DOI: 10.54254/2754-1169/144/2024.GA19084

Economic Outcomes from Reliance on Foreign Capital: Taking South Korean and Brazil's Crises in the 1990s as Examples

Yuming Zhou[1,a,*]

[1]*Beijing 101 Middle School, Beijing, 100091, China*
a. Zhouyuming0703@ldy.edu.rs
**corresponding author*

Abstract: This article analyzes the economic crises of South Korea in 1997 and Brazil in 1999, focusing on the two countries' reliance on foreign capital and their recovery policies under the leadership of the International Monetary Fund (IMF). Both countries suffered severe currency devaluation and economic recession due to capital flight. However, with different economic structures and response policies, the recovery paths of the two countries are also very different. South Korea had benefited from an export-led recovery and sweeping financial reforms, while commodity-dependent Brazil faced more challenges. This study provides an important reference for emerging economies dealing with foreign investment dependence and post-crisis recovery issues. This article specifically analyzes key economic indicators such as Foreign Direct Investment (FDI) flows, per capita Gross Domestic Product (GDP), and exchange rate fluctuations during the economic crisis in South Korea and Brazil, and conducts an in-depth comparison of the two countries' policies to respond to the crisis. Finally, this article puts forward specific countermeasures and suggestions such as diversifying the industrial structure, strengthening the independence of monetary policy, and improving public trust to deal with possible financial instability in the future.

Keywords: economic crisis, post-crisis policies, foreign capital

1. Introduction

South Korea's 1997 economic crisis and Brazil's economic turbulence in 1999 exemplify two financial crises that had a bailout by the International Monetary Fund (IMF) in recent history. Both Korea and Brazil faced a capital flight situation and were heavily influenced. There were some economic crises followed by the miracle, escalating a high inflation rate history. The economic crises were mainly caused by capital flight, which they opposed accordingly, but today there is a big gap between the two countries' economic development status [1].

Nowadays, there are still many emerging economies that import high technique products and export commodities, and rely on foreign capital cultivated. The focus on economic crises, particularly in emerging markets, is essential for understanding the vulnerabilities in the global financial system. South Korea and Brazil had an economic miracle in recent history, resulting in reliance on foreign capital and an unstable economic environment. By examining how South Korea and Brazil faced and

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responded to their economic crisis, this paper tries to give a better understanding of the risks associated with borrowing and the potential pathways to recovery.

Previous research was particularly concerning the impacts of crises on economic development, sovereign debt dynamics, and external borrowing practices, and the triggers of these crises [2-4]. This paper compares the economic crises that occurred in the emerging economies of South Korea and Brazil in 1997 and 1999, respectively, which were caused by capital flight following a decline in investor confidence due to the poor financial environment, and discusses the resolution of these two countries under IMF loans and agreements. In the last, this paper summarizes the lessons learned and gives suggestions for new economies to cope with the situation.

2. 1997 Crisis in South Korea

Korea's 1997 economic crisis was triggered by a combination of internal and external factors. Internal causes include the consequences of moral hazard and improper management of external debt, particularly the absence of prudential supervision during the capital market liberalization process, which raised the risks associated with the sustainability and liquidity of external debt. In addition, over-reliance on short-term external debt, especially in the private sector, further exacerbated crisis vulnerability. By the end of 1997, about 55 per cent of Korea's external debt was short-term debt, held mainly by financial institutions and large conglomerates (chaebol). On the external front, the contagion effects of the regional Asian financial turmoil and coordination failures in the economic policy response exacerbated the crisis. Due to the devaluation of the Thai baht in July 1997, which set off a regional financial crisis and resulted in a sharp decline in investor confidence and a massive capital flight, Korea has been heavily dependent on foreign capital. As a result, the Korean won sharply depreciated against the US dollar, falling by approximately 46% by the beginning of March 1998. According to the Bank of Korea, foreign investors in the stock market withdrew investments worth $1,969 billion from August to November 1997 [2].

