Comments on Guillermo A. Calvo, "Crises in Emerging Market Economies: Global Perspective"

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Major Arguments of this paper

- **Emerging market experienced a series of crises, associated with huge capital inflows followed by Sudden stops in the 1990s**
  - **Globalization Hazard**
  - **Tequila 1994 and Asia/Russia 1997-98 were a huge shock in EMBI Spread**
  - **Current Account behaviors different after 1994 and after 1998**
- **Global factors are important, along with domestic fundamentals**
- **Global solutions are needed**
  - **E.g., Emerging Market Fund (EMF)**

My comments on this paper

- **Immediate Reactions to the arguments**
- **Asian Perspectives**
  - **How we see the “sudden stops” episode**
  - **How Asian Countries have reformed since the 1997-98 crisis**
  - **Movement toward “self-insurance” and “regional mechanism”**
- **LLR or PSI?**
- **Case for an Independent IMF**

(1) Globalization Hazard

- **Emerging market (EM) crises—globalization hazard**
  - **"Greater access to the global capital market has made those economies more vulnerable to shocks coming from the capital market itself" (p.2)**
  - **Global capital market, external to EM, disturbances plus local factors**

Tequila & Asian/Russia Crises

- **Figure 1: EM world different after 1998**
  - **EMBI incr, above 1,500 bp in both crises**
  - **Current account remained negative after Tequila, but turned positive after Russia**
- **Figure 2: Responses of I and Y different between Latin America and Asia**
  - **Latin America, benign in 1997, but sharp decline from 1998, until 2003**
  - **Asia, sharp decline 1997-98, but V-shape recovery after 1998**
  - **But investment and growth rate remained lower than peak 1996 in Asia; permanent scar? Or correction of over-investment?**

Recovery (Phoenix)

- **Strong V-shape recovery in output, exports, etc**
- **Post-crisis recovery, only a fraction of the level before the crisis**
  - **Domestic bank credit**
  - **Current account deficits**
  - **Investment**
- **Interpretation?**
  - **Good to get rid of "over-borrowing" or a permanent scar?**
- **Global phenomenon: "The *Phoenix Miracle* suggests that systemic Sudden Stops are *preventable accidents.*" "If the triggering factor is external to Ems then global solutions are called for." (p.3)**

Sec 3, Model

- **Model in Sec 3,**
  - **Explains increase in r (sudden stop) will affect the profit max EM firm**
  - **More info on production function may increase the relative-price volatility, but welfare increasing**
- **A model is good to explain the cost of the sudden stop, but**
- **A model does not explicitly explains the difference between solvency crisis vs. liquidity crisis, or global nature of the sudden stop (we need analysis of lenders)**

Sec 4, empirical evidence

- **Bunching of sudden stop episode**
  - **External roots**
  - **Sudden stops => large depreciation**
  - **Sudden stops => dollarized liability**
  - **Sudden stops => volatility in relative prices Fig 7 (as expected in theory)**
- **Sudden stops are largely prompted by external factors, but the probability of sudden stops reflects domestic characteristics (p.26)**
- **Comments: full modeling of early warning of signals may be called for to distinguish external factors and domestic factors?**

Policy issues: domestic

- **Calvo thinks that sudden stops are preventable accidents**
  - **Yes, I agree. But task primarily rests on EM**
- **Domestic policy**
  - **Low exposure to foreign-denominated debt (Low DLD)**
  - **Discourage large private debt in terms of foreign exchange by levying a tax on total borrowing (not just int'l borrowing) – side effect**
  - **Discourage foreign-exchange-denominated borrowing by large exchange rate fluctuations – side effect**
  - **Chile suffered sudden stop (wrong response to Russian crisis), but did not have LDL. No current account deficits and public debt was tiny.**

Policy issues: global

- **Calvo asks: What Russia taught us?**
  - **Margin calls**
  - **Reverse moral hazard**
    - **I would say unintended PSI**
- **EM Fund (EMF), to stabilize an EM bond price or spread index—Calvo (2002)**
  - **Would it prevent currency depreciation? How to differentiate fundamental spread increase vs. global liquidity problem**
  - **Who takes risk? Who provides funds?**
  - **Is it better to have LLR in bonds (EMF in Latin America) rather than LLR in exchange rate (Asian Monetary Fund) ?**

My variations of Calvo's theme on global and regional issues

Asia's response

Role of IMF

Independence of IMF

Asian responses, post-crisis

- **Causes of the Asian crisis**
  - **Exchange rate regime**
  - **Too much borrowing**
  - **Double Mismatch**
  - **Vulnerable financial sector (twin crises)**
  - **Lack of LLR when needed**
- **Corrective Action**
  - **Managed Float (exception, China, HK, Malaysia)**
  - **Simply say “no” to borrowing (no borrowing.)**
  - **Pile up foreign reserves (instead of LLR)**
  - **Regional Chiang Mai Initiative (instead of LLR)**
  - **Develop Asian Bond market (double match)**
  - **Strengthen Sup and Reg of the banking sector, accept foreign capital into the banking sector (least popular option)**

Global Solution?

- **Too little, too late in Asian/Russian crisis and post-crisis reform**
  - **LLR—too late to introduce SRF**
  - **PSI—fail to push Int'l Bankruptcy Court, or SDRM master**
  - **CCL—good idea, in first glance, but cannt fly for good reason, and crashed to ground**
- **Role of regional response**
- **Role of "self-insurance"**

Role of IMF, 1997 vs. 2007

- **1997**
- **Large financial needs: Access limit and IMF borrowing constraint**
  - **SRF**
  - **NAB and Quota incr.**

- **2007**
- **Not enough borrowers: Cannot earn enough to cover operational costs**
  - **Why they pay back in a hurry?**
  - **Why no more crisis?**

IMF worries about a crisis

- **Calvo's worry**

  "Without new and effective global instruments, the old modus operandi in which IMF missions are sent to nurse the woulds of economies hit by crisis may still alleviate the pain, but it is unlikely to wipe out the plague" (p.2)

- **No, Guillermo. IMF's worry is opposite**
  - **Plague does not seem to happen in the 21st c. unlike the prediction of Camdessus**
  - **No more plague? No more earnings!**
- **Is "no plague" temporary or semi-permanent**

IMF in a no-crisis era

- **Two interpretations:**
  - **(Kind interpretation) Is IMF like a doctor who discovered the virus of the plague (global financial flue) and developed antidote, then found herself unemployed because of no patient—producing vaccine (surveillance) does not support the huge R&D team**
  - **(Cynical interpretation) IMF treatment was so painful (apply salt to the wounds, rather than “nurse the wounds”) that patients became extra careful in keeping themselves healthy and fit. No smoking, no fatty diet, no drinking**

A Case for independent IMF

- **IMF needs to find new mandates in the preventive medicine-no plague era**
  - **Multilateral Surveillance**
  - **New “insurance” (disguised CCL)**
  - **Occasional LLR-type operations when warranted**
- **IMF needs to become “independent” to be effective in carrying out new mandates**
  - **“Independence” like a central bank**
  - **Decisions for LLR have to be non-political**
- **IMF has to represent members fairly**
  - **Adjust quotas and ED chair so that they reflect economic reality. Implement theoretical quotas**
- **Reference: Eichengreen, De Gregorio, Ito, Wyplosz, *An Independent and Accountable IMF*, Geneva, 1999**