Contents

Editor-in-Chief v	The Intensity of Liberalization 38
Section Editors vii	Foreign equity portfolio holdings 39
Preface xix	Measuring Market Integration 40 Effects of Stock Market Liberalization 42
Contributors xxiii	Financial Effects 42
Contributors xxiii	Expected returns (cost of capital) 42
	Return volatility and correlation 42
 Financial Globalization and Crises: Overview 	Market liquidity 42
T. BECK, S. CLAESSENS, AND S.L. SCHMUKLER	Capital flows and contagion 43
	Macroeconomic Effects 45
Introduction 1	Investment and GDP growth 46
Evidence on Financial Globalization 3	Allocative efficiency and productivity 47
Forces Behind Globalization 4	Conclusion 48
Effects of Financial Globalization 6	Acknowledgments 48
Monetary and Exchange Rate Policy Under Financial Globalization 8	
Crises 9	4. Bilateral Financial Links
Final Words 12	F. SÁ
Acknowledgment 12	1.00
	Introduction 51
	Bilateral Data on External Assets and Liabilities 52
T	Main International Data Sources 52
1	Foreign Direct Investment 52
EVIDENCE ON FINANCIAL	Portfolio Equity and Portfolio Debt Securities 52
GLOBALIZATION	Foreign Exchange Reserves 53
GLOBALIZATION	Other Data Sources 54
2. Measurements of Capital and Financial Current	Euro Area Accounts 54
Account Openness	Individual Country Data Sources 54 Custodial Center Bias 54
D.P. QUINN, M. SCHINDLER, AND A.M. TOYODA	What Explains Bilateral External Financial Linkages? 55
D.F. QOINN, M. SCHINDLER, AND A.M. TOTODA	Theoretical Foundation for Gravity Models in Goods Trade 55
Measuring Financial Integration 16	Theoretical Foundation for Gravity Models in Cross-Border Asset
The IMF's AREAER 16	Trade 55
Indicators Based on the AREAER Categorical Table of	Information Asymmetries, Familiarity Effects, and Trust 56
Restrictions 18	Stylized Facts 57
Indicators Based on Text of AREAER 22	Data 57
Other De Jure Indicators 22	Network of Financial Linkages 58
De Jure and De Facto Data Compared 23	Undirected Network 58
Coding 23	Directed Network 59
Data Properties 26	Comparison with the Trade Network 60
Uses of Measures 31	Cross-Border Financial Links and International Transmission of
Conclusions 32	Shocks 63
Acknowledgments 33	Conclusions 64
	See also 64
Measurement and Impact of Equity Market	
Liberalization	Global Imbalances

ix

C. LUNDBLAD

Country Funds and American Depository Receipts 38

Introduction 35

Equity Market Liberalization 36

Official Equity Market Liberalization 36

M.D. CHINN

Spendthrift America and the Saving-Investment Approach 70

A US Productivity Surge and the Intertemporal Approach 71

The Contested Landscape of Global Imbalances 67

Global Imbalances Defined 68

East Asian Mercantilism and Bretton Woods II Versus Self-Protection 72 A Global Saving Glut? 73 Imbalances and the Financial Crisis 77 See also 78 Acknowledgments 78

6. Aid Flows

D. CASSIMON, D. ESSERS, R. RENARD, AND K. VERBEKE

Introduction 81 Situating Aid Flows Within Financial Globalization 82 The Particularities of Aid Flows 84 Aid Effectiveness and the NAA 87 Recipient Participation and Country Ownership 87 Harmonization and Alignment 89 Country Selectivity 92 Division of Labor 93 Importance of Budget Support 93 The Debate on Aid Effectiveness 94 Interaction of Aid Flows with the Larger Global Financial Architecture 94 Aid as a Catalyst, Complement, or Substitute? 95 Aid as a Stabilizing or Insurance Mechanism? 96 Aid Flows in the Global Financial and Economic Crisis 97 Appendix 99 See also 100