The credit crunch hit South Korea due to capital flight and the severe devaluation of the won. This led Korea to turn to an IMF bailout and shift its foreign exchange rate system from a free-floating exchange rate system to a Market Average Exchange Rate System (MARS), where the won-dollar exchange rate fluctuates within a daily trading margin [3].

2.1. Government Policies

After the 1997 financial crisis, South Korea turned to the IMF for assistance, signing a financial aid package worth $58.3 billion, which required the government to implement stringent stabilization policies. Because non-performing loans (NPLs) were promptly resolved and non-viable financial institutions were closed on schedule, the Korean economy could quickly allay the fears of creditors. Furthermore, the quick post-crisis adjustment to the economic crisis was facilitated by the quick changes in monetary and fiscal policies [4]. In addition to making Korean goods more price competitive in foreign markets, the significant depreciation of real exchange rates also had a significant role in the abrupt turnaround in Gross Domestic Product (GDP) growth. The Korean economy is mostly export-oriented.

These included broad structural changes, the quick closure of bankrupt financial institutions, and strict monetary policy. The National Assembly passed laws to create new regulatory bodies like the Financial Supervisory Commission (FSC), Korea Asset Management Corporation (KAMCO), and Korea Deposit Insurance Corporation (KDIC). Non-viable financial institutions were closed, and efforts to dispose of NPLs were central to financial sector restructuring [5].

A floating nominal exchange rate policy replaced the heavily managed one, and the bank of Korea targeted foreign exchange reserves at a constant share of GDP, a share long maintained at or slightly

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above 25 percent. Meanwhile, Korea implemented a framework for monetary policy that targets inflation and further opens up the capital account. This framework allows for macroprudential measures while maintaining greater currency flexibility and the necessity of utilizing foreign direct and portfolio equity investment. Examined in Figure 1, there was a short term Foreign Direct Investment (FDI) outflow reduction after the crisis affected by the policy.

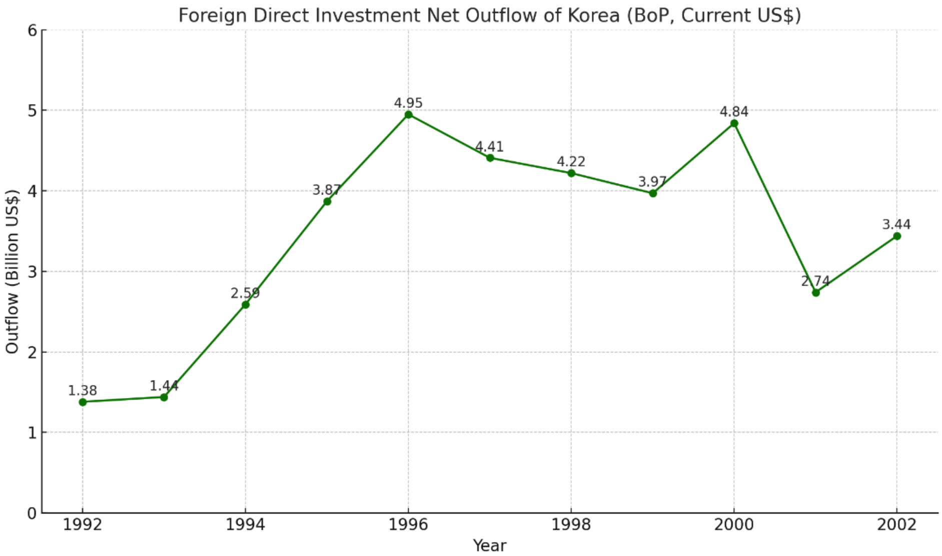

Figure 1: FDI net outflow of Korea between 1992 and 2002 (Data Source: World Bank).

2.2. Economic Impact

The economic impact of South Korea's 1997 financial crisis can be seen through a number of key indicators. As shown in Figure 1, net FDI outflows rose sharply during the crisis, especially between 1997 and 1998, reflecting the loss of investor confidence. After the implementation of IMF-supported policies, outflows gradually decreased and stabilized by the early 2000s, underscoring the importance of prompt policy action in restoring economic stability.

