynes – they actually promoted contractionary fiscal policies for countries facing an economic downturn – and they advocated policies like capital market liberalization, for which there was little evidence that growth was promoted, while there was ample evidence that such policies generated instability.”

Stiglitz’s narratives emphasize the policy negligence of Washington policy-makers heightened macroeconomic dissonance in the global financial system. Correspondingly, Stiglitz (2010) adds further that the U.S. also forced their monetary views on developing

countries, suggesting they “had only *pushed* its views – misrepresenting them as the lesson of economic orthodoxy.” The conjoined economic malpractice of the IMF and the U.S. is seen through the economic downturn of case studies of Argentina and Russia presented above. As the U.S. rose domestic rates, adding pressure to the underlying financial conditions of Argentina and Russia, the IMF then assisted various contingencies with unfavorable and coercive conditionalities. Policy-makers in Washington have blurred long-run economic visibility, and they have imposed coercive measures and arrangements that continue to hinder economic growth and autonomous austerity of emerging market economies.

As a student, I am scandalized by the monetary prerogative and continued negligible considerations by U.S. technocrats. My shock falls in line with the narrative of both Reich and Stiglitz. My research’s regression result and qualitative country-specific case study reaffirm the notion in a more sobering display. My econometric results corroborate the argument of Reich and Stiglitz, as the causal relationship from 2000 to 2020 suggests that when the U.S. 2-Year Treasury rose by 1%, all eight countries saw an increase in the cost of borrowing proxying declining economic conditions<sup>208</sup>. Similarly, when the U.S. The S & P 500 stock market saw elevated volatility, these selected emerging market economies faced a decline in their economic conditions. In that, U.S. policy-makers continue to fully consider its policy while neglecting potential spillover onto other countries’ economic autonomy and health. The landscape of international finance cannot solely favor the U.S. and therefore must be appropriately adjusted if countries want to see sustained economic growth in the coming years. If the U.S. continues to enter dialogues with other countries or decides to alter short-term macroeconomic variables, the FEDs policy making approach must be adjusted, accounting for its spillover.

If the U.S. continues to exercise negligence in its policy-making process, it will see a decline in its sphere of influence. In the scope of my thesis, consider the position of Russia. The Russian Federation is the second-largest oil exporter and the largest gas producer globally. Russia has, and is showing its rise as a competing global hegemony, off the back of private solid market health, soaring-export revenues, strong inflows of capital to Latin America and Africa, and ample reserve rations. Not to mention the current

---

<sup>208</sup> Reference Table 5.

improving Sino-Russian relations adds further to the top-down pressure on the U.S. and Washington policy-makers.

With a shifting geopolitical landscape, current U.S. policy will cause its inevitable downfall off the back of sovereign clashes. Critiquing the U.S. hegemony, Dylan Grice's<sup>209</sup> stated that he has “never seen weaponization of money on this scale before, you only get to play the card once” adding later “It’s a turning point in monetary history: the end of the USD hegemony.” Grice is targeting the U.S. influence from two angles. The first, the context of his comment address U.S. imposed SWIFT<sup>210</sup> sanctions on Russian commercial banks following their invasion of the Ukraine. In doing so, Washington and European politicians have cut off inflows of capital to SWIFT members. As the U.S. and the East block inflows of capitals to Russia, soon thereafter, was a subsequent “run on the bank” as many Russian nations withdrew cash as the ruble devalued by 28% since its Friday close on February 25, 2022. This sanction among others, worsened Russian macroeconomic fundamentals, further strengthening the importance of the U.S. dollar as the ruble, under Washington coercive restraints devalued the ruble. Further, banks and other European economies aligning with the U.S. have provided a vivid demonstration of the U.S. dollars power in the global market. On the other hand, Grice in his second comment alludes to the reality that the dollar is not a top-down system created by world leaders. Instead, it was established by businessmen and investors who wanted to trade greenbacks following the Civil War in the late 19th Century. In all, the dollar has been the most stable and liquid currency due to its accountable government and transparent legal system. Most importantly, this stability of the dollar was further solidified in 1944, as the U.S. hegemony forcefully created its political-military hegemony. Acknowledging the rise of the Sino-Russian alliance and given the rise of China’s military and economic power, I, among many others like Grice, should not underestimate the future risk of the dollar in the global economy. We are entering a new era of geopolitical competition and

---

<sup>209</sup> Dylan Grice is the co-founder of Calderwood Capital, a British investment advisory and research firm.