II

FORCES BEHIND GLOBALIZATION

Composition of International Capital Flows
 K. KIRABAEVA AND A. RAZIN

What the Chapter Is About 105 Introduction 106 Home-Court Information Advantage 107 Pecking Order of Capital Flows 107 Foreign debt investment 108 Foreign portfolio investment 108 Foreign direct investment 109 Debt Flows 109 Bank Loans and Banking Crises 109 Capital Flow Reversals 111 Equity Flows and Liquidity Shocks 111 Information-Liquidity Trade-Off Between FDI and FPI 112 Composition of Equity Flows and Financial Crises 113 Moral Hazard in Debt Contracts Under Limited Enforcement 114 Role of Bonds in the Presence of Home Bias in Goods and Equities 116 Home Bias in Goods and Equities 116 Real Exchange Risks and Financial Risks: Bonds Versus Equities 117 Conclusion 118 Acknowledgment 118

8. Migrant Remittances and Development D. RATHA AND S. MOHAPATRA

Introduction 121 Remittances Reduce Poverty 122 Remittances Improve Health and Education Outcomes of Recipient Households 122 Remittances can Provide Funds for Small Business Investments and Entrepreneurial Activities 123 Remittances Tend to Remain Stable and are Often Countercyclical to Crises and Natural Disasters 123 Remittances can have Some Downsides 124 Remittances can have a Positive Impact on Economic Growth and Development in the Presence of Supportive Institutions 124 Remittances can Improve Access to Capital Markets 125 Cost of Sending Remittances has Declined Steadily, but Remains High in Some Corridors 126 Post Offices, Savings Cooperatives, and Mobile Money Transfers can Play an Important Role in Reaching the Poorest 127 Remittances Data Need to be Improved 127 The International Remittances Agenda 127 Monitoring, Analysis, and Projection 127 Retail Payment Systems 128 Financial Access of Individuals or Households 128 Leveraging Remittances for Capital Market Access of Financial Institutions or Countries 128

International Mutual Funds, Capital Flow Volatility, and Contagion – A Survey

G. GELOS

Introduction 131 Portfolio Choice, Fund Managers' Incentives, and Consequences for Capital Flows 133 Theoretical Considerations 133 Empirical Evidence 134 Aggregate patterns 134 Herding 135 Momentum trading 136 Portfolio rebalancing and contagion 136 Transparency, Informational Asymmetries, Asset Allocation, and Capital Flow Volatility 137 Transparency and Asset Allocation 137 Transparency and Volatility 138 Empirical Evidence 138 Conclusions 140 Acknowledgments 140

10. Capital Raisings G. HALE

Introduction 145
Developed World: Patterns and Effects of Cross-Border Capital
Raisings 147
Portfolio Equity Issuance 147
Bond Issuance 148
Bank Loans 149
Effects of the European Monetary Union (EMU) 149

CONTENTS xi

Emerging Markets 150
Domestic Equity Market Development and Foreign Equity
Issuance 150
Private Bond Issuance 150
Bank Loans 151
Effects of Financial Crises 152
Capital Raisings During the 2007–09 Global Financial Crisis 153
Conclusion 153
See also 154

11. International Cross-listings L. GAGNON AND G.A. KAROLYI

Introduction 155
Some New (and Old) Wisdom on International Cross-listings 158
The Current State of the World Market for International
Cross-listings 159
Price Discovery, Multi-market Trading, and Arbitrage 167
The Dynamics of Multi-market Trading 170
Concluding Remarks 175
Acknowledgments 177