Figure 2: GDP per capita of Korea between 1990 and 2023 (Data Source: World Bank Open Data).

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As shown in Figure 2, South Korea's sharp decline in per capita GDP from 1997 to 1998 reflected the direct impact of the financial crisis. However, by 1999, GDP growth resumed, mainly due to the recovery of the export sector. The sharp depreciation of the Korean won, coupled with South Korea's export-oriented industrial structure, has enhanced the global competitiveness of its products and played a key role in economic recovery.

3. 1999 Crisis in Brazil

Beginning with 1997 Thailand economic crisis, a chain of economic collapses spread through many emerging economies in Asian which had great demand for foreign capital [6]. In addition, Brazil, with its high levels of foreign debt and historical inflation issues, might be seen as a higher risk during global turmoil. Since 1998, foreign capital had been withdrawn from Brazil, amounting to about $30 billion. Between June and September 1998, lending by US banks to Brazil declined by a quarter. Meanwhile, crisis in major economies can reduce global demand for commodities. As a significant commodity exporter, Brazil's revenues and economic stability could be affected, increasing the perceived impact of the crisis.

In November 1998, the Brazilian government finally reached a long-awaited loan agreement with the IMF. The agreement called for the Brazilian government the need to reduce its fiscal deficit from the current 8% to 4.7% in 1999 and eventually achieve a revenue surplus of 2.6% to 3% of GDP in 2001. Under the loan agreement, the IMF would eventually disburse a total of $45 billion to Brazil, of which $9 billion was to be disbursed immediately.

However, on 7 January 1999, investors' nerves were rattled again when the governor of Minas Gerais, Brazil's third largest state, announced a delay in the repayment of $13.4 billion owed to the federal government. On 13 January, the Brazilian central bank announce that it was raising the exchange rate from the previously rigidly guarded line of 1.12-1.22 to 1.20-1.32, implying a devaluation of Brazilian Real by about 8%. As a result, the US rating agency Standard & Poor's downgraded Brazil's national credit rating to B- and its short-term foreign currency credit rating to B. The 1999 Real Crisis, known as the Samba effect, had been going on ever since.

3.1. Government Policies

Brazil's responses to the crisis began with a call for outside help. When Brazilian authorities realized the crisis was coming, they asked for a loan from the IMF. The IMF was willing to lend, but only if Brazil implemented a series of measures to stabilize its financial system and economy.

Alarmed by the crisis and urged by the IMF, the Brazilian government adopted a series of measures to help restore the normal operation of the economy and carried out financial reforms. Specifically, from the perspective of macro-control, in monetary policy, Brazil's central bank decided to undertake reforms in the exchange rate in order to enhance the independence of monetary policy, avoid sacrificing other economic goals to maintain a fixed exchange rate, reduce dependence on foreign exchange reserves, and minimize the direct impact of external economic shocks on domestic economic. At the same time, the benchmark interest rate was also raised to curb the inflation. In fiscal policy, the government adopted a series of contractionary fiscal policies to address issues such as currency depreciation, capital outflows, and high inflation. The government also raised some tax rates and strengthened supervision of tax collection to increase fiscal revenue.

Brazil also underwent financial reforms, including strengthening regulation and restructuring non-performing assets, all aimed at increasing economic stability. The Brazilian government imposed stricter capital adequacy requirements and strengthened auditing and supervision of banks and other financial institutions. At the same time, in response to the NPL problem brought about by the crisis, the government encouraged banks to restructure and clean up NPL in order to improve their balance

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sheets. In addition, Brazil was committed to improving the transparency of its financial institutions and promoting the standardization of information disclosure and risk management. By building a better financial market infrastructure, Brazilian authorities hoped to improve the efficiency of the financial system and reduce systemic risk [7].

Further, Brazil was also aware of the importance of strengthening communication with the international financial market and restoring the confidence of international investors. This could not only facilitate the acquisition of financial support, but also amplify international influence, fortify global competitiveness, and consequently advance domestic economic growth while effectively managing external shocks. To this end, the Brazilian government had enhanced the transparency of economic and financial data by consistently disseminating economic indicators and policy changes to international investors, while actively pursuing collaboration with international organizations and engaging in global conferences.