<sup>210</sup> SWIFT stands for the Society for Worldwide Interbank Financial Telecommunication. Founded in 1973, as of today, there are 11,000 SWIFT members from roughly 200 countries. The goal of SWIFT is to easily transfer remittances and capital to different bank accounts making the financial space more globally connected.

Washington must adjust or simply acknowledge its spillover onto the monetary austerity of many governments.

## 6.4 Evaluating Processes of U.S. FED Policy-Making

While acknowledging the FEDs spillover effects onto the economic austerity of sovereign countries in the global market, my thesis aims to qualitatively and quantitatively present the effects on nations considered emerging market economies. Of equal importance, my Thesis adds to existing literature the weighted impact country-specific conditions have when compared to U.S. influence. In that, the *dual mandate* goal only considers domestic adjustment. Instead, while the FED should still meet the targets of the *dual mandate* goal, these elected policy-makers should account for its spillover onto regional and global countries. Evidently clear both empirically and qualitatively, from my chapter, from 2000 to 2020, U.S. short-term rates influenced the cost of borrowing for the eight nations considered as emerging markets. While proxying international finance, further adjustment needs to be made to effectively abate future FED spillover. When addressing these policy-making parameters and their preceding raised question presented in my Senior Thesis, I acknowledge that all economic outcomes are a byproduct of intricate sequences of decisions that are guided upon exogenous factors and available information.<sup>211</sup> With this in mind, it is often impossible to credit responsibility to any certain decision in the policy-making process, whereas holding one element of accountability is complicated. Yet, the process illustrated in figure 17 clearly does not encompass a domestic and global perspective on U.S. influence. Addressed throughout this thesis, acting as the sole political-military hegemony, U.S. economic conditions alter market health and perceived risk premium in many countries throughout the world. Moreover, when accounting for the volatile oscillation in economic health of the four case studies coupled with the provided regression analysis, this manipulative conditionality of FED policy towards international finance holds true. In sum, for convenience, therefore, this evaluation will be led by the following criteria for each stage of U.S. policy-making:

---

<sup>211</sup> The process of making economic policy is subjected to various schematic stages and elements, an innate process present in most democratic countries. In so, economic policy does not have the foresight, so it is all hypothetical hedging in current metrics and projections based on market assumptions.

- (1) Stage one: whether the FEDs analysis encompassed all relevant information at the given time and was driven on sustainable macroeconomic projections based on adjusting for the dual mandates two targets and their goals;
- (2) Stage Two: whether government intervention is needed and to what extent should the government intervene given its *mixed* economy features – should they target certain industries and their respective subsectors;
- (3) Stage Three: whether domestic, regional, and discretionary global macro<sup>212</sup> conditions would have led to an alternative, and or, more appropriate diagnosis – ensuring the stability of equitable market conditions and ensuring the protection of monetary and fiscal policy making autonomy of each respective country;
- (4) Stage Four: whether the FED's deployments monetary easy or tightening instruments (i.e., adjustments in short-term rates, exchange rates, money supply, reserve ratio, buy-backs of government securities, taxes, government spending) were deployed in their best ways that maximized its effects, hedging for it spillover onto international financial markets;
- (5) Stage Five: whether the deployed initiatives and their transmission channels are both correctly and appropriately accounting for all relevant factors, potential considerations for alternatives and the risk they pose to austerity and autonomy of emerging market micromanagement;
- (6) Stage Six: whether alternative decisions or initiatives might have prompted another ideal and superior result;
- (7) Stage Seven: whether their hedged policy considerations negatively affect the underlying macroeconomic conditions in certain global economies and domestic U.S. market equitability, thus increasing their perceived risk premium – warranting a lagged meeting with regional and global technocrats;

---

<sup>212</sup> As presented earlier, discretionary global macro conditions is a top-level outlook of the global economy.

