Foreword by David Lipton, First Deputy Managing Director, International Monetary Fund

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Financial crises are damaging and contagious, prompting calls for swift policy responses when they happen, and justifying much effort to avoid them. As seen in recent years, crises can result in deep and long-lasting recessions, and trigger, in some cases, sharp current account reversals. Unsustainable macroeconomic policies, excessive credit booms, large capital inflows, and balance sheet fragilities appear prominently as common patterns prior to financial crises. However, not all crises are preceded by such events. Some crises can be contagious and rapidly spread to other countries with no apparent vulnerabilities.

The quest for knowledge on the best predictors of and the best policy responses to financial crises is an ongoing task. There has been an extensive research program on various aspects of crises, including analyses of centuries-old episodes. The IMF has been closely involved in the resolution of crises and mitigating their macroeconomic impact. In addition, the Fund has pursued a comprehensive research agenda over the years to analyze the causes and consequences of financial crises, to develop best measures to prevent crises, and to formulate strategies to cope with their consequences. Moreover, the Fund has been a major international forum for researchers and policymakers to debate and exchange their views on these issues.

As a result of these collective efforts in academia and policy institutions, there is much accumulated knowledge on the causes, evolution, and resolution of various types of crises. Despite the progress so far, these issues remain topics of intense policy discussions, as ongoing events clearly remind us every day. As such, there is much value in having leading researchers in the field of financial crises provide their cutting-edge perspectives on the topic, combining their contributions with those of economists at the Fund, and to disseminate their insights broadly. This book exactly serves this purpose.

Prevention is always the best cure, so the book includes a detailed analysis of the key factors leading up to financial crises. For example, credit booms are a particular characteristic that comes up as one of the most powerful predictors of crises over decades, as Alan Taylor's contribution makes again clear. Increases in leverage and rapid credit growth are patterns that seem to repeat time and again. The contribution by Carmen Reinhart and Kenneth Rogoff, building on their studies of crises over a very long history, makes this pattern very evident. In addition, funding fragility shows up prominently, in particular during the recent crisis, as Hyun Shin's contribution documents.

The book has valuable lessons on how countries can better monitor their economies and financial systems. However, due to rapid changes in financial systems and growing linkages among economies, it remains quite difficult to find robust patterns that can help us in predicting crises accurately. Surely, given the developments witnessed during the latest episodes, the view that only emerging markets are prone to crises is wrong. Advanced economies were at the epicenter of the crisis, while many emerging markets proved relatively resilient. In his contribution, José de Gregorio provides an elegant perspective on the sources

of this resilience in the context of emerging markets in Latin America, and explores the potential lessons for other emerging markets and advanced countries.

In addition to the contributions from these eminent scholars, a number of contributions from researchers at the IMF working on these issues are presented in the book. These focus on the causes and consequences of financial crises, and best policies for their resolution. They reflect that Fund research and policy activities are geared to improving its crisis prevention and resolution toolkits, covering surveillance, technical assistance, policy design and emergency lending.

Recent work on credit booms and banking crises conducted by IMF researchers confirms academic research on the critical role of rapid credit expansion prior to crises. This work has found that one in three boom episodes ends up in a crisis. While it is difficult to differentiate a good credit boom from a bad one *ex-ante*, this research shows that bad booms tend to be longer. Specifically, roughly half of the booms lasting longer than six years end up in a crisis.

Research conducted at the Fund also documents that cross-border financial linkages have intensified over time and become more complex. While increased linkages promote risk diversification by reducing exposure to local shocks, global financial networks also facilitate transmission of shocks and can make the sudden elevation of systemic risk more likely. When such risks materialize and turn into systemic crises, they affect a large number of countries, including "bystanders," i.e., those countries with relatively strong fundamentals and less vulnerable to an idiosyncratic crisis.

As research advances, we hope to further improve early detection of vulnerabilities. As we learn more about *ex-ante* incentives and factors that lead to financial fragility, we will be able to design better policies, including macro-prudential ones, and improve the institutional infrastructure, strengthen supervision, and thereby reduce the incidence of crises. Having said this, I am realistic enough to realize that there is a long road ahead in having the knowledge and tools available, combined with the necessary political will, to prevent all financial crises.

It is clear that political economy considerations are often at the core of the challenges policy makers face in preventing and coping with financial crises. They were an obstacle in the past hampering the design of an efficient policy response and they have also been present in recent crises. Much needs to be explored to design effective regulatory and supervisory interventions when the signs of excessive risk-taking demand strong actions. The rapidly flourishing area of research on macro-prudential policies can help provide some answers towards a better design of such interventions.

The findings presented are not just important for crisis prevention, but can also guide the appropriate design of international lending instruments and safety nets, including those of the Fund. For example, to reduce the incidence and scale of crises brought on by contagion, resources should be pooled globally. This would help provide proactively the necessary liquidity to avoid self-fulfilling crises and reduce the risk of contagion. In turn, this provides policy space for innocent bystanders. The Fund has internalized this lesson, by quadrupling its resources and revamping its lending toolkit by giving greater emphasis to crisis insurance.
Although further research in this area can help in many dimensions, there are challenges

ahead and it is inevitable that crises will happen again. Therefore, the global policy community should also continue devoting efforts to buttressing our understanding of crisis resolution policies. As papers in the book show, designing a strategy for resolving a crisis and formulating policies to accelerate economic recovery involve many tradeoffs. Resolution policies that transfer wealth from savers to borrowers can help restart productive investment, but can create moral hazard. It is clear now that adequate implementation requires arrangements that properly align incentives. Open-bank assistance without proper restructuring and recapitalization is not an efficient way to deal with an ailing banking system. Moreover, excessive liquidity support and guarantees cannot substitute for proper restructuring and recapitalization. After all, most crises involve solvency problems and not only liquidity shortfalls.

The book highlights the macroeconomic challenges and consequences of crises. Resolution itself, especially if not properly designed, may result in large fiscal costs. And a weak fiscal position can be a major constraint to implementing the necessary restructuring measures. The book highlights that better outcomes will be achieved, including lower real and fiscal costs, the sooner restructuring policies are implemented. Such a strategy removes residual uncertainty that leads to precautionary contractions in consumption and investment, further exacerbating recessions. Delayed economic recoveries are nevertheless common with financial crises with substantial medium-term output losses. These and other challenges emphasize the need for further research on crisis resolution.

The collection of papers in this book provides an excellent overview of these critical policy areas. However, as many challenges in the prevention and resolution of crises are yet to be addressed, the topic of financial crises remains a fertile area of future research.