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Financial Crises in 1997 - 2001
Shortcomings of the International Financial Architecture

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What economists and policy-makers for a long time had considered as virtually impossible has happened: except for North America and Europe, since 1997 the world financial system has moved with dazzling speed from crisis to crisis. Major countries in Asia, Europe and Latin America collapsed or fell prey to the contagiousness of the crisis.

It all started in Thailand in the summer of 1997, quickly spread to other South-East Asian countries, dragged down Japan, infested Russia and spread to Latin America. The starting point in South East Asia is all the more remarkable as these economies were admired world-wide for their achievements and the World Bank – surely a very involved and knowledgeable institution – wondered in a publication of 1993 about explanations for the "Asian miracle". And, indeed, these countries had accomplished the miracle of lifting themselves out of poverty during the last 20 -30 years. Their success was sustained for several decades. And this success was achieved despite or because of, a social organisation in opposition to Western values: all these countries had limited democracy and, instead, substantial oligarchic structures with widespread corruption and extensive import protection and state involvement. But

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[*] This note reflects strictly personal opinions.

they were successful. Hence the search for "Asian values" to understand the "Asian miracle".

Had the crisis –with a major financial turmoil including currency collapse, widespread bankruptcy of the banking and corporate sector, drop in GDP – been linked to Asia one could have argued that special Asian factors (excessively rapid growth, corruption, fixed exchange rates, etc…) were at work. But in the meantime the list of victims of financial turmoil lengthened: Russia, Brazil, Argentina and Turkey. And whilst Korea and Malaysia came out of the crisis relatively unscathed, Indonesia is still on the brink. Are there lessons to be drawn?

The first lesson of the crisis is that there is much more systemic risk than previously admitted. In 1997 and 1998 lenders and investors had reconsidered emerging market risk as a whole and changed tack abruptly, without a clear change in fundamentals. The second is that the IMF's surveillance does not work as well as assumed and that the IMF has difficulties in effectively stemming an unfolding crisis. The world markets have become more global, but international institutions have not kept pace. The official mission of the IMF is to assist countries with a balance of payments problem. But in fact the IMF is expected to carry out surveillance to prevent financial crises and their spreading to other countries and to assist countries with international liquidity problems. It would be unreasonable to expect the IMF to deal well with all these expectations for which it was not set up. This paper argues that the IMF, more often than not, has made the severity of a crisis worse.

Causes

In the post-war period the repeated causes of national financial crises have been macroeconomic mismanagement, typically a combination of laxist fiscal and monetary policies, resulting in impaired international competitiveness, current account deficits and accumula-

tion of foreign debt. Repeated occurrences of such crises generated solid experience for dealing with them and the IMF excels in that task.

Unfortunately, the causes of the Asian crisis were completely different (Krugman, 1998; Radelet and Sachs, 1998; Reisen, 1998). Fiscal and monetary policies were not responsible and, although appreciation of the dollar (to which the South East Asian currencies were pegged) in relation to the yen made them somewhat less competitive in Europe and in Japan, they had no major problem with competitivity. Their growth was strong and the current account deficits were a result of domestic excess investment over savings. What was wrong in Asia was the counterpart of foreign debt: either inefficient domestic investment or capital flight by the well-connected[1]. The inefficiency and extravagance of investment was highly visible, particularly in real estate. But even those who did not see it could have reasoned that countries with a domestic savings rate of between 30 and 40% of GDP had enough resources for investment. Going beyond that was highly risky in terms of efficiency. Countries that invest 30% or more of GDP are bound to be wasteful. (In 1996 Indonesia invested 38% of GDP, Korea 35%, Malaysia 51% and Thailand 43%.)