- (8) Stage Eight: whether changes in U.S. policy impacted the economic integrity of certain countries, then FED officials will then reconsider its policy moves and seek out potential changes, assuming it's a collection of countries rather than a small cohort.

By the very nature of my policy suggestions, I acknowledge that like any forms of policy and the direction of the global market economy, it is nearly impossible to have the foresight of its implications on the targeted conditions. But, as contested by many, on the grounds of global economic ethics, it is good practice that U.S. policy making considers the conditions of the global economy, as my results corroborate the casual relationship between U.S. interest rates and the economic conditions of emerging market economies. Furthermore, monetary policy is governed on financial present and past financial conditions, which again, provides a lagged perspective as it assumes previous crises will be similar – which is evidently not correct to assume. A key issue in policy making that is absent in the current operating model of FED is building in flexibility.<sup>213</sup> This suggestion does build in flexibility. The FED does not consider its spillover onto the global market nor does it often give itself the policy flexibility to legislate appropriate monetary policy. Even so, when highlighting innate limitations of monetary policy-making in mind, I anticipate that the approach to evaluate changes in FED policy, shifting off the objectives of the dual mandate, will enable future U.S. technocrats to consider its amplified spillover onto the autonomy of many countries in international finance. This may take shape in a potential “boomerang” effect, where poor macroeconomic conditions and production in global markets will limit various U.S. sectors. For example, current U.S. sanctions on Russia following its invasion of Ukraine, the price of oil is \$115.5 per barrel; up 7.81% on the year. While U.S. sanctions are geo politically and socially reasonable – given Stalin's, invasion is now a humanitarian crisis – U.S. production is facing higher operating costs.

While not having the ability to foretell the future, continued negligence in the matter of monetary policy will undermine the U.S. hegemony and lead to the near collapse

---

<sup>213</sup> Mohamed El-Erian of Gramercy and Allianz advisor speaks about this during his interview with CNBC on March 3rd, 2022.



of its sphere of influence in the context of international finance. To the same effect, the U.S. hegemony should promote equitable conditions in the global economy through policy that accounts for potential spillover. In so doing, not only will it protect its position as the focal point of international finance, but it will prompt economic growth amongst countries with robust growth prospects ultimately improving U.S. conditions in the long-run – assuming the globalized economic structure stays intact. Similarly, with the suggestions for improved policy making, the FEDs practices should hedge for such amplified spillover onto the monetary austerity of other countries.

## 7. Conclusion

My thesis aimed to test and examine U.S. policy, and subsequent spillover on emerging market economies' financial conditions. More specifically, it looks at the U.S. political-military hegemony – in the context of monetary policy – relationship with the risk premium for sovereign nominal credit spreads. In regard to the Federal Reserve, my thesis complements former Brazilian President Luiz Inácio Lula da Silva's claim that "...the world is at the mercy of the U.S. Treasury." Paradoxically, the U.S. attempts to promote neoliberal, free-market conditionalities in the global economy, but they do the exact opposite through targeted defensive moves to adjust its domestic markets.<sup>214</sup> Instead, the ebb and flow of U.S. economic health is a hegemonic tool manipulating the equitable landscape of international finance.