3.2. Economic Impact

When the financial crisis hit, as shown in Figure 3, Brazil's GDP per capita exhibited negative growth, indicating a state of economic recession.

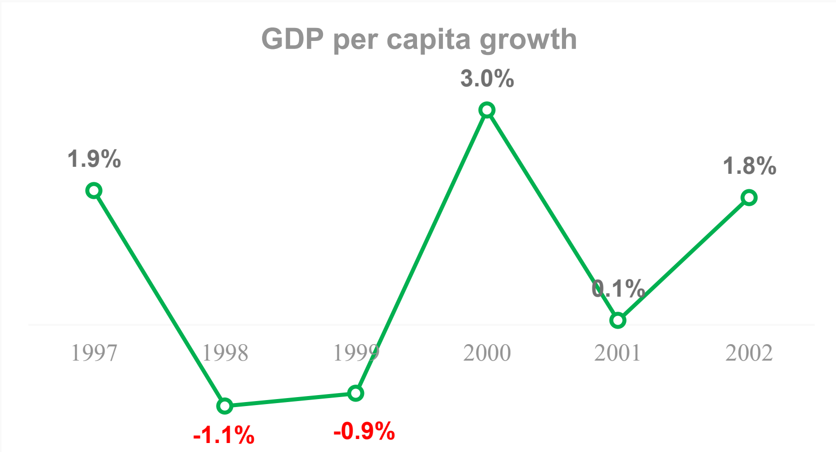

Figure 3: Growth of GDP per capita of Brazil between 1997 and 2002 (Data source: World Bank).

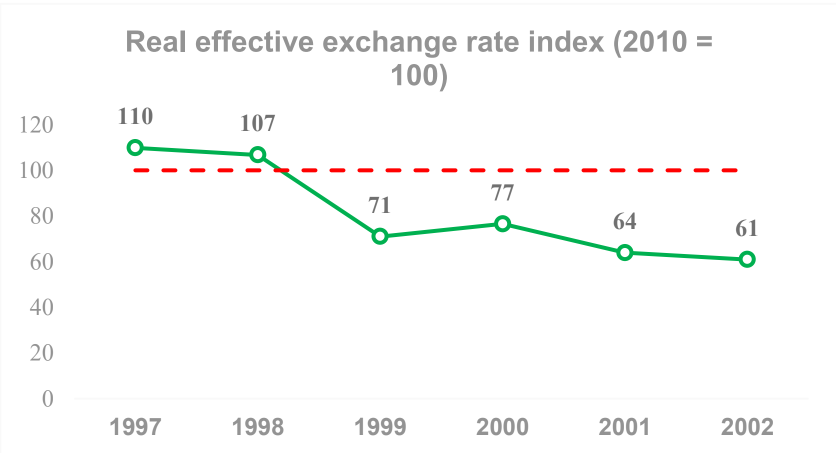

Figure 4: Effective exchange rate index of Brazil's Real between 1997 and 2002 (Data source: World Bank).

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The currency depreciation caused by the crisis can also be reflected in the data. As Figure 4 shows, the Real effective exchange rate index decreased significantly in 1999 and remained below 100 in the following years, indicating a decrease in the purchasing power of the Real internationally. The nominal currency depreciated, and international investors' confidence in Brazil's economy also decreased accordingly.

In addition to macroeconomics, various industries had also been affected by the overall environment. For example, in the financial industry, many banks were facing liquidity crises, bankruptcy, or forced mergers, with stricter loan conditions and higher loan costs, making it more difficult for businesses and individuals to obtain financing. In addition, in the manufacturing industry and agricultural industry, the depreciation of the Real promoted exports, but also increased the cost of the imported raw materials or fertilizers.

4. Lessons and Suggestions

Although South Korea and Brazil had economic crises with foreign capital outflow, which happened in neighboring years, they are facing different situation at present. Moreover, Korea's reconstruction was much more efficient than Brazil's [8]. These situations can be attributed to three factors.

