

PREFACE

No sooner had the Asian crisis broken out in 1997 than the witch-hunt started. With great indignation every Asian economy pointed fingers. They were innocent bystanders. The fundamental reason for the crisis was this or that – most prominently contagion – but also the decline in exports of the new commodities (high-tech goods), the steep rise of the dollar, speculators, etc. The prominent question, of course, is whether contagion could really have been the key factor and, if so, what are the channels and mechanisms through which it operated in such a powerful manner. The question is obvious because until 1997, Asia's economies were generally believed to be immensely successful, stable and well managed.

This question is of great importance not only in understanding just what happened, but also in shaping policies. In a world of pure contagion, i.e. when innocent bystanders are caught up and trampled by events not of their making and when consequences go far beyond ordinary international shocks, countries will need to look for better protective policies in the future. In such a world, the international financial system will need to change in order to offer better preventive and reactive policy measures to help avoid, or at least contain, financial crises.

These questions are not simply “academic.” There are a number of immediate, important issues. If there is contagion – imported crises so to speak – are capital controls the right answer as Malaysia concluded? How important is the choice of an exchange rate regime – fixed, managed or floating – on outcomes such as growth and financial stability? If contagion is not the critical issue, how can Asian countries that firmly hold that view be persuaded otherwise? If the volatility of major currencies is the problem, should the entire system be changed or should national balance sheets be better managed? These are interesting questions not only for national policy makers, but also for lenders who must contemplate their diversification and exposure risk in their emerging markets' positions.

This book brings together a formidable body of research on every aspect of this problem. It approaches these questions from a number of very different vantage points. There are studies that question outright the well-accepted contagion paradigm, while other chapters fully document the existence of contagion. There are studies focusing on financial channels in the transmission of crises, while other chapters highlight trade. Several studies highlight precautionary measures such as early-warning indicators, while others consider damage assessment and optimal policy responses. The strength of the volume is that it offers such a wide variety of views, rather than beginning with a common finding and imposing a common conclusion for every study.

This book is based on a selection of the papers prepared for the conference “International Financial Contagion: How it Spreads and How it Can Be Stopped” held at the International Monetary Fund on February 3-4, 2000. The conference was jointly sponsored by the World Bank, Asian Development Bank, and International Monetary Fund, with initial funding provided by WIDER. Participants in the conference included representatives from international institutions, individuals from the private sector, leading academics and economists, and the press. The emphasis of the conference was on sharing and discussing current research on the financial market turmoil of the late 1990’s. The conference concluded with a round-table discussion on how to rebuild the global financial architecture to reduce this turmoil in the future.

It is difficult to avoid being impressed by the very high level of quality in this research collection. For those who attended the conference meetings, this comes as no surprise since the atmosphere was wonderfully dynamic and full of tough give and take. That flavor is not lost in this more formal rendition. The work reported here, far from resolving the issues, opens up an important area of applied research in terms of approaches and country studies. Before this conference, very little was available in this area. Policy makers, policy research departments and students of emerging-market finance will find a wealth of information in this book. They will also find some answers, plenty of controversy, and lots of open questions.

The editors are to be congratulated for bringing together this important body of research.

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