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Analyzing The Ramifications of The Global Financial Crisis in Nepal: A Book Review Titled Guaranteed to Fail

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ABSTRACT

The book *Guaranteed to Fail* seems to be a useful examination of the neurotic flaws in the American financial system with a focus on the collapse of Fannie Mae and Freddie Mac. The book focuses on failure in incentives, lack of proper regulation, and the occurrence of moral hazards which had eventually led to the GFC. The teachings have special bearing for Nepal at the time when it is more or less a maneuvering through a complex economic environment. But it must be noted that the economy of Nepal faces challenges in the way of rising Non-Performing Loans and inflation and also less credit disbursement despite the presence of ample liquidity in the financial system. There seems a need for Nepal to get transformed into a market-oriented economy going in alignment with the establishment of robust regulatory frameworks in an effort to manage fiscal and monetary balance. The case of the U.S indicates that Nepal can learn to strengthen its institutional capacity to cope with external shocks, avoid duplication of existing systemic risks, and sustain the growth. This review brings out the outcome of the book and relates it to the current economic status of Nepal and comes up with shedding a light can on how we can come up with the optimum risk forbearance in the country.

KEYWORDS: systemic risk, financial crisis, regulatory framework, economic growth, Nepal

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INTRODUCTION

While the world economy has gone through several revolutions at times, the recent challenges that influenced it are the consequences of the COVID-19 pandemic, as well as the events such as the conflict in Ukraine and the tensions in the Middle East. However, several challenges have been evidenced to bear witness to the fact that the world economy has remained vibrant with growth rates having been in an established form in most of the regions in world. However, these crises' impacts are felt till today and they are the major causative agents for the instabilities in economies, especially the in the emerging and in the developing ones. To this concept, Acharya, Richardson, Nieuwerburgh, and White's book namely *Guaranteed to Fail*, is a timely and insightful review on why systematic quandaries in financial systems cause systemic failures that lays impact throughout the global economy (Acharya et al., 2011). This book centers on Fannie Mae and Freddie Mac companies which played a significant role in the U. S. mortgage finance system triggering the Great Financial Crisis (GFC) and their failure. It asserts that those institutions which enjoy implicit governmental assurance acted progressively more leveraged and riskier till they caused the occurrence of the 2007/08 financial crisis. The lessons from *Guaranteed to Fail* are particularly relevant to Nepal as the country navigates its own economic challenges. Nepal, like many other developing nations, is experiencing a period of significant economic transformation. To this, the government of Nepal has set ambitious targets for economic growth, aiming for a 6 percent economic expansion in 2024/25, supported by increased investment in infrastructure, agriculture, and the energy sector (MoF, 2024). However, these growth objectives are set against a locale of global economic uncertainty, where inflation remains a persistent issue, particularly in emerging markets, and where external factors such as fluctuating fuel and food prices could derail domestic economic plans.

Managing Nepal's economic structure involves issues of government intervention on certain strategic development sectors which has a comparative kink to that of the United States housing market's Fannie Mae and Freddie Mac. This also involves the financial institutions which are anticipated to spearhead the development of hydropower, tourism, and agriculture among others. Nonetheless, as the book *Guaranteed to Fail* enlightens, the participation of government in the financial markets increases the hazards of moral, if regulated appropriately. The case of the U. S. indicates that when organizations affiliated to the government are seen as immune to failure, they are capable of undertaking risky projects hoping that in case of failure, the government will bail them out. This scenario seems to be relevant for Nepal, not now but in near future, which aids in achieving the economic growth without compromising the financial stability of the country.

As it can be seen there are opportunities and threats in the current macroeconomic environment of Nepal. According to the National Statistics Office, it entails a moderate economic growth of 3.87 percent for the fiscal year 2023/24 grouped by sectors including food services, electricity, and transport (NSO, 2024). However, challenges persist especially in construction and manufacturing industries. Some of the measures aimed at stimulating the growth of economy are increasing the capital investments and solving the questions connected with the financial and organizational problems in the spheres which are considered important by the government, such as microfinance institutions, savings, and credit cooperative societies. However, such efforts have to be embarked upon with a lot of care so as not to end up in the disaster seen with Fannie Mae and Freddie Mac.