One consequence of this reasoning is that unhampered capital flows were not a propeller of Asian growth, but a facilitator of their excesses for which the bill turned out to be very high in the eventual crisis. Traditionally, capital flows are considered beneficial in three dimensions. The first is income smoothing over time, allowing a country with insufficient domestic savings to accelerate investments for some time and pay back debt at a later stage with the returns from this additional investment. That was not the case in Asia. The second advantage is to diversify risk by investing part of domestic wealth abroad. Again, Asia did not benefit from that opportunity because with the Asian growth performance domestic investors preferred to

[1] Net foreign debt should correspond to the accumulated current account deficits over time. For example, in Indonesia, Korea and Russia foreign debt is more than twice the sum of current account deficits, suggesting major capital flights. As a result no corresponding assets produce returns to pay back foreign debt.

invest at home and because regulations were more liberal to capital inflows than outflows. In Brazil, Russia and Turkey capital flight was motivated by uncertainty at home. The third advantage is greater discipline imposed by foreign investors who impose a rational, unpolitical risk-return approach. Again, this view turned out more theoretical than practical as the events demonstrated. I would, therefore, argue that, on balance, such capital flows were detrimental to Asian countries, apart from foreign direct investments that also benefit countries with capital controls, such as China[2].

Not only with hindsight can it be argued that capital flow liberalisation was a fatal mistake. Elsewhere, for example in Europe, governments were reluctant until the early 1990s to totally liberalise capital flows because they were concerned about a weak domestic financial system and the fickleness of capital flows. Why did Asian countries and Russia jump the gun and liberalise capital flows before their banking systems were tightly regulated and more robust? Domestic reasons certainly provide a partial explanation. But it is also a fact that the United States and the IMF put pressure on these countries to liberalise capital flows. This pressure certainly reflected the ideological conviction that free capital flows are first-best (neglecting the second-best theorem according to which partial first-best policies are not optimal in a second-best world), but also the US self-interest in allowing US financial institutions to get a share in the Asian miracle. A World Bank economist recently made the joke that as soon as an emerging country joins the OECD it is hit by a crisis so that a dummy variable of recent OECD membership is highly explanatory in a regression estimating the occurrence of financial crises. In fact it is not a joke: one condition for OECD membership is capital flow liberalisation. That is why Korea and Mexico liberalised[3]. The same is true in Russia. When a totally inadequate banking sector should have generated

[2] [2] See also Steinherr and Perée (1999).

[3] [3] There is even a US Republican Party paper suggesting that IMF assistance should be made conditional on liberalised capital flows.

concern about liberalism, the IMF preached from the beginning free capital flows to introduce market discipline. The result was that the Russian government massively borrowed until investors lost confidence and pulled out abruptly and massively.

In the discussion of the Asian crisis the exchange rate regime received much more attention than the question of capital flows. The simple US (and hence IMF) position is that flexible exchange rates, that is, exchange rates determined in the market, are to be preferred to fixed exchange rates. But the IMF is not consistent on exchange rates: it recommended the currency board solution to Argentina and a stabilization programme with a crawling peg for Turkey. Was then the exchange rate regime responsible for the crisis? It certainly contributed. Not so much by the choice of fixed exchange rates, but by the way they were managed. Small and very open countries have thin exchange markets so that US experience – nevertheless characterised by large swings of over- and undervaluation – cannot be transposed. Overshooting (i.e., a depreciation of the exchange rate in response to negative news that is initially much in excess of the one in final equilibrium) risks to be even more pronounced with thin exchange markets, inviting speculators to take a bet by cornering markets. In addition, small Asian economies competing and trading much with each other had a clear motivation for fixed exchange rates. Although the US market is an important one for Asian exporters, the Asian market is more important. All Asian countries sell around 50% of their exports to Asia, with Japan alone accounting for a share of between 11% (for Malaysia) and 25% (for Indonesia). It was, therefore, a mistake to give the US dollar too much weight in the basket to which domestic currency was tied. For Russia where foreign trade depends very much on oil and gas prices, flexible exchange rates made sense. Brazil and Turkey used a fixed (respectively a crawling) exchange rate as an anchor for inflation control. Moreover Turkey is part of the European customs union and Brazil of Mercosur so that fixed exchange rate made sense.

Fixed exchange rates tie the fate of small countries in the club together and obviously helped to spread the Thai devaluation rapidly to other countries on account of their mutual trade relationships and the fact that they were competitors in the same segments of the world market. Panic and contagion are mutually reinforcing as the phenomenon lacks a rational fundamental underpinning.