12. Disclosure of Ownership and Public Companies J.A. MCCAHERY AND E.P.M. VERMEULEN

Introduction 181 The Enron and Parmalat Examples 182 Disclosure of Beneficial Ownership 184 Inside and Outside Ownership: Costs and Benefits 184 The Importance of 'Strict' Disclosure and Reporting Mechanisms 185 Nominee and omnibus accounts 186 Derivatives 187 Control-enhancing mechanisms 187 Chains of corporate vehicles 188 Beneficial Ownership and Control: The Challenges 189 Related Party Transactions 190 Why Should One Care About Related Party Transactions? 190 Identifying Related Party Transactions: The Challenges 191 Disclosure of Beneficial Ownership of Corporate Vehicles 192 Corporate Vehicles and Their Potential for Misuse 193 An Example: Combating Illicit Use of Corporate Vehicles in Europe 195 Combating Illicit Use of Corporate Vehicles: The Challenges 196 Conclusion 197

13. Role of Trade Finance

Introduction 199
What is Trade Finance? 200
Risks Inherent in International Trade 201
Existing Evidence on Trade Finance Patterns Around the World
New Evidence on Trade Finance Patterns Around the World
Theories of Trade Credit and Trade Finance 205
Relationship Between Bank Credit and Trade Credit 206
Trade Credit Versus Bank Credit during the Financial Crisis 206

Trade Finance Behavior during the Most Recent Global Financial Crisis 207 Role for Policy Interventions to Support Trade Finance During the Crises 209 Conclusion 211

Foreign Bank Participation in Developing Countries

R. CULL AND M.S. MARTINEZ PERIA

Introduction 213
Foreign Bank Participation in Developing Countries: Trends and Regional Patterns 214
The Drivers of Foreign Bank Entry 217
Following Home Country Customers 217
Pursuing Opportunities in the Host Country 218
Restrictions on Foreign Participation and the Role of Crises 218
Mechanisms That Help Mitigate Information Costs 218
The Consequences of Foreign Bank Entry 218
Foreign Bank Presence, Efficiency, and Competition 218
Foreign Bank Penetration and Banking Sector Stability 220
Foreign Bank Entry and Access to Credit 221
Conclusions 222
Acknowledgments 222

15. Opportunistic Foreign Currency Debt Issuance M.R. MCBRADY AND M.J. SCHILL

Introduction and Overview 223
Related Literature 224
Other Opportunistic Debt Issuance 224
Other Explanations for FC Debt Issuance 224
Empirical Evidence on FC Debt Issuance 224
Long-Term IRP 228
Evidence on the UIP 229
Evidence on the CIP 230
Opportunistic FC Debt Issuance 232
Conclusion 236
See also 237

16. International Government Debt U. PANIZZA, F. STURZENEGGER, AND J. ZETTELMEYER

Introduction 239
Trends 241
Looking Beyond Averages 244
The Theory of International Government Debt 249
Evidence on International Borrowing and Default 250
Debt Structure and Debt Crises 252
Conclusions 253
See also 253
Acknowledgment 253

17. Carry Trade ò. JORDÀ

Introduction 257
Designing Carry Trade Strategies 258
A Trading Laboratory for the Carry Trade 260

The Trader's Decision Problem 261
Adjusting for Returns: KS*, AUC*, and Gain–Loss Ratio 263
Are Carry Trade Returns Compensation for Risk? 264
Conclusion 265

III

EFFECTS OF FINANCIAL GLOBALIZATION

18. Capital Market Integration W.R. CLINE

The Empirics of Financial Globalization and Growth 269
Statistical Tests for Crisis Impacts of Openness 271
Studies of Historical Crisis Incidence and Costs 273
Calibrating Ranges for Costs of Openness-induced Crises 274
Evidence from the Global Crisis of 2007–09 275
Conclusion 276
See also 277

Collateral Benefits of Financial Globalization AYKUT AND M.A. KOSE

Introduction 279
What Are the Theoretical Arguments for Collateral Benefits? 281
Financial Sector Development 281
Institutional Quality and Governance 281
Macroeconomic Policies 282
What Does the Empirical Evidence Say? 282
Financial Sector Development 282
Institutional Quality and Governance 285
Macroeconomic Policies 286
Does financial integration only a productivity grouph? 286

Does financial integration enhance productivity growth? 286
Financial Openness and TFP Growth: FDI and Equity Flows 286
Financial Openness and TFP Growth: De Jure and De Facto
Measures 287