In addition to this, there exists several issues with the financial sector of Nepal such as raising non-performing loan which was 3.04 percent in mid-June, 2023 rose to 3.98 percent by mid-June, 2024 (NRB, 2024). This seems to be accompanied by weak domestic consumption as well as economic slouch, two factors that might potentially trigger other genres of instability. This critical area of the book makes the analysis useful for Nepal, as it attempts to repair and strengthen the regulatory framework and safeguard the financial companies from the effects of negative economic shocks.

The IMF reported through global economic outlook that showed a slight recovery in the economy for the next few years; however, the global economic growth is expected to stabilize at approximately 3.2 to 3.3 percent in the fiscal years 2023 and 2025 (IMF, 2024). In Nepal, while everything outside might boost the economic growth, there is a need for the nation to remain vigilant of internal vulnerabilities. More crucially, it becomes imperative of continuing to defend a surplus in balance of payments and managing inflation which are one of the integral components of stability in case of Nepal. However, the risks associated with global fluctuations in price, especially in the price of fuel and food, define the requirement for proper financial measures that would be insensitive to the external factors.

This book review contributes in understanding the *Guaranteed to Fail* by constructively contributing to Nepal's quest for economic goals. The analyses of the failure of Fannie Mae and Freddie Mac can be viewed as a cautionary tale anytime any country that relies mainly on government backed institutions to drive development. Not only this but also the moral hazards and other system related risks, always tend to linger in the background of the economy. With this reference, Nepal seems to have a challenge of delivering its robust economic plans while balancing the threats caused by several issues. Thus, this review shall establish how the contents of *Guaranteed to Fail* relate to the current situation of the economy of Nepal. The review of this book has not been carried out on Nepal's perspective so far, thereby it's obvious to claim the original contribution of this study. It also contains recommendations (informal) informing how the country could perhaps achieve the kind of economic growth which it wants, but do not bear the capability to achieve it due to the financial constraints when compared to the economy of the United States.

ANALYSIS

Discrepancies in motivations and the presence of moral hazard

Previous section of this review seems to ogle at the original structure of Fannie Mae and Freddie generating a certain quantity of moral hazard. Such companies tended to act on the misguided premises which was created by governmental funds eventually leading to failure, thereby engaging in the risky business. This seems to be an illustration of the principal-agent problem which was also clearly visible when the financial managers attempted to make a risky decision during the time of 2007/08. That was responsible to lead to the financial crisis. That particular lesson seems to be applicable in the understanding for the context of Nepal. This time, Nepal has aimed at achieving a 6 percent economic growth rate. To align with this, it seems crucial for the government to ensure that lending practices embraced in the financial institutions remain sustainable. However, at present scenario the lending has not been as expected. The essence is to enhance the government expenditure that should be increased which ensures to fulfill the desired economic growth not due to the reckless financial behavior enhancing growth and leading to risks similar to the case of Fannie Mae and Freddie Mac.

Regulatory Deficiencies and Government intervention

The authors *Guaranteed to Fail* assert that soft regulation of Fannie Mae and Freddie Mac entailed the backlog of the systemic risk in the organization. Due to the inefficiency of the regulations, those institutions were worst in their performance which led to the failure. We can understand that for Nepal there seems an essential need to focus on the similar complications of regulation. It also seems that there are problems related to microfinance and savings, and credit cooperatives and to the provision of settlements of payments in the construction sector. One of the important conditions seems to be the enhancement of the supervised institutions – especially those that has capability to expand in the nearest future; electric power producing in hydropower plants and the tourism services. With this, it seems evident that Nepal can steer to wipe out the systemic hazards associated with weak regulation which also have been evident in the case of the U.S. Nepal can also facilitate the development of the industries of significant importance which could contribute to promote and enhance the financial stability in the country.

Systemic Risk and Financial Stability

We can assess that how the excessive levels of systemic risk can become disastrous for the financial system of the United States through the observation of the case of Fannie Mae and Freddie Mac. This concept seems to be equally applicable to Nepalese context given the fact that financial sector seems to be the key contributor for managing the financial stability of the nation. Nepal enjoys Balance of payments and current account surplus accompanied by enhanced remittance. However, if these factors are not properly controlled, these factors seem to have capability of causing systemic hazards similar to those that did struck the U.S housing market. To take an example, shocks such as huge decline in the inflow of remittances can increase the vulnerability to the wider financial system, and this was evidenced by the collapse of the core institutions in the U.S established to cater for the same. That is why, it seems crucial that Nepal government needs to undertake policies and make relevant strategies that will enhance viability in the country's financial structure to act as shock absorbers in the country.