The most serious mistake in managing Asian exchange rates before the crises was, however, an IMF advice. Namely, to pursue tight monetary policy to stem the domestic inflationary pressures resulting from booming economies. The IMF knows perfectly well that with free capital movements a small country no longer has a free hand for monetary policy. As a consequence of tight monetary policy and hence domestic interest rates substantially above dollar interest rates, the incentives were created to borrow in dollars and invest in domestic loans or paper – as long as confidence in the exchange rate remained. Overborrowing abroad was thus not only the result of unscrupulous Asian bankers and of an irrational belief in Asian success – but, most importantly, the result of wrong policy advice. The purpose of high interest rates was also defeated since borrowers discouraged by these rates then turned to dollars with the effect that excess demand was not choked off. The vicious circle then continued with interest rates increasing further, providing even greater incentives to borrow abroad.

What should these countries have done? In the first place, if they had maintained capital controls they would have retained monetary independence. Once they had opted for free capital flows they should have allowed domestic interest rates to converge to dollar rates (plus a risk and liquidity premium). To choke off excess demand, they could have used fiscal policy or they could have revalued the currency.

This makes my first point, namely that IMF advice contributed to causing the crisis.

The IMF as crisis manager

My second point is that IMF intervention made the crisis worse and unnecessarily so. Thailand first devalued by 10% and as speculative pressure continued unabated the IMF advice was to float the currency, to increase interest rates, to embark on fiscal austerity measures (not really necessary), to reform the political system and the financial system. I am not concerned with the last condition because, whilst it is easy to see that such reforms are desirable, they take quite a long time under any scenario and are, therefore, unsuited as a precondition for financial crisis support. This is a point also made by Feldstein (1998). Fiscal austerity was just a traditional IMF institutional measure, which was subsequently relaxed. The real problem is with the couple floating exchange rates – sharply higher interest rates. We all know from theory and experience (see, e.g., Flood and Garber, 1984) that with floating exchange rates in a situation of loss of confidence an infinity of equilibria are possible. If the problem is not lack of competitiveness but high indebtedness, this policy mix is lethal. No economy can survive unscathed the Indonesian shock: domestic interest rates of 70% and above and an exchange rate that went from 2 500 to the dollar to 20 000 before falling back to 10 000 in 1998. A sound balance sheet with foreign debt at 2 500 rupia to the dollar has turned into a bankrupt balance sheet at 10 000 rupia, as long as domestic prices increase by "only" 80%, as has been the case in Indonesia in the first year after the crisis.

The social costs of this bitter IMF medication are unacceptably high. Inflation soared and domestic production collapsed. More than 100 million Indonesians have crossed the absolute poverty line. Table 1 gives changes in GDP. To interpret these numbers, it is useful to remember that Western governments would be concerned with zero growth and catastrophed by small negative growth. In fact, Indonesia had a GDP decline in 1998 of 13.1% and Turkey a 5% decline both in 1998 and 2001.

Which country managed the crisis best? Without any doubt Malaysia and South Korea. Remarkable is the fact that Malaysia refused any IMF advice or programme, did not let its currency float and avoided overshooting. The Ringgit exchange rate remained fixed after devaluation

Table 1: *Real GDP (% change from previous year)*

	1996	1997	1998	1999	2000	2001(f)
Indonesia	8.0	4.7	-13.1	0.8	4.8	2.2
Malaysia	8.6	7.3	-7.4	5.8	8.5	3.0
South Korea	7.3	5.0	-6.7	10.9	8.8	2.5
Thailand	5.5	-1.7	-10.2	4.1	4.3	2.5
Russia		0.4	-4.9	3.2	8.3	2.0
Brazil		3.3	0.2	0.8	4.5	2.5
Turkey		7.5	3.1	-5.0	5.9	-5.0

f =IIF forecast

Source: The Institute of International Finance, May 2001.

Depreciated exchange rates could have been hoped to strongly stimulate exports and discourage imports to generate the necessary current account surpluses to pay back foreign debt. Indeed, current accounts have swung around violently (see Table 2).

Table 2: *Current Account Balance (billions of dollars)*

	1996	1997	1998	1999	2000	2001
Indonesia	-8.9	-5.8	4.1	5.8	7.8	5.8
Malaysia	-4.9	-5.9	9.5	12.6	8.2	2.0
South Korea	-23.7	-8.2	40.4	24.5	11.0	18.0
Thailand	-14.4	-3.0	14.2	12.5	9.2	7.0
Russia		-0.4	-2.3	22.0	43.4	32.7
Brazil		-30.8	-33.6	-25.4	-24.6	-29.8
Turkey		-2.6	2.0	-1.4	-9.8	6.9

Source: The Institute of International Finance, May 2001.