Why TFP Growth but not Output Growth? 291 Conclusion 294 Acknowledgments 296

20. Foreign Direct Investment and Growth L. ALFARO AND M.S. JOHNSON

Introduction 299
Overview of the Recent Empirical Literature 301
FDI, Growth, and Productivity 301
FDI, Capital, and Labor 302
Complementarities 303
Channels, Mechanisms, and Linkages 304
Concluding Comments 307
See also 307

21. International Technology Transfer and Foreign Direct Investment

B.S. JAVORCIK

Introduction 311
Why should we Expect FDI to be a Source of Knowledge Transfer
Across International Borders? 311

Evidence on Knowledge Transfer to Foreign Affiliates 312
Knowledge Externalities 314
Spillovers Within Industries 314
Spillovers to Upstream Sectors 316
Spillovers of Knowledge About Export Markets 317
Conclusions and Policy Implications 318

Role of Multinational Corporations in Financial Globalization

S. KALEMLI-OZCAN AND C. VILLEGAS-SANCHEZ

Introduction 321
What Are the Determinants of FDI? 323
Macroeconomic Evidence 323
Microeconomic Evidence 324
Are There Any Growth Effects of FDI? 325
Foreign Investment, Volatility, and Crises 327
Conclusion 329

23. India's Reintegration into the World Economy in the 1990s

A. SHAH AND I. PATNAIK

From Autarky to Reintegration 333

Empirical Facts About Reintegration 334
Composition of Capital Flows 334
Internationalization of Firms 335

Foreign Portfolio Investment in the Equity Market 336
Concerns About Herding Behavior 337

The Role of FDI 338
Inbound FDI 338
Foreign Borrowing 339

Effectiveness of Capital Controls and the Exchange Rate
Regime 339

Domestic Finance and International Finance 341

Policy Questions About Capital Controls and Monetary Policy 342

See also 343

24. Reforms of China's Banking System J.R. BARTH, L. LI, T. LI, AND F. SONG

Challenges and Opportunities for China's Growing Economy and Developing Financial System 345
Past and Future Contributors to Economic Growth 345
Increasing Integration into the World Economy 346
Changing Composition of the Financial System 348
Current Financial Regulatory Structure 348
The Dominant Role of Banks in the Financial Sector 349
Major Recapitalization of the 'Big Five' State-Owned Banks 350
Banking Problems and Issues 351
Impacts of sterilization 351
Allocation of credit 352
Recent growth in bank credit 353

25. Policy Issues of China's Financial Globalization J.R. BARTH, L. LI, T. LI, AND F. SONG

China's Capital Markets Grow in Both Importance and Scope 355
Bond and Equity Markets Provide a Growing Source of
Funds 355

CONTENTS xiii

Opening of China's Capital Markets to Foreign Investors and Firms 356

China's Expansion Overseas Through Merger and Acquisition Activities and Foreign Investment by Firms 357

Monetary and Foreign Exchange Policy 359

Monetary Policy 359

China's Monetary Policy Targets 359

China's Monetary Policy Instruments 359

Exchange Rate Policy 361

Conflicts Between Monetary Policy and Exchange Rate Policy 361

Future Developments in China 361

Will Shanghai Replace Hong Kong as the Main International Financial Center? 361

What Will Be the Role of China's Currency in the Future? 362 Current Situation of RMB Internationalization 363 Bilateral Swap Agreements 363 RMB in Cross-Border Trade Settlements 364