Policy Recommendations and Future Reforms

Guaranteed to Fail concludes with a series of prescriptions by the authors in an effort to stave off any future financial crisis. These measures include tighter capital requirements, better regulatory oversight, and the possible reorganization of government-sponsored enterprises like Fannie Mae and Freddie Mac. Nepal can learn a lot from these ideas, after all the country needs massive infrastructure development and high capital expenditure to promote economic activities in its backyard. It seems that strong financial regulations are required to support these initiatives, and the case for good liquidity management (through rational use of the liquidity tools and open market operations) contributing as a support of financial stability. Adopting similar changes would help Nepal achieve a stronger financial system, less possibility of future crises and ensure that economic growth is sustainable yet resilient.

ANALYSIS IN THE CONTEXT OF NEPAL

Government-Backed Financial Institutions

The implications from the organizations presented in this book review attempts to provide a cautionary signal for Nepal focusing to the government institutions or the institutions that have a significant stake in the sectors such as energy and infrastructure. These organizations seem to be closely watched to avoid the circumstances in which they would engage in operations that may contribute to the embankment of the financial crises. Regarding the perspective, there are the issues connected with the increase of electricity production and the role of private investments in the development of the economy of Nepal. However, these initiatives have to be backed-up by sound risk management system (including the GRID concept) or else they might easily lead to over-leveraging of the financial institutions.

Regulatory Oversight

The absence of regulation that led to the crisis as presented in the book seems to show the significance of regulation in the Nepalese market. The growth in the sectors such as agriculture, tourism, and hydropower should be guarded from getting into a financial distress and to fall into the pit of over borrowing. In total, it seems important for Nepal to follow the recommendations made in the book (wherever appropriate) and consider the rigorous prudential regulations. For instance, as Nepal sees the need to generate a higher capacity of electricity and also to welcome more tourists. For this, it seems important that the implemented policies should be cautious to manage debt which seems risky in nature for the economy.

Systemic Risk Management

The issue regarding Nepal's financial position through the realization of Balance of Payments surplus and increasing remittances seems equally vulnerable to generating systemic risks. Since financial institutions seem to have a close linkage with each other, there are chances to affect other firms within the economy. The same thing happened in the case of the Credit Crunch in the US's housing industry. The regulators should be keen to support country's financial system whether it seems sufficiently capable of responding to shocks or not. Changes in the level of remittances or the shifts in global economic conditions seem important. In this way following the recommendations from the *Guaranteed to Fail* by prevention of systemic risks Nepal can strengthen its financial sector so as to make it stable for sustainable economic growth despite several hardships.

Housing Market Dynamics

The housing market or the real sector seems to be unsustainable and prone to risks every time in case of Nepal. When we align our reviews to this, we found that the housing market though is vulnerable to the external shocks, should be cautiously regulated. At the current times, where the regulation seems quite stringent and fully correct in terms of maintaining the stable financial system, we must also learn from the book that unless the economy is not backed up by the productive sectors growth, the sectors such as housing should not be heavily regulated. Or else it becomes difficult to dive the economy even a little bit.

Lessons from Global Financial Crises

The picture of the global economy and the effects of restrictive monetary policy along with the geopolitical instabilities entail that Nepal must carefully assess in terms setting the economic plans. To set the economic plans, the lesson that could be learnt from the financial crisis seems invaluable for Nepal. The best practices in financial regulation and in the systemic risk management allows Nepal to withstand the destructive impact of external shocks and it might lead to build a stable economy in the long run. Also, the development of the cross-border cooperation and adherence to the standards applied in the international sphere leads Nepal's dimensions to the global context. That is why, the lesson learnt from the economies from India and China concerning their inflation trends and the monetary stances seems invaluable for Nepal to deal with the challenges that come along with the global economic systems.