For example, after a current account deficit of USD 24 billion in 1996, Korea has managed to generate a surplus of USD 40.4 billion in 1998. That is a swing of USD 64 billion in two years. In 1998 the surplus accounted for 15% of GDP (partly due to the fall in GDP), allowing Korea to pay back one-fourth of outstanding international debt. Russia managed to swing from a deficit of USD 2 billion in 1998 to a surplus of USD 43.1 in 2000. Are these turn-arounds the result of the strong depreciation? Never in isolation. Russia was helped by the increase in oil prices, Brazil did not achieve a turn-around, and Malaysia achieved a big swing without a very big devaluation. What helped was the fall in imports in all the countries. In the year after the crisis the strong GDP decline led to a contraction of imports. (In Asia, the turn-around of the growth rate one year before and one year after the crisis was above 15%).

Table 3 confirms that the current-account turn-around is not the result of increased export receipts. Export receipts actually declined during the first years in most crisis-stricken countries due to the terms-of-trade loss and because foreign exchange credits for imported intermediate goods and for export pre-financing were no longer available. This is well-known to economists as the J-curve effect.[4]

Table 3: *Merchandise Exports (% change from previous year)*

	1997	1998	1999	2000	2001
Indonesia	7.3	-11.0	2.0	28.0	-1.0
Malaysia	-1.2	-7.0	17.0	17.0	-12.0
South Korea	5.0	-5.0	10.0	21.0	6.0
Thailand	4.0	-7.0	8.0	20.0	3.0
Russia		-16.0	8.0	43.0	-4.0
Brazil		-3.0	-6.0	15.0	7.0

[4] [4] Mexico recuperated quickly from the 1994/95 shock thanks to soaring exports. Latin America, during the 1980s, went through a "lost decade" because adjustment, as in Asia, was made with collapsing production and imports.

Turkey	-4.0	-6.0	6.0	15.0

f = IIF forecast and own adjustments

Source: The Institute of International Finance, May 2001.

What should these countries have done? They should have devalued, say, by 20-50% in Thailand, Korea and Indonesia. And they should have received the support of the IMF at these levels to regain confidence in the markets. They also should have reintroduced capital controls, as Malaysia did.

Economists have criticised the IMF, but for what I believe are minor or even irrelevant reasons. Most attention has been focused on moral hazard. This is a sound theoretic argument, but the practical relevance is not that obvious.

National governments are quite unabashed about moral hazard when their own institutions are concerned, but they never tire of criticising the IMF for it. If moral hazard was an important problem, then one should expect that after the bailout of US banks exposed to Mexico in 1995, US banks would continue to lend in high profit emerging counties. But the fact is that US banks are much less exposed in Asia, Russia and even Brazil (their home turf) than European banks. In Russia, German banks, which have the largest exposure, benefited from subsidised government guarantees. How can the German (or other governments) criticise the IMF after they helped to create the moral hazard in the first place?

Table 4 provides information on the structure of capital flows. It shows that net direct foreign investments have been remarkably stable. Portfolio investors reacted to the crisis by calling back funds, but much less so than banks. Net private capital (equity, bank and other creditor lending) inflows amounted to USD 93 billion in 1996, compared to USD 5 billion in 1997. This represents a swing of USD 88 billion, equal to 10% of GDP of these countries. Of the USD 88 billion decline in inflows, USD 73 billion came from commercial bank lending. Lending is arguably the most short-term and volatile component of foreign capital flows. Such volatility is difficult to manage and,

therefore, best avoided. Bank lending would be most affected by controls and, according to the previous line of reasoning, at little social cost.