See also 364

26. Financial Integration in Europe T. JAPPELLI AND M. PAGANO

Financial Integration and Financial Development 368

Barriers to Financial Integration 368

Financial Integration and Financial Development 368

Financial Integration and Growth 369

Financial Integration and Capital Mobility 370

Financial Integration and Risk Sharing 370

How Integrated are European Financial Markets? 371

Money Markets 371

Bond Markets 371

Stock Markets 373

Credit Markets 374

Prospects for Security Market Integration 375

Clearing and Settlement 375

Stock Trading Infrastructure 375

Government Bond Issuance 375

Transparency in the Corporate Bond Market 376

Prospects for Credit Market Integration 376

Prudential Regulation and Banking Supervision 376

Loan Contract Enforcement 377

Information Sharing Systems 377

Deposit Guarantee Schemes 377

Concluding Remarks 377

See also 378

IV

MONETARY AND EXCHANGE RATE POLICY UNDER FINANCIAL GLOBALIZATION

27. The Impossible Trinity (aka The Policy Trilemma) J. AIZENMAN

The Trilemma and Mundell-Fleming's Framework 381 The Trilemma Choices of Countries - Trends and Trade-offs 383 Testing the Trilemma 384

Beyond the Trilemma Triangle: International Reserves and the Impossible Trinity 385

The Trilemma and the Future Financial Architecture 387 See also 389

28. Financial Globalization and Monetary Policy S.B. KAMIN

Introduction 391

Globalization and Long-Term Interest Rates 393

Uncovered and Real Interest Rate Parity 393

A Rough Cut at the Data on Nominal Bond Yield

Spillovers 394

Recent Research Documenting Financial Spillovers 395

Identifying Globalization Effects Cross-Sectionally 398

Which Way do the Spillovers Run? 398

Spillovers in Action: The 'Conundrum' 398

Is Financial Globalization Reducing Central Bank Influence Over Bond Yields? 399

Exchange Rate Regimes and Short-Term Interest Rates 400

Do Floating Currencies Insulate Short Rates from External Shocks? 403

Are Exchange Rates Becoming More Responsive to Monetary Policies? 406

Are Exchange Rates Exerting Greater Effects on Macroeconomic Performance? 407

The Financial Crisis, Liquidity, and the Credit Channel 408

Reinforcement of Old Lessons 408

International Dimensions of Liquidity and Credit 408

New Challenges for Central Banks 410

Conclusion 411

Acknowledgment 412

See also 412

29. Interest Rate Parity

R.M. LEVICH

Introduction and Overview 417

Origins and Theory of IRP 417

Limits to Arbitrage and Factors Associated with Parity

Deviations 419

Empirical Evidence on IRP from the Last 50years 419

Early Empirical Studies 419

Refinements to the Traditional Model and Improved Data 420

Further Applications and Empirical Evidence

on IRP 422

Empirical Evidence on IRP During the Global Financial

Conclusion and Cautionary Notes on Parity Deviations 424 Appendix 425

30. Exchange Rate Regimes E. LEVY YEYATI

Introduction 429

Exchange Rate Regimes 429

Taxonomy and Classification 430

Trends 436

Why do we Care about ERR? 439

ERR and Growth 439

ERR and Inflation: Anchors 440
Other Links: Trade, Finance 441
Exchange Rate Policies in the Post-Bretton Woods Era 442
Exchange Rate Anchors in the 1980s 442
Financial Integration and Financial Crises in the 1990s 443
Float cum Inflation Targeting 444
Leaning-Against-the-Wind Exchange Rate
Intervention 445
The prudential motive 445

Taking Stock 448

31. Currency Unions

J.M.C. SANTOS SILVA AND S. TENREYRO

Introduction 451
The Benefits 452
Increased Trade 452
Increased Capital Integration 454
Commitment Gains 454
The Costs 455
Similarity of Shocks and Inflation 455
Factor Mobility 456
Openness 457
Economic Diversification 457
Price and Wage Flexibility 457
Fiscal Transfers 458
Concluding Remarks 458
Acknowledgment 459