The regression analysis produces compelling results addressing the effect U.S. policy and country-specific conditions have on the risk premium or the cost of borrowing for eight emerging market economies from 2000 to 2020. First, I find that U.S. short-term policy and market volatility, proxied through the perceived risk in the S&P 500, positively correlates with high-risk premium levels. Confirming my original hypothesis and the narrative from existing literature, as the FED adjusts its dual mandate targets to realign its domestic economy, emerging market economies will see an increase in the cost of borrowing, affirming the manipulation of the U.S. political-military hegemony in the global credit cycle. The monetary intentions of Washington officials are a massive focal

---

<sup>214</sup> Stiglitz (2010), Brown (2015)

point in the global economy, where the macroeconomic conditions of emerging market countries typically co-move with oscillations in the U.S. market.

Correspondingly, I observe that the cost of borrowing increased under heightened political and domestic instability, benchmarked through inflation and political vulnerability. Other studies have empirically highlighted the destructive effects U.S. policy has on watershed financial conditions of emerging market economies. This result differs from what I assumed for the relationship of political structures with sovereign nominal credit spreads. Refuting my original hypothesis, and to my surprise, as countries become or show more liberally democratic conditions, they see a rise in the cost of borrowing, making it the most arguably emblematic result of my entire thesis. This may come as a surprise; however, in the context of the global credit cycle, sustained macroeconomic fundamentals far outweigh the political thesis and direction of each emerging market economy. In each country's case study, particularly Russia's mutant market economy under Putin's illiberal rhetoric, my paper argues that the financial health of the respective country takes precedence over its political agenda, *mutatis mutandis*, of the relationship yielded in the Argentina fixed-effect regression. Compared to the aggregated, regional, and country-specific results, Argentina is the only country with a negative relationship with the cost of borrowing – confirming my original hypothesis and main narrative of the paper. When considering the case of Argentina, the Central Bank has defaulted four times from 2000 to 2020. Moreover, Argentina's debt restructuring lasted from 2005 to 2016, as the government tried to adjust its macroeconomic fundamentals. Different from Russia, due to Argentina's historically poor macroeconomic conditions, relative to other emerging economies, when the government sees improved liberal democratic characteristics, it can be assumed that the global credit cycle looks upon this favorably as their risk premium lowers – refer to table 10.

Despite yielding different relationships with its cost of borrowing, the results and narrative found in the Russian Federation and Argentina case studies highlight the influence historically sustained sovereign financial conditions have in the global credit market. Due to the nation's poor financial credit profile, this result may suggest that international finance weighs macroeconomic stability more than the government's political agenda. My results indicate that the political regime or more liberal democracy is relatively

negligible in the light within international finance as the market looks favorable upon financing abilities as it suggests that the government can meet repayment conditionalities. But as alluded earlier, this idea is not the case with Argentina, as the nation has struggled to remedy its economy since as early as 1991.

Although many Central Bank officials carry out orthodox and countercyclical monetary policy to protect their nations from spillover, countries still “catch a cold” when the U.S. “sneezes.” The neoliberal free-market global economy is a pejorative statement when accounting for the U.S. hegemonic stronghold and its coercive influence on the decaying foundations of the globalized system. The current operating model of FED policy making has to first acknowledge then account for its spillover onto the global economy. Fundamentally apolitical, the FEDs policy continues to hinder countries from benefiting from their improved economic system and subsequent developments throughout international trade. Since 1944, changes in the U.S. economy have put downward pressures on the policymaking ability of emerging market Central Bank officials, which ultimately prevents nations from reaching their projected growth prospects.

Limitations of this study and further improvements are such. Future research should use quasi-sovereign or corporate bonds to be analyzed in conjunction with sovereign issuances to enhance the scope and accuracy of my empirical model. Given that governments of many emerging market countries own or hold some stakes in private companies, examining the spread of quasi-sovereign bonds would complement the nation's perceived risk premium. For example, the Mexican government owns PEMEX and Aeroméxico, the country's largest state-owned petroleum company and airline. Similarly, the Brazilian government owns Petrobras, Eletrobras, and 147 other firms. State ownership is prevalent across many other emerging market countries as these firms generate strong revenue margins for the state. At the same time, the government, in some cases, is risk-off as they do not fully own the firm – protecting them from potential financial collapse. Of equal importance, many emerging market economies have private corporations that continue to see robust growth. For example, consider Samsung Electronics, Hyundai Motors, POSCO, and others in South Korea. Or Al Jazeera Media Network of Qatar, Ecopetrol of Colombia, and Erdemir of Turkey. These developing economies see strong

flows of revenue from private and government shell companies. Considering these issues will elevate the robustness of my current empirical model.

