

Preface

This book contains papers on capital market issues in Emerging Market economies (EMs). These issues caught the public's eye during Mexico's Tequila crisis in 1994–95 and have not ceased to grab the headlines since then. Over the last fifteen years EMs have been pleasantly raised by the tide of capital inflows, only to be rudely thrown back to the ground by a crisis in which credit stops and exchange rates jump out of control. These episodes have hit everyone, saints and sinners alike.

When Mexico and Argentina were hit during the Tequila episode, many observers attributed the crisis to low saving rates and simply saw it as a replay of the crises of the early 1980s. However, this view got a serious jolt in 1997 when several East Asian economies suffered similar crises despite displaying awe-inspiring high saving rates. Finally, all conventional views held prior to 1994 were thrown into disarray after the Russian crisis in 1998. Russia represents a tiny share of the world's output, commerce, and finance. However, the Russian default resulted in a massive collapse of EM bond prices even though it entailed only a partial repudiation of Russia's *domestic* debt.

The issues raised by the above episodes are still hotly debated. Thus, it seemed to me that the time was ripe for putting several of my crisis papers between two covers. I thought too that the collection should contain not only the most refined version of an idea, but also papers in which the idea was taking shape. This has the advantage of presenting the issues from the "front lines." This may be especially valuable for younger generations that have not lived through these episodes. The papers cover a wide range of topics, from a search for stylized facts to formal theories focusing on a narrow but relevant issue. However, the introductions to the book and to each of the first four parts motivate and outline the main issues covered by the papers and, in some cases, provide context to the discussion.

A book like this is not produced in a vacuum. To begin with, several of the papers in this collection are coauthored with a group of first-rate scholars: Allan Drazen, Alejandro Izquierdo, Leo Leiderman, Enrique Mendoza, Rick Mishkin, Carmen Reinhart, and Ernesto Talvi. These scholars and many other friends and colleagues have helped me shape a veritable morass of fact and opinion into (I hope) simple ideas and stylized facts; besides, I have learned a lot from their own research.

To be sure, what remains from a decade of thinking and research is, in essence, very little. However, paradigm change is, as a general rule, based on what initially appears to be a slight change of focus. I do not claim that my effort has resulted in a paradigm change, but I sense that the research that has taken place in the last decade—while still short of earth-shaking results—has laid the ground for a major revision of the way we think about financial crises and policymaking in Emerging Market economies. That is why, through several years of thinking and writing on these issues, I have experienced first-hand the difficulty of articulating and “selling” new ideas. In order for new concepts to take root, first they must be accepted by a select group of individuals who are prepared to think “outside the box.” I was very fortunate to find such a group with a predisposition to help me nurture “baby” ideas, while ensuring that the babies followed the straight and narrow path of logical and factual consistency. Moreover, being a member of a group with those characteristics was instrumental in enhancing the persuasiveness of the new concepts, and leveling the playing field in the battle against outdated concepts that stubbornly refuse to go away. In this respect I cannot help but cite John Maynard Keynes in (the last sentence of) the preface to his *General Theory*: “The difficulty lies, not in the new ideas, but in escaping from the old ones, which ramify, for those brought up as most of us have been, into every corner of our minds.”

The production of this book would have been very hard without the help of Pilar Bilecky. Pilar has been my guardian angel at the Inter-American Development Bank for more than three years, helping me to find the time for this task in a busy schedule, and efficiently monitoring the gestation of this book through all the stages of production.

I am also thankful to the institutions that housed me while these papers were written: the International Monetary Fund, the University of Maryland, and the Inter-American Development Bank. The first and the last gave me a view of the battleground that would have been inaccessible from the ivory tower; they also provided me with a keen sense

of the relevant policy issues. Finally, the University of Maryland gave me the opportunity to write and speak without fearing the rage of some powerful bureaucrat or politician.

By now I have clearly established that my debts are multiple and large, but there is still one collaborator who has remained unmentioned and for whom I cannot find the words to express my boundless gratitude: Sara Calvo. Sara has been my companion for over twenty years. She singlehandedly lifted me from the dark caves of the Nibelungs to the thin air of Valhalla. While covering my back, she provided invaluable professional expertise and knowledge, helping me not to get easily distracted by the lovely rainbow, and to pay more attention to the wise voice of Erda. The equilibrium that Sara brought to my life has kept my mind focused on the exciting issues covered in this book while holding steady my fingers on the keyboard.