The mercantilist motive 447

32. Financial Dollarization

A. IZE

Introduction 463 Background 464 Definitions 464 Trends 464 Relative Magnitudes 465 Determinants 466 Financial Equilibrium 466 The Price Risk Paradigm 467 The Credit Risk Paradigm 469 The Risk-Shifting Paradigm 470 The Financial Environment Paradigm 471 Structural Dollarization 471 Empirical Evidence 471 MVP-Based Explanations of Dollarization 472 Going Beyond Observed MVP 472 Costs and Risks 473 Limits to Monetary Policy 473 Financial Fragility 474 The Policy Agenda 475 Efficient Versus Pathological Dollarization 475 What can be Done? 476 Conclusion 477 Acknowledgment 478 See also 478 Appendix 478

V

CRISES

Models of Currency Crises R. GLICK AND M.M. HUTCHISON

Introduction 485 Causes of Currency Crises 486 Currency Crisis Models 486 Impossible Trinity 486 Association with Other Crises 487 Incidence of Currency Crises 488 Crisis Definitions and Measurement Issues 488 Frequency of Currency Crises 489 Predicting Currency Crises 490 Determinants 490 Statistical Methodology 491 Event study approach 491 Signaling approach 491 Probit and other approaches 493 Assessment of Crisis Prediction Approaches 493 Globalization, Capital Controls, and Currency Crises 493 Effects of Currency Crises 495 See also 496

34. Predictive Indicators of Financial Crises M. CHAMON AND C. CROWE

Survey of Early Warning Models 499
Early Warning Models by Investment Banks 501
IMF Work on Early Warning Systems 501
Conclusion 504
See also 504

35. A Perspective on Predicting Currency Crises R.P. FLOOD, N.P. MARION, AND J. YEPEZ

Introduction 507
Literature Survey 508
A Model of Currency Crises 511
Data Generation 512
Devaluation Crises 513
Estimating Crisis Probabilities 514
Method 1: Structural Method 515
Method 2: Logit 515
Method 3: OLS Method 515
Accuracy of the Estimated Probabilities 516
Conclusion 521
Appendix:Data Used 522

36. Empirical Literature on Financial Crises: Fundamentals vs. Panic

I. GOLDSTEIN

Introduction 523
Empirical Evidence on the Role of Fundamentals 524
Banking Crises 524
Currency Crises and Twin Crises 526

CONTENTS

Contagion 526 What do we Learn from the Evidence about the Role of Panic? 527 How can we Test for Panic? 529 Conclusion 532 See also 532

Acknowledgments 533

37. Sudden Stops in Capital Flows A. IZQUIERDO

Introduction 535 Empirical Definition of a Sudden Stop and Evidence on the Costs of Sudden Stops 536 Costs of Sudden Stops 539 Determinants of Sudden Stops 539 Ex-ante Policies and Policy Responses to Sudden Stops 541 Conclusion 543 See also 544

38. Definitions and Types of Financial Contagion M. PRITSKER

Introduction 547 Definitions of Contagion 547 The Channels for Shock Transmission 550 Trade Links 550 Transmission through trade during normal times 550 Transmission of exchange rate crises 551 Financial markets 552 Correlated information 552 Wealth effects and risk aversion 552 Deleveraging and margin calls 553 Patterns of comovement 553 Banking 553 Common creditor 554 Interbank deposits 554 Correlated information 554 Asset fire sales 555 Summary 555 The Empirical Literature on Contagion 555 Recent Examples of Contagion 556

Asian Financial Crisis of 1997 556 The Great Recession of 2007-09 556 See also 558

39. Cross-Border Banking: Regulation, Supervision, and Crisis Resolution

L.D. WALL

Introduction 561 Significance of Cross-Border Banking 562 Importance of Incentive-Compatible Supervisory and Resolution Structures 566 Illiquid and Insolvent Banks 567 Lender of Last Resort 568 Resolution of Failed Banks 568 Prudential Supervision 570 Microprudential Supervision 570

Macroprudential Supervision 571 Conclusion 572

40. Market-Based Approach to Financial Architecture

G.R.D. UNDERHILL

XV

Introduction 577 Postwar Background 577 Discomfitures of Reality 578 Toward Financial Globalization 1971-80s 579 Financial Globalization and 'Governance Light' 1990-2007 583 The Crisis-Reform-Crisis Dance 583 Back to the Future of Instability and Crisis See also 586