Furthermore, given that these countries are listed on major indices, they are more exposed to changes in the prerogative of U.S. economic policy. Holistically, the eight countries of interest and many other emerging market economies have many corporate and quasi-sovereign firms that continue to churn strong earnings, which ultimately help improve the country's financial stability or risk premium. My paper could not pull quarterly sovereign spreads from 2000 to 2020, as some data points were missing. To remedy this, creating a basket or tranche of sovereigns, quasi-sovereign, and corporate bonds will improve the accuracy of future research. The analysis looking at the U.S. political-military hegemony, in the context of FED monetary policy on the economic conditions of emerging market economies, can be done on a more significant macro level.

Equally important, another limitation is the multicollinearity between my political regime and political vulnerability variable. To improve future robustness, future research should seek out a variable that better targets the social conditions found within emerging market economies. In so doing, this will first hedge against further multicollinearity but improve my model investigating the causal relationship of country-specific political standards on the nations risk premium.

In light of these results, further research is essential. Considering the results of my research, it is evident that the future of the economic austerity of international finance while under the U.S. political-military hegemony remains uncertain. Still, it is essential to revisit the holistic question addressed throughout my thesis to analyze historical U.S. spillover on emerging market economies and apply those results to better position the global economy to best safeguard the monetary autonomy of nations today. This coercive relationship leads me, among many political scientists, economists, and market analysts, to evaluate the choices made by Washington in the future. The geopolitical ecosystem is shifting due to improving Sino-Russian relations and “soft war” measures imposed through the macroeconomic prerogative of the FED, which will lead to the demise of the U.S. political-military hegemony. Accounting for the rise of Beijing's sphere of influence and the slow rise of the Yuan, the weaponization of U.S. monetary policy may lead to the end of the U.S. influence. Although analysts, economists, and political scientists alike may continue

to promote the strength of the U.S. monetary power, they have to know that the dollar or other U.S. metrics are not a top-down invention of world leaders. Yes, the Bretton Woods conference in 1944 propelled the U.S. as the focal point of the global market. But, businesses, traders, and private investors decided that they preferred to use greenbacks decades ago.<sup>215</sup> When compared to the macroeconomic metrics and conditions of other countries, most notably China, U.S. economics standards are easily traded and relatively stable due to the nation's transparent legal system and accountable government – when compared to other countries. The Yuan and Chinese conditions are a potential rival to the U.S. hegemony. Failing to acknowledge the shift in the geopolitical and economic landscape will lead to the demise of U.S. influence or further decay of equitable conditions in the global economy.

In closing, the results and narrative presented in this thesis show that U.S. policy and country-specific conditions negatively impact the economic conditions of emerging market economies. Hopefully, Washington considers its spillover as if they continue to decay the equitable landscape of international finance and constrain free-market conditionalities; the U.S. hegemony may lose its sphere of influence.

---

<sup>215</sup> They turned to greenbacks as it was more liquid than the gold standard and bimetallism.

