

International Financial Crises and the Multilateral Response: What the Historical Record Shows

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In the three decades ending in 1980, serious crises implicating financial systems and sovereign creditworthiness were few. Since then, however, crises have proliferated. The debt crisis of the 1980s, centering on syndicated bank loans, engulfed a large number of Latin-American countries, most prominently Mexico, Argentina, and Brazil, but extended also to Asia, Africa, and Eastern Europe. The Tequila crisis of 1994-95 affecting Mexico and Argentina was the first since the 1930s to center on international bond markets. The Asian crisis in 1997-98, felt most acutely in Thailand, Indonesia, South Korea and Philippines but with wider repercussions, brought to the fore other international financial contracts, including currency forwards and futures and interbank credits. The crisis in Russia and the succeeding events spanning the period 1998-2002 threatened financial stability in Brazil, Argentina, Uruguay, and Turkey. Finally, the most recent set of crises—in Ukraine, Hungary, Iceland, Latvia, Romania, Greece, Ireland and Portugal—highlights even more prominently than before the connections between financial-sector and sovereign-credit risks.

Just as the frequency and nature of crises have changed, so have multilateral rescue efforts. The IMF has been at the center of the multilateral response, although the role of other official bilateral and multilateral lenders has grown over time. The number of IMF-supported programs has been predictably bunched: up in the early 1980s, up again in the mid -1990s, up more modestly around 2000, and up again starting in 2008. IMF credit in billions of U.S. dollars shows a similar bunching superimposed on a rising trend. As documented below, cofinancing from other official sources has further increased program financing commitments. IMF commitments since 2009 also include those granted under the Flexible Credit Line arrangements to Mexico, Poland, and Colombia, which are also substantial although less likely to be drawn, and a Precautionary Credit Line arrangement for Macedonia which was partly drawn in March 2011.

We review this experience in the present paper, providing a broader context for the other papers at this conference focusing on the most recent crisis. Along with indicators of economic performance in the crisis countries, we present a comprehensive description of major multilateral rescue efforts spanning the last 30 years. Our review highlights the heterogeneity of experience—to paraphrase *Anna Karenina*, every unhappy crisis is unhappy in its own way. But it has also revealed some common trends. The violence of financial reversals has tended to grow, mirroring the progress of financial liberalization such as it is and the growth of international capital movements. One consequence has been that the financial requirements of international intervention have increased.

An explanation for this last trend is the absence of viable alternatives. Private lenders have an obvious interest in holding out for full payment, whether directly from the sovereign or indirectly through resources provided by international financial institutions. National officials have an interest in pushing into the future a difficult and politically embarrassing restructuring in the hope that good news will somehow turn up. Multilaterals find it hard to go against the wishes of

those national officials and, being risk averse, fear restructuring as one of those “unknown unknowns.” Recognizing that restructuring is difficult during a crisis, private investors have an incentive to lend at rates that are, in retrospect, too low. This implies that the next crisis has a larger capital outflow, increasing the size of the official financing needed to limit the damage.

We therefore explore ways of automating the restructuring decision as a way of countering this bias. Automating the process preserves the integrity of the contract (which avoids the uncertainties involved in triggering CDS). It is predictable. And it can be priced. To this end, we explore the idea of adding to future government bond issues so-called sovereign cocos, contractual provisions that automatically lengthen maturities or reduce interest and amortization payments when a pre-specified debt/GDP ratio is reached.