41. Housing Is the Business Cycle

E.E. LEAMER Introduction to the Revision 590 Introduction 591 Housing and Academic Macroeconomics 591 Warning: Causal Conclusions from Temporal Orderings 592 Summary 593 The 3-3 Rule of US Real GDP 594 Temporal Orderings of Components of GDP 595 Residential Investment is a Small Part of Long-Term Growth 595 The Residential Investment Contribution to US Recessions is Huge 596 A summary table 600 Average cumulative abnormal contribution: seven consumer cycles 602 What about False Positives? 604 Multivariate Confirmation: It is a Consumer Cycle, not a Business Hormones and Housing: It has been a Volume Cycle, not a Price Cycle 606 Sales Prices and Volumes of New and Existing Homes in Los New Homes Nationwide have a Volume Cycle, not a Price Cycle, too 608 Fixed Price Stories 609 This Time was Different 612 The Phases of the Housing Financial Cycle: Hope, Hype, and Havoc 613 A Story of the Financial Cycle 614 Evidence of Diminished Underwriting Standards: Appreciation Greatest for Cheaper Homes 614 (Non)Evidence of Diminished Underwriting Standards in Idiosyncratic Risk 616 The Conflicts between Housing and Inflation Targeting 617 Homes and Consumer Durables Create Special Control Problems 617

Inflation is Persistent, But for Housing, It is the Cycle that is

Persistent 619

Policy Conflicts among the Targets: Inflation Unemployment and Housing 619

Estimated Regressions for the Fed Funds Rate and Housing Starts 620

A Report Card Based on the Housing Target 622

By the Way 626

The Great Depression: Housing Again! 626

Durables and the Wealth Effect 626

International Evidence 626

Conclusion 627

The Pertinent Facts: It is a Consumer Cycle, not a Business Cycle 627

Policy Targets 627

Appendices 628

Correction of the Defense Filter 628

Probit Models for Predicting Rising Unemployment 628

Case-Shiller Regression 630

Details of Contributions in All Ten Recessions 633

42. US Stock Market Crisis of 1987 M. CARLSON

Introduction 645 Background 646

Timeline of the Crash 647

Wednesday, 14 October-Friday, 16 October 1987 647

Monday, 19 October 1987 648

Tuesday, 20 October 1987 649

Factors That Contributed to the Severity of the Crash 650

Margin Calls 650

Program Trading 651

Technical Problems 652

Difficulty Obtaining Information 652

Response of the Federal Reserve 652

Conclusion 655

See also 655

43. Mexican Financial Crisis of 1994–1995

A. MUSACCHIO

Origins of the Crisis 657

Trade Liberalization 657

Liberalization of Capital Flows 658

The Mexican Peg 659

The Consequences of Financial Liberalization 659

Mexico's Bank Privatization 660

Investor Enthusiasm 661

The System under Stress in 1994 662

Consequences of the 1994 Crisis 663

Crisis and the US Bailout 665

What did Mexico Gain in the Long Term? 666

44. East-Asian Crisis of 1997

S.R. GHOSH

Introduction 669

Origins of the Crisis 670

Dimensions of Vulnerability and Their Causes 671

Introduction 671

Dimensions of Vulnerability 672

Macroeconomic vulnerability 672

Banking sector fragility 672

Corporate sector vulnerability 676

Causes of the Buildup in Vulnerability 676

Incentives for short-term external borrowing spurred by

macroeconomic policy responses 676

Regulatory and supervisory weaknesses in East Asia's financial sectors, leading to financing of risky investments and

weakening balance sheets 678 Weaknesses in corporate governance and transparency,

