Preface

As a former executive director of the International Monetary Fund and having left the IMF only recently, I still felt very much involved when the Mexican crisis erupted in December 1994. But since I could follow the unfolding events in 1995 solely as an outsider, I was grateful for the invitation of the Forum on Debt and Development to chair a meeting of an international group of outstanding experts who were closely involved with the Mexican crisis and its aftermath. The seminar on which this book reports created a welcome moment to discuss the many sides of past and future currency crises in a quiet setting. It was the kind of gathering you can have only after the crisis has happened and not when you are still in the middle of it.

When the IMF decided to act as a "crisis manager" in the beginning of 1995, my own feeling was that the Mexican authorities could have acted more forcefully at an earlier stage, and that the financial market could have foreseen that Mexico's current account deficit was going to be unsustainable. I must confess, however, that it is very difficult for policymakers to identify the elements which constitute an unsustainable situation before a crisis has emerged, and to judge what the moment is to act and take unpopular measures. Moreover, policymakers are rightly concerned about not starting the crisis themselves. So I agree that one should err on the side of caution, as one of the participants in the seminar said. Likewise, market participants may find it difficult not to extend loans and make portfolio investments when everybody still considers it profitable and safe. With the benefit of hindsight, of course, things look different.

One of the basic questions that was addressed in the seminar was whether currency crises can be prevented. My own answer is no, at least not always, because we live in a real world where mistakes are made by authorities as well as by markets. However, it should also be realised that currency crises do correct mistakes, though in a rather painful way. In fact, one of the ways to manage a currency crisis is to do nothing, because the financial market will do the job and correct misalignments. This and other ways of managing currency crises was the other basic question addressed at the seminar.

One of the other ways of managing a currency crisis is to provide emergency finance to the country in trouble, to enable it to support its currency, to finance its debts, and thus soften the impact of the crisis. The argument in favour of this option is that doing nothing may lead to very great damage to the country, the financial markets or even the global economy. A convincing case can therefore be made that policymakers cannot just leave it to the markets: a local crisis may

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develop into a systemic crisis, obliging financial authorities to come up with a financial rescue package.

Currency crises come unexpectedly, in different circumstances and in different forms. In the liberalised international capital markets we have today, very large capital movements take place within a few days, even hours. The decision to support a country which suffers from a large and immediate capital outflow therefore has to be taken in a very short time if a payment moratorium is to be prevented. In the case of the Mexican crisis the US government and the IMF acted very fast indeed, and put together a financial assistance programme for Mexico of an unprecedented size. In my view, this raises the important question of whether the costs of the crisis have been shared properly by markets and governments. Of course, the financial support extended by the international community to Mexico, through the IMF, has to be repaid by Mexico. But if no support programme had been carried out, wouldn't the capital providers - mainly institutional investors rather than banks, as was the case in the debt crisis of the 1980s - have suffered the losses they ought to have run as a result of assuming commercial risk, at least in the short term? After all, the capital providers had received a return on their investments which reflected higher risks than when they had invested in long-term US bonds, for example. The seminar therefore also discussed another basic question: the feasibility of work-out arrangements for both borrowers and lenders to make sure that the costs of a crisis are shared in a more satisfactory way.

There are many lessons to be learned from the Mexican crisis. Generally, in my view, participants in financial markets should not be protected from their own mistakes, but the markets should be protected from the mistakes of the participants. The contributions included in this book provide profound insights into a problem which is of concern to policymakers, private actors and the public at large in many parts of the world. I hope that this book will help decisionmakers in governments, central banks, and financial markets to prevent the next crisis, and if they fail to do so, to manage it better.

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