ANALYSIS WITH OTHER WRITERS

The financial crisis of 2007/08, as discussed in *Guaranteed to Fail*, underscores the critical flaws in the U.S. housing finance system. The government's intervention in these companies saved the institutions but created moral hazard by reinforcing the belief that large financial institutions would always be rescued, regardless of the risks they took. This pattern, while stabilizing in the short term, raises serious concerns about the long-term implications for capitalism and market dynamics. Ha-Joon Chang's *Kicking Away the Ladder* (Chang, 2002) offers a critical perspective on the issue of government intervention. Chang argues that developed countries, including the U.S., often promote free markets but rely heavily on government support and protectionist policies during critical phases of their own development. The bailouts of Fannie Mae and Freddie Mac exemplify this paradox, where governments, in moments of crisis, step in to save institutions that have grown too large to fail, yet advocate for free-market principles in other contexts. This is the inherent contradiction in Chang's view, and by extension those of many on global poverty which are, the resource shedding ladders would be legged away from nation states upon development, thereby leaving nations like Nepal with none to manage systemic risks. This has special relevance for Nepal, which needs to understand how the state can intervene and change this trajectory with an appropriate privatization strategy without falling into the same traps as during the U.S. financial meltdown when economic growth was driven by market rather than driven by the intervention-led economy.

To similar case, in an analysis of capitalism by Joseph Stiglitz, he has continuously emphasized the fact how oppression of unbalanced markets become more throbbing under capitalism without brakes, especially during government's intervention that bails out massive financial firms (Stiglitz, 2019). He believes that those kinds of measures lead to worsen the inequality and hurts the heart of the market economy as financial elites' interests come before those of the public welfare. This intervention again illustrates Stiglitz's doubts about the deficiencies of capitalism in that the concern with bailing out huge companies dominates the concern with more structural changes. For Nepal, the lessons learnt from Stiglitz's criticism are indeed the consequences. Since the government of the country is trying to expand (mostly and sometimes partially) its business with state-controlled investments in energy and tourism, it must ensure that only the rich do not benefit from such government initiatives. Rather, Nepal could use the example of growth during the crisis in the United States by encouraging growth which was not concentrated at the top of the power structure and where government measures were rather aimed at the economy than at the financial elite.

Another look into the effects of government intercessions and financial structures is given by Richard Werner in his book, Princes of the Yen in 2003 (Werner, 2003). Werner regards both monetary policy centralization and government credit management as negative for the financial bourgeoisie. He argues that these central banks are selective in extending credit to different economic units especially the large companies and financial institutions but deny other subsectors of the economy. Stiglitz and Chang have a similar view on capitalism and government bailouts, because the concentration in the financial system is a potential determinant of greater inequality and inefficiency. According to Werner's concept in coherence with Nepalese context, a reasonable financial decentralization may foster fair and organic growth of Nepalese local industries and small firms in particular. Nepal seem not to ask for the crony capitalisms by ensuring the monetary policy targets on general economic development instead of consolidating financial facilities to large state owned or affiliated corporations.

PROBABLE LESSONS LEARNT

Robust Regulatory Oversight

The events around Fannie Mae and Freddie Mac also give the idea of how important the role of the regulators is to ensure the financial sector is healthy or not. Regarding this perspective, we have seen several prominent institutions, which if not are well regulated, they become a root cause of the systemic risk. Especially in the case of Nepal, seeking to develop the financial sector and some strategic industries, seems to require a strong legal foundations and environments. Regulating financial transactions must be mandated to ensure the compliance to the standards by institutions to avoid situations that expose the economy to vulnerability of the credit risks. Through proper regulation therefore, Nepal have potentiality to avoid the shortcomings that led to the U.S financial crises in the 2007/08.

Moral Hazard Management

Moral hazard can be defined as a situation where the institutions are exposed to a potent level of risk, and they think that they are to be rescued by the government in case they completely go bankruptcy. This was the condition that was also helpful in the downfall of Fannie Mae and Freddie Mac. Also, it is a risk that Nepal needs to be cautious at, especially to the government owned institutions and public limited companies as well. It has been necessary that these institutions should be made accountable and should not be permitted to indulge in highly risky operations. The concept of responsible lending and responsible investment should be practiced to reduce the risks associated with the financial firms and to ensure financial stability in the long run. The indulgent in the reckless financial activities are of a much risky tasks, which in case of Nepal should be discouraged. The government institutions, public limited companies, and even the regulators in Nepal should be cautious to take care of this kinds of risks and that is controlled through the financial behavior of the firm. For instance, going beyond the directives and guidelines and seeking a loophole in the procedures seems fairly correct at the short run, however, in the long run it stockpiles a huge amount of risks to the aggregate financial sector.