leading to overleveraging and inefficient risky

investments 680

Microeconomic factors contributing to the buildup of vulnerability 682

Onset of the Crisis and the Role of Contagion 683

Why Was the Crisis So Protracted? 686

Structural Nature of Problems and Coordination Issues 686

High Leverage 686

Conclusions 687

45. Financial Globalization and the Russian Crisis of 1998

B. PINTO AND S. ULATOV

Introduction 689

Global Context 690

The Country Crisis 690

Russia's 3-year Road to the 1998 Crisis 690

The Stabilization Program 691

Impact on the Enterprise Sector 692

Impact on Government Debt 693

The Crisis and Eventual Meltdown 695

Financial Globalization and Russia 1998 697

Improving Sentiment 697

Capital Inflows 698

Russia's Banks 700

Moral Hazard 701

Financial Globalization and the Meltdown 702

Lessons and Insights from Russia 1998 70

Concluding Remarks 706

See also 706

Acknowledgment 706

46. Argentina's Default of 2001

Introduction 709

Economic Performance Under the Convertibility Plan,

1991-98 710

Early Achievements, 1991-94 710

The Mexican Crisis and Recovery, 1995-98 711

Economic Difficulties, 1998–2001 712

Recession and Early Signs of Economic Distress, 1998–2000 712

The Crisis Unfolds, 2001 712

Economic and Political Background 713

Economic Origins of the Crisis 713

Fiscal Policy Developments 714

CONTENTS xvii

Political Background to the Crisis The Default and Its Aftermath 716 The Collapse of the Convertibility Regime 716 Dislocation and Subsequent Recovery 717 See also 719

47. Assessment of Solutions to US Financial Crisis of 2008-09

C. HO AND F.M. SIGNORETTI

Introduction 721 Measures Introduced between September 2008 and Mid-2009 Timeline 722 Phase One (September 2008): Standalone Support Actions for Large Institutions 722 Phase Two (October 2008): Comprehensive Support Packages 722 Phase Three (November-December 2008): Fewer New Programs, more Standalone Actions 722 Phase Four (January-April 2009): New Packages with more Emphasis on the Assets Side 722 Phase Five (May-June 2009): Exiting for some, Just Getting Started for Others 724 General Characteristics of Measures 724 Capital Injections 725 Debt Guarantees 726 Asset Purchase and Guarantees 726 Cross-Country Snapshot as of June 2009 726 Adoption 726 Magnitudes 729 Participation in Programs 729 Bank-Level View 731 Effect of Government Rescue Measures on Banks 731 CDS Premia 731

Market-Level Reactions to Announcements of Program

Packages 731 Bank-Level Reactions to Bank-Specific Announcements 732

Stock Prices 732 Financing Behavior 733

What Happened After June 2009: A Brief Update 733

Recapitalizations 733 Debt Guarantees 734

Asset Purchases and Guarantees 734

48. A Cross-Country Perspective on the Causes of the Global Financial Crisis

S. CLAESSENS, G. DELL'ARICCIA, D. IGAN, AND L. LAEVEN

Introduction 737 Causes of the Crisis 738 Commonalities with Previous Crises 738 Asset price bubbles Credit booms 739 Marginal loans and systemic risk 741 Regulation and supervision 742 New Dimensions of the Crisis Increased opaqueness 742 Financial integration and interconnectedness 743 The role of leverage 745 Central role for households 745 The Evolution of the Crisis 746 The Channels and Mechanisms of the Crisis 747 Government Interventions to Resolve the Crisis 748

49. Lessons and Policy Implications from the Global Financial Crisis

Conclusions: Crisis Resolution Going Forward and the Path to

Economic Recovery 751

See also 752

S. CLAESSENS, G. DELL'ARICCIA, D. IGAN, AND L. LAEVEN

Introduction 753 Lessons for Macroeconomic Policy 754 Lessons for Redesigning Prudential Regulation and Supervision 755 Regulatory Perimeter 756 Microprudential Regulation 757 Macroprudential Regulation 758 Information and Market Discipline 758 Organization of Regulation and Supervision 759 Lessons for Reform of the International Financial Architecture 759 Conclusion 761

Index 755