Table 4: *External Financing (Net) (billions of dollars)*

	1996	1997	1998	1999	2000	2001(f)
Five Asian Economies *						
Equity investment	19.1	5.2	17.8	30.8	24.0	12.2
Commercial banks	55.5	-17.4	-48.7	-28.7	-15.2	-10.5
Other private creditors	18.4	17.3	-6.9	-4.3	-3.8	-5.1
Official flows	-0.2	34.4	23.9	0.1	1.3	-9.3
Resident lending abroad, errors and omissions	-19.6	-44.4	-16.2	-23.8	-22.9	-18.8
Russia						
Equity investment		3.6	2.0	0.6	0.6	1.8
Commercial banks		9.9	-2.2	-1.0	0.9	0.6
Other private creditors		24.5	8.6	0.5	-0.8	-0.5
Official flows		5.1	8.1	-0.5	-1.4	-2.6
Resident lending abroad, errors and omissions		-39.7	-19.5	-19.5	-26.5	-28.9
Brazil						
Equity investment		21.3	24.4	30.5	28.1	21.8
Commercial banks		11.9	-4.4	-14.9	-3.1	-3.0
Other private creditors		1.3	19.6	1.6	4.2	8.5

Official flows	4.6	14.0	9.3	-5.1	3.1
Resident lending abroad, errors and omissions	-16.0	-27.8	-9.2	-2.8	-0.7
Turkey					
Equity investment	0.5	0.2	0.7	-1.5	2.0
Commercial banks	5.6	1.0	5.9	8.9	-8.3
Other private creditors	6.5	2.3	2.7	3.1	-7.2
Official flows	2.6	0.5	1.2	4.4	16.0
Resident lending abroad, errors and omissions	-9.3	-5.8	-3.6	-4.8	-5.4

f = IIF forecast

* South Korea, Indonesia, Malaysia, Thailand and the Philippines

Source: *Institute of International Finance, May 2001*

The sharp drop in lending within one year was hardly motivated by a change in economic fundamentals. It was the result of a panic, which then generated a liquidity crisis as banks recalled commitments from their borrowers, who in turn became unable to respect their commitments. Failing banks, sharply higher interest rates and crushing exchange rates, all as a result of the bank withdrawals, did the rest.

The volatility of commercial bank lending and relative stability of equity investments were not specific to the Asian crisis. In Russia positive bank lending of USD 10 billion in 1997 turned to an outflow of USD 2.2 in 1998. Equity investment remained positive. In Brazil, equity investment increased in 1998 whereas bank lending swung by over USD 16 billion.

Are foreigners the main culprits? No! Residents lending together with errors and omissions suggest that in all eight countries capital is always (that is every year) fleeing the country and that the

amounts swash all the other items everywhere, most of the time. Confidence is a particular issue during a crisis but remains a problem even when the crisis is over.

International policy reform

During 1998-99 there were numerous discussions about the need to reform the international financial architecture. Although the problem has not disappeared – see Argentina and Turkey in 2001- the international financial system has not been reformed. Asking the question again today is as urgent as it was three years ago (and the likelihood of reform is as low as it was three years ago!) What then could be constructive reforms for the international financial system and for IMF responsibilities?

Ideally, a global market should be overseen by a global regulator equipped with global safety standards and backed up by a global lender of last resort. But this is little more than dreaming. In practical terms measures can be envisaged that make financial markets more robust to the vagaries of capital flows; early warning signals can be developed; and ultimately crisis management can be improved and moral hazard minimised.

How to make markets more robust

The US ideology of free capital movements independently of local conditions needs to be replaced by the notion that free capital flows is the coronation of developing a robust and well regulated domestic financial system. The IMF's advice should be not to liberalise capital flows as long as it does not consider the domestic financial system to be sufficiently mature. The IMF may even be given the prerogative to approval of financial soundness and, hence, aptitude for free capital flows. Non respect of this certified sequencing could be punished by disqualifying the country for IMF support. This would seriously lower moral hazard risk.

In addition, the idea is already widely accepted that countries with free capital flows may "throw sand into the wheel", like Chile, by imposing deposit requirements that penalise short-term capital inflows.

Emerging countries within the span of the BIS should be reinforcing their banking regulations and their regulatory procedures according to BIS standards adapted to emerging markets. International organisations should stress this important target more than in the past. At the same time, as already stated, they should dethrone capital account convertibility as part of their official credo.

More effective signalling

For early crisis signalling, the IMF already has the mandate to monitor emerging markets. Unfortunately, it cannot do this job satisfactorily. The principal dilemma is that even when the IMF catches a problem situation[5] it cannot possibly blow the whistle for fear of self-fulfilling prophecies. In addition, whilst it is relatively easy to identify macroeconomic disequilibria, the identification of problems in the financial sector is much more difficult and time-consuming, involving direct interference in internal matters of a country and problems in the financial sector are very difficult to interpret. Asia's banking and corruption problems have been around for 30 years. When exactly should the whistle have been blown?