Crisis's preparation

The financial crisis in 2007/08 made many institutions realize that they needed to be equipped with the measures to the tackle economic slowdown and financial disorders. It is clear that like any other country in the world, Nepal is also an open economy (registered in WTO) and therefore it becomes sensitive to both domestic as well as global economic forces. Because of this, the systemic risk has to be regulated and the adaptation to financial shocks has to be planned in prior terms. This becomes the key to the economic stability. This entails the development of the action plans, scenario analysis of financial institutions, and there being enough reserves in the cases of calamities. The external threats that threaten the development of Nepal including the geo-political risks and unstable world commodity prices are also the key factors that should be taken care of. In this way, Nepal becomes able to develop a specific strategic model of the proactive crisis management that in turn can assist to create a more robust financial system and make able to withstand external shocks.

Economic Growth's sustainability

Nepal, for instance, desperately needs to manage sustained economic growth in the prioritized sectors such as hydro power generation and tourism along with real estate development. In the U.S. financial crisis, speculation in housing—a source of unsustainable growth—again turned into a disaster. Nepal must make sure it does not drive into a bubble economy based on speculation and ensure the growth is led by chunks of the sectors only. This includes planning ahead, wise regulation, and investing wisely in policies that facilitate sustainable growth. Sustainable growth can help avoid the pitfalls of speculative booms and maintain a strong economy in Nepal for the years to come.

Global Experiences, the Lessons

One of the major conclusions that can be made after reading the *Guaranteed to Fail* is that the failure and success of other countries should be closely studied and analyzed in case of one's country as well. The financial crisis that occurred in the U.S should be used to educate people what can happen when systemic threats are unaddressed and when the regulatory frameworks are substandard. Thus, for Nepal it has been found that adapting best practices prevailing in the international financial regulation and simultaneously keeping updated on such regulation is of high importance. Specifically, in the banking sector, the adherence to the norms of BASEL guidelines (fully upgrading to the adherence to the III and studying for IV) should be looked again and again. For instance, the definition of high-quality liquid assets is still unknown in case of banks and financial institutions of Nepal, to adhere with one of the regulatory domains of the BASEL III norms. There are many more than this concerning with the monetary transmissions and using of the optimal buffers in maintaining capital adequacy of banks as well. The need for integration of the economic policies of Nepal with the international economic systems especially in the areas of inflation and monetary management should be a priority, however, taking only few variables should not only be an ultimate goal. For this, in case of central bank, the definition of goal and targets should be well understood by the policymakers and the stakeholders as well. When policymakers and analysts learn the international economic environment and adapt the best practices of the financial systems worldwide, Nepal ought to look at the future adversities and build a solid economic foundation.

CONCLUSIONS

Guaranteed to Fail offers a detailed investigation of the incongruities that precipitated the failure of the mortgage giants, which places emphasis on regulatory functions and soundness. Such lessons are true for the U.S. but also pose several important challenges for Nepal as it is in the process of expanding its infrastructure, working on the financial basin, and tends to depends on hydropower and tourism industries in the near future. The point of the book is that financial institutions which are guaranteed by the government, pose threats particularly if such institutions consider themselves as too big to go bust. Such perceptions lead to imprudent behavior with regard to risk management and lead to a crisis such as was witnessed in 2007/08 in the U.S. Since Nepal is undergoing structural transformation, these implications are especially relevant. Nepal should learn from this case and take timely measures to build a more resilient economic structure and control systemic risk. It is important to keep government backed institutions under control and financial operations within the horizons of growth as Nepal advances.

The concepts learned from *Guaranteed to Fail* are very much applicable in the current scenario of Nepal's economy. In view of these considerations, the key areas for reform in Nepal are to commit to strict regulatory enforcement, to contain moral hazard, to prevent and prepare for crises, to foster sustainable economic growth, and to learn from the global experiences. All these steps are important as the country grows and becomes more involved in the global market which means that it seems to be ready for the future prospects.

Disclaimer: The opinions presented in this study are the subjective opinions of the researchers and do not reflect the official stance of the institution where the writers work.

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