## Appendix

**Table 13:** Mexico Fixed Effect Regression

	<i>Dependent variable:</i>			
	nominalspread			
	(1)	(2)	(3)	(4)
US_2yr	-0.602*** (0.214)	-0.171 (0.224)		
VIX	0.024** (0.009)	0.034*** (0.009)	0.046*** (0.008)	
LIBOR	0.438** (0.166)	0.150 (0.184)		0.021 (0.054)
spot	0.158** (0.060)	0.260*** (0.047)		0.085 (0.061)
inflation	-0.022 (0.020)		0.044*** (0.005)	
ab	-0.00002 (0.00002)		0.00001 (0.00002)	-0.00000 (0.00002)
vul	-5.944** (2.335)	1.900 (1.435)		-4.258* (2.245)
regime	17.533*** (4.781)	26.607*** (4.472)	16.240*** (4.490)	
fdi	-0.00005 (0.0001)			-0.0002*** (0.0001)
Observations	57	73	57	57
R <sup>2</sup>	0.787	0.631	0.657	0.571
Adjusted R <sup>2</sup>	0.746	0.597	0.631	0.529
F Statistic	19.263*** (df = 9; 47)	18.787*** (df = 6; 66)	24.950*** (df = 4; 52)	13.602*** (df = 5; 51)
<i>Note:</i>			*p<0.1; **p<0.05; ***p<0.01	

**Table 14:** Colombia Fixed Effect Regression

	<i>Dependent variable:</i>			
	nominalspread			
	(1)	(2)	(3)	(4)
US_2yr	-0.977** (0.408)		-0.348** (0.145)	-0.511*** (0.115)
VIX	0.065*** (0.018)		0.049** (0.021)	0.031* (0.017)
LIBOR	0.299 (0.359)			
spot	-0.001 (0.001)	-0.002*** (0.001)		0.002*** (0.0003)
inflation	-0.135*** (0.031)	-0.105*** (0.029)		
ab	0.0001 (0.0002)		-0.00001 (0.0002)	
vul	-10.033*** (2.741)		-10.972*** (1.805)	-13.418*** (1.053)
regime	6.843 (7.923)	2.245 (7.245)		
fdi	0.0004 (0.0002)	-0.001** (0.0003)		
Observations	72	72	72	72
R <sup>2</sup>	0.816	0.533	0.601	0.737
Adjusted R <sup>2</sup>	0.789	0.505	0.577	0.721
F Statistic	30.514*** (df = 9; 62)	19.134*** (df = 4; 67)	25.188*** (df = 4; 67)	46.907*** (df = 4; 67)
<i>Note:</i>			*p<0.1; **p<0.05; ***p<0.01	

**Table 15:** South Korea Fixed Effect Regression

	<i>Dependent variable:</i>			
	nominalspread			
	(1)	(2)	(3)	(4)
US_2yr	-0.559*** (0.163)	-0.602*** (0.151)		
VIX	0.035*** (0.008)	0.039*** (0.006)		
LIBOR	0.268* (0.135)	0.328*** (0.111)		
spot	0.0003 (0.001)		0.002** (0.001)	0.002*** (0.001)
inflation	-0.054*** (0.014)	-0.047*** (0.008)		-0.046*** (0.006)
ab	-0.00003*** (0.00001)	-0.00002*** (0.00001)		
vul	1.699 (1.380)		-3.782*** (1.005)	
regime	-3.263** (1.448)	-2.401** (0.952)		-2.691** (1.272)
fdi	0.001 (0.003)		0.010** (0.004)	0.010** (0.004)
Observations	76	81	76	81
R <sup>2</sup>	0.786	0.773	0.310	0.540
Adjusted R <sup>2</sup>	0.756	0.755	0.281	0.515
F Statistic	26.856*** (df = 9; 66)	42.082*** (df = 6; 74)	10.785*** (df = 3; 72)	22.265*** (df = 4; 76)
<i>Note:</i>			* p<0.1; ** p<0.05; *** p<0.01	



