



P.R.I.M.E. FINANCE

Panel of Recognised International
Market Experts in Finance

Never Saw It Coming

*Why the Financial Crisis Took Economists
by Surprise*

Foreign Affairs, November/December 2013





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By Alan Greenspan

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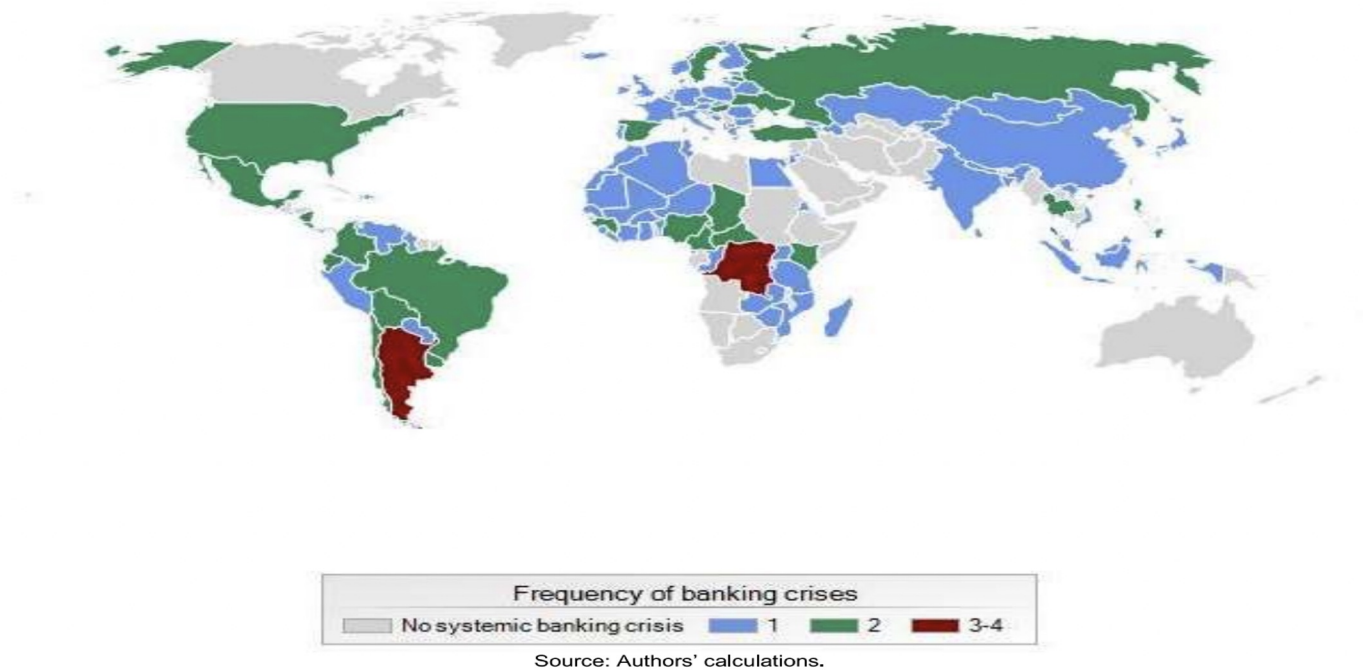


Definition of a Financial Crisis

A financial crisis is a severe disruption or breakdown in the functioning of a financial system or market, characterized by a sharp decline in the value of financial assets, widespread panic or loss of confidence among investors, and often accompanied by a contraction in economic activity.