First, the two countries have different focuses of economic development. Export-oriented industrialization (EOI) has been South Korea's development strategy since the days of Park Chung-Hee's warlord rule in the 1960s. Through a series of five-year economic plans, the country has focused on developing heavy industry, shipbuilding, chemicals, and steel. Brazil, on the other hand, because of its rich natural resources, has a long lineage of coffee-based agriculture and mining export-oriented economy in Brazil. As a result, compared to Korea, Brazil's industrial and technological innovation development has lagged behind, and its economy is still highly dependent on international demand for commodities, making it highly susceptible to the influence of foreign investors and their capital [9].

Second, in South Korea after the crisis, the emergency stabilization of the people's hearts played a big role. In 1998, the South Korean people spontaneously launched a “gold donation campaign”, to help the country pay off foreign debt. In a few months, about 3.5 million Koreans donated more than 200 tons of gold. In February 1998, South Korea's exports increased by 21%, realizing a surplus of 3.2 billion US dollars. Of this, $1.05 billion was the precious foreign currency that the people exchanged for gold. Also, the Korean government had stepped up unemployment benefits and reemployment training to improve the social security system. In contrast, Brazil's government of President Fernando Henrique Cardoso in the late 1990s faced serious political challenges. Although he pursued market-oriented reforms and privatization policies during his first term, by his second term in 1999, political support had slipped and social trust in the government had declined. This political instability affected the government's ability to respond to crises. The government's economic reforms failed to improve the living standards of the middle-income groups, and divisions and discontent within Brazilian society rose, erupting in many protests [10].

Third, the two countries differ greatly in their relations with foreign capital, especially the military cooperation between the United States and South Korea has been further deepened after the 1997 crisis. South Korea's security and stability are critical to US strategy in Northeast Asia. South Korea exports high-tech products to the US market, and the US has become a key trading partner in South Korea's economic recovery. Direct investment by US firms in South Korea has increased, further cementing economic ties between the two countries. Brazil, on the other hand, its export structure is dominated by agriculture and minerals, and it competes with the US for market shares in the agricultural sector, such as soybeans, sugar, and beef. Moreover, Brazil's political instability, currency devaluation, and uncertainty about economic reforms have made US investors cautious about Brazil's economic prospects, attracting relatively limited US direct investment.

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Considering these two crises as learning opportunities, the emerging economy should really take industrialization as a crucial development strategy instead of mono-development of agriculture though with the abundance of natural resources, and pay attention to stabilizing public sentiment especially in a period of economic instability.

5. Conclusion

In summary, a comparative analysis of the economic crises in South Korea and Brazil in the late 1990s highlights the critical role of economic structure, government response, and international cooperation in determining the outcome of recovery. South Korea's rapid financial reforms, coupled with its export-oriented economy, contributed to a faster recovery. In contrast, Brazil's dependence on commodity exports and slower reform process led to a prolongation of the crisis. For emerging economies, this study suggests that economic diversification, prudent financial regulation, and strong social cohesion are critical to coping with crises caused by capital flight and global economic instability. This paper compares in detail the response and recovery speed of South Korea and Brazil in the economic crisis. South Korea's rapid recovery is due to its mature export-oriented industrial policy, sound crisis management, and highly unified social response mechanism. The South Korean government quickly adjusted monetary policy, closed down NPLs and implemented a series of structural reforms, which effectively restored investor confidence and economic growth. In contrast, Brazil's recovery was slow due to political instability, high dependence on commodity exports, and poor policy implementation. In addition, Brazil failed to effectively mobilize social resources to help alleviate the crisis, resulting in a long-term economic downturn.

However, this paper also has some limitations. First, the analysis of the causes of the crisis in this paper is mainly based on macroeconomic indicators, lacking an in-depth exploration of the social and political background. Second, the timeliness of the data may affect its applicability to the current economic situation. Future research can further analyze the impact of social factors and international policies on crisis response, and combine a wider range of cases to explore the differences in the performance of countries at different stages of development in the crisis.

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