**Table 16: Qatar Fixed Effect Regression**

	<i>Dependent variable:</i>			
	nominalspread			
	(1)	(2)	(3)	(4)
US_2yr	-1.243** (0.529)	-0.862*** (0.159)		-0.958** (0.462)
VIX	-0.001 (0.012)		0.009 (0.013)	-0.006 (0.011)
LIBOR	0.458 (0.524)			0.058 (0.447)
spot	7.254 (5.348)		9.272 (6.332)	
inflation	0.092* (0.054)	0.040 (0.032)		0.020 (0.034)
ab	-0.00001 (0.00003)			-0.00004* (0.00002)
vul	1.768 (1.565)		3.610*** (1.062)	
regime	113.457** (46.997)	89.073** (39.509)		93.429* (46.853)
fdi	0.001 (0.0004)		0.0004* (0.0002)	
Observations	45	45	45	45
R <sup>2</sup>	0.673	0.587	0.448	0.626
Adjusted R <sup>2</sup>	0.589	0.556	0.393	0.567
F Statistic	7.995*** (df = 9; 35) 19.404*** (df = 3; 41) 8.127*** (df = 4; 40) 10.621*** (df = 6; 38)			
<i>Note:</i>			*p<0.1; **p<0.05; ***p<0.01	

## Bibliography

- Arora, Vivek B., and Martin D. Cerisola. 2000. "How does US monetary policy influence economic conditions in emerging markets?"
- Bernanke, Ben S. "The Taylor Rule: A benchmark for monetary policy?" 2015.
- Bräuning, F. and Ivashina, V., 2020. US monetary policy and emerging market credit cycles. *Journal of Monetary Economics*, 112, pp.57-76.
- Brown, Wendy. *Undoing the Demos: Neoliberalism's Stealth Revolution*. , 2015. Print.
- Calvo, Guillermo A., Leonardo Leiderman, and Carmen M. Reinhart. 1993. "Capital inflows and real exchange rate appreciation in Latin America: the role of external factors." *Staff Papers* 40, no. 1 108-151.
- Cantor, Richard, and Frank Packer. 1996. *Multiple ratings and credit standards: differences of opinion in the credit rating industry*. No. 12. Nueva York: Federal Reserve Bank of New York, 1996.
- Clarida, Richard, Jordi Galí, and Mark Gertler. 1998. "Monetary policy rules in practice: Some international evidence." *European economic review* 42, no. 6: 1033-1067.
- Desai, Radhika. 2013. *Geopolitical economy: After US hegemony, globalization and empire (the future of world capitalism)*. London: Pluto Press.
- Dibooglu, Sel, Seyfettin Erdogan, Durmus Cagri Yildirim, and Emrah Ismail Cevik 2020. "Financial conditions and monetary policy in the US." *Economic Systems* 44, no. 4.
- Dudley, William C. 2019 "Financial stability and monetary policy." *Business Economics* 54, no. 3: 160-162.
- Eichengreen, Barry, and Ashoka Mody. 1998. "What explains changing spreads on emerging-market debt: fundamentals or market sentiment? (No. w6408)."
- Foucault, Michel, Arnold I. Davidson, and Graham Burchell. 2008. *The birth of biopolitics: lectures at the Collège de France, 1978-1979*. Springer.
- Friedman, Milton. 1994 *Money mischief: Episodes in monetary history*. HMH.
- Friedman, Benjamin M. 1995. "Principles of Economics." *The American Economist* 39, no. 2