Systemic Banking Crises

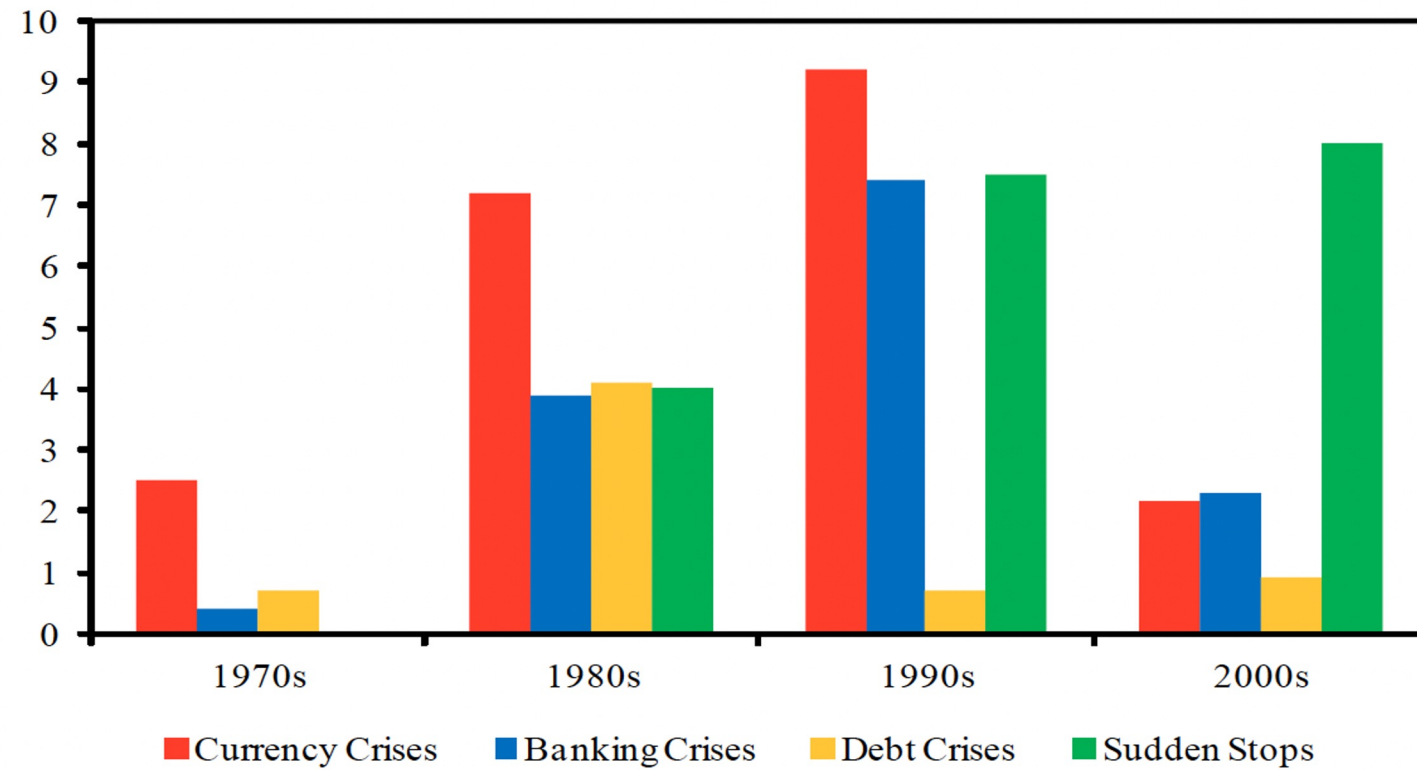
Figure 2. Frequency of Systemic Banking Crises Around the World, 1970–2011



Source: *Financial Crises: Explanations, Types and Implications* IMF Working Paper WP/13/28, January 2013

Financial Crises over the Decades

Figure 5. Average Number of Financial Crises over Decades



Source: *Financial Crises: Explanations, Types and Implications*, IMF Working Paper WP/13/28, January 2013

CRISIS	TRIGGERING EVENTS	NATURE OF DISPUTES	POLICY RESULTS
Herstatt Bank (1974)	Overtrading in FX markets adjusting to floating exchange rates	FX settlement disputes Bankruptcy related actions Mismanagement & negligence	Stricter capital adequacy requirements and risk management guidelines Creation of the Basel Committee Development of real time settlement systems Expansion of deposit insurance
Latin American Debt (early 1980s)	Foreign debt buildup by Latin American countries and spike in US interest rates put a strain on foreign currency reserves	Disputes over restructuring terms Sovereign immunity Violations of bondholder rights	IMF structural adjustment programs “Brady Plan” and Brady Bonds Liberalization of trade terms Promotion of export industries
Savings & Loan (late 1980s)	Deregulation in the early ‘80s led to riskier activities by S&Ls, particularly in the area of real estate and property lending	Individual accountability for failed institutions Fraudulent activities Insider trading	FIRREA and RTC for thrifts Creation of the Office of Thrift Supervision Stricter capital requirements Legal and regulatory reforms
Asian Emerging Markets (1997-98)	Over-expansion of banking sectors in developing countries coupled with currency policies “linked” to the USD	Disputes over debt rescheduling Investor-State disputes	Expansion of SAPs to Southeast Asia Flexible exchange rate regimes Increased role for major Asian economies Supervisors started to focus on risk mgt
DotCom Bubble (2000)	Rapid growth, speculation in and over-valuation of internet-based companies extended to non-DotCom sector (Enron; WorldCom)	Securities fraud and misrepresentation Creditor claims in bankruptcy Copyright issues Breach of contract	Corporate governance and accounting reforms (S-Ox) Tightening of IPO rules Movement away from future earnings-based models
Great Recession (2008)	Reduced lending standards in the housing markets, over-dependence on ratings-based credit review, insufficient risk disclosure by financial institutions	Fraud and misrepresentation Termination value disputes Market manipulation allegations	Demand-focused stimulus plans Expansionary monetary policies Focus on legislative and regulatory reforms (Dodd-Frank) FSOC creation and other regulatory reforms