Comments on Paper 9

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The paper by Chanon, Ghosh, and Kim proposes a unified approach for modeling crisis – as the confluence of an underlying vulnerability plus a specific crisis trigger. Not only I enjoyed reading this paper, but also learned a great deal from it. I was especially pleased since most of findings in the paper confirmed some of the claims made in the counterpart paper written by myself.

By utilizing the recent financial crisis as a natural experiment, the paper successfully shows that EMEs economic performances after the outbreak of the crisis are highly correlated with their pre-existing vulnerabilities. The main results of this paper imply that fundamentals matter, since not only they could reduce possibility of outbreak of crisis but also alleviate adverse impacts from crisis.

The analyses are intuitively straightforward and insightful, which is very natural given the authors' expertise on this issue. After some relatively minor issues regarding the paper itself are discussed, my comments will be concentrated on the implications of the results on on-going discussion regarding financial regulation, and restructuring of the world economy

One notable aspect of the regression results (Table 3) is relatively poor performance of financial sector variables. Given the critical role of financial sectors in many crises and the usefulness of the financial variables due to relatively short time-lag in data availability, the result is somewhat disappointing. I suspect this might be due to different levels of financial development across sample countries. In addition, I wonder why the authors did not consider level variables such as credit/GDP, short-term credit/GDP etc rather than growth rates.

Another interesting fact I found is that Asia and Latin America became more resilient in contrast to the case of emerging Europe where vulnerability level has increased (Figure 2). It would be interesting to explore what factors have driven these discrepancies among regions in detail.

The fact that large capital flows from Korea and Brazil – not because investors worried about vulnerabilities, but because the larger and more liquid markets in theses countries allowed investors to pull out funds from them more easily is particularly interesting to Korean audience and active discussion is warranted during the conference. As shown in the paper, large capital outflow have direct impact on the performance of each countries. Given the fact that sound management of vulnerability could not prevent this sudden capital in and out flows (Figure 5), it is not easy to think of what would be the optimal policy response.

In general, I agree with the view of the authors that policy efforts should be directed at eliminating the underlying vulnerabilities. In fact, this view should be delivered to the policy makers of developed countries as well as those of emerging markets. As we have seen recently in the case of Southern European countries, no country will be immune to lax balance sheet management any longer. In this regard, the increasing public debt in developed countries could become a clear and present danger to the world economy without careful management.

In addition, considering the fact that global imbalances have been financed at least partly by the effort to build enough financial buffer such as foreign reserve accumulation or current account surplus with undervalued currency, it is necessary to promote more systematic approach like multi-lateral currency swap agreements or international emergency fund in order to prevent further incentive to cope with another unexpected crisis trigger.