- Goodhart, Charles, Carolina Osorio, and Dimitrios P. Tsomocos. 2009. "Analysis of monetary policy and financial stability: A new paradigm."
- Kamin, S.B., Von Kleist, Karsten. 1999. *The evolution and determinants of emerging market credit spreads in the 1990s*. No. 653. Board of Governors of the Federal Reserve System (US).
- Kose, M. Ayhan, Christopher Otrok, and Eswar Prasad. 2012. "Global business cycles: convergence or decoupling?." *International Economic Review* 53, no. 2: 511-538.
- Kose, M. Ayhan, Christopher Otrok, and Charles H. Whiteman. 2003. "International business cycles: World, region, and country-specific factors." *American Economic Review* 93, no. 4: 1216-1239.
- Kose, M. Ayhan, Csilla Lakatos, Franziska Ohnsorge, and Marc Stocker. 2017. "The global role of the US economy: Linkages, policies and spillovers."
- Lerner, A. 1941. The economic steering wheel. *University Review*. 2–8.
- Maćkowiak, Bartosz. 2007. "External shocks, US monetary policy and macroeconomic fluctuations in emerging markets." *Journal of monetary economics* 54, no. 8: 2512-2520.
- Miranda-Agrippino, Silvia, and H  lene Rey. 2020. "US monetary policy and the global financial cycle." *The Review of Economic Studies* 87, no. 6: 2754-2776.
- Mishkin, Frederic S. 2008. "Whither federal reserve communications." *Presentation to the Peterson Institute for International Economics*.
- Mishkin, Frederic S. 2009. "Is monetary policy effective during financial crises?." *American Economic Review* 99, no. 2: 573-77.
- Mishkin, Frederic S. 2011 *Monetary policy strategy: lessons from the crisis*. No. w16755. National Bureau of Economic Research.
- Murray, Christian J., Alex Nikolsko-Rzhevskyy, and David H. Papell. 2015. "Markov switching and the Taylor principle." *Macroeconomic Dynamics* 19, no. 4: 913-930.
- Oatley, Thomas, and Jason Yackee. "American interests and IMF lending." *International Politics* 41.3 (2004): 415-429.
- Orphanides, Athanasios. 2003. "Historical monetary policy analysis and the Taylor rule." *Journal of monetary economics* 50, no. 5 (2003): 983-1022.
- Reich, Robert B. "Beyond free trade." *Foreign Affairs* 61.4 (1983): 773-804.

- Reich, Robert B. "How capitalism is killing democracy." *Foreign Policy* 162 (2007): 38.
- Reich, Robert B. 2016. *Saving capitalism: For the many, not the few*. Vintage, 2016
- Rey, Hélène. 2015. *Dilemma not trilemma: the global financial cycle and monetary policy independence*. No. w21162. National Bureau of Economic Research, 2015.
- Romer, Christina D., and David H. Romer. 1994. "Monetary policy matters." *Journal of Monetary Economics* 34, no. 1: 75-88.
- Stiglitz, Joseph E. 1969. "Distribution of income and wealth among individuals." *Econometrica: Journal of the Econometric Society*: 382-397.
- Stiglitz, Joseph E. 2010. *Memoir*: Columbia University.
- Taylor, Mark P., and Emmanuel Davradakis. 2006. "Interest rate setting and inflation targeting: Evidence of a nonlinear Taylor rule for the United Kingdom." *Studies in Nonlinear Dynamics & Econometrics* 10, no. 4.
- Taylor, John B. 1993. "Discretion versus policy rules in practice." In *Carnegie-Rochester conference series on public policy*, vol. 39, pp. 195-214. North-Holland.
- Taylor, John B. 2008. "Monetary Policy and the State of the Economy." *testimony before the Committee on Financial Services, US House of Representatives* 26 (2008).
- Webb, Michael C., and Stephen D. Krasner. 1989. "Hegemonic stability theory: an empirical assessment." *Review of International Studies* 15, no. 2: 183-198.
- Williamson, John. 1998. *Washington Consensus*, ed. Narcis Serra and Joseph E. Stiglitz. Oxford University Press.
- Woodford, Michael. 2001. "The Taylor rule and optimal monetary policy." *American Economic Review* 91, no. 2: 232-237
- Yellen, Janet L. 2006. "Speech at the Euro and the dollar in a globalized economy conference, May 27, 2006." In the *Federal Reserve Bank of San Francisco*.
- Zakharov, Nikita. "Does corruption hinder investment? Evidence from Russian regions." *European Journal of Political Economy* 56 (2019): 39-61.
- Zandstra, Deborah, Jon Zonis, Hugo Triaca, and Jennifer DeMarco. 2021 *SOVEREIGN DEBT RESTRUCTURING PROPOSED AMENDMENT TO NEW YORK BANKING LAW THROUGH NEW ARTICLE 7*. London, U.K.: Clifford Chance, 2021.