This is not to say that the IMF should not make more of its reports available to the public, but the task of early identification of problems cannot be discharged by the Fund.

More effective signalling could be obtained through intensive co-operation, for example, within the BIS framework. In this respect, recent enlargement of the BIS forum to include a number of emerging markets makes co-operation easier. One idea to be examined in more detail is the following. Countries may suffer from a

[5] For example, at the outbreak of the Mexican crisis end-1994, the IMF's estimation of foreign currency debt was off-the-mark by about a half. One objective difficulty is the assessment of derivatives positions. See Steinherr (1998).

sudden speculative attack or from contagion – as was the case in Asia. Without the excessive exchange rate depreciations the Asian crisis would have been, above all, a liquidity crisis. This is also argued by Feldstein (1998). To be prepared for such an eventuality, central banks hold foreign exchange reserves. These reserves could be augmented by credit lines either from commercial banks (as does Argentina) or at a lower cost from other central banks. Thus, instead of appealing to the IMF in an emergency situation, credit lines that are negotiated during quiet times could be used first.

The first advantage of such a procedure would be the signaling aspect of not obtaining, or not bothering about obtaining, a credit line, of a reduction in the credit line, or of increased costs. The second advantage would be that liquidity would be available when needed. Under the present IMF procedures it takes months to negotiate a programme. Whilst it is obvious that credit lines would not have been sufficient and should not have been used up to defend fixed exchange rates in Asia, they could have served to avoid an overshooting of the exchange rate in Asia, Russia, Brazil or Turkey and they would have helped to sustain export activity. No moral hazard would have been involved.

Providing credit lines is, however, not part of the IMF's mission. This task could either be given to the IMF under a new mandate or could be entrusted to central banks under the BIS umbrella. Giving this function to the BIS would have another advantage. As became apparent in Mexico and Asia, powerful neighbours have a greater readiness and self-interest to provide support than the world community at large. It is, therefore, a relevant and important question, whether the IMF should always be in the lead of managing crises. De facto, in the Mexican case it was the US Treasury (as seems to be the case in Indonesia), although officially it was the IMF. In the Asian crisis, Japan was prepared until January 1998 to support Indonesia forcefully, but was prevented from doing so. As ex ante li-

quidity providers, major central banks (Japan in Asia, the United States in Latin America, Europe's Central Bank in Eastern Europe) can, in their self-interest, assume greater regional responsibility. This may be further stimulated by (and may influence) the choice of exchange rate target: the US dollar in Latin America, the yen in Asia and the euro in Eastern Europe.

Moral hazard

Finally, it seems important to reduce the moral hazard in international lending. Bank lending is the most volatile part of capital flows. Bankers do charge a risk premium to compensate for the risk they are accepting. They should also be forced to make a loss when they misjudge or are unlucky. To do this, I propose the elaboration of an internationally agreed Master Loan Agreement that specifies general principles about the seniority of the loan (for example, preventing higher seniority than previously contracted domestic debt - today a frequent feature in countries with ill-defined contract laws), that prevents pledges on foreign revenues and requires notification of third-party (e.g. government) guarantees to an organisation selected for that purpose (IMF or BIS).

The goal of this measure, together with tighter banking regulation, would be to make foreign lenders deal directly with the domestic borrower, without public sector guarantees and without domestic bank guarantors. Governments find it difficult to default, or to let banks default, but they may be more easily forthcoming in letting corporate borrowers sink. The goal would also be to take private lending out of international negotiations. In all past crises there has been a strong asymmetry between bank lending and securitised lending. Bond holders are sitting out the crises, whereas banks are at the centre of the negotiation process, influencing their own governments, possibly the negotiation line of international organisations, and bringing the weight of their cartel to bear on local governments. This creates a vicious circle where banks may lend

too freely because they can count on being bailed out. This moral hazard has to stop. Perhaps an international arbitration court needs to be created that deals with bank debt outside of the wider international negotiations, limiting participation to borrowers and lenders, thus excluding governments.

A final decision could be taken by national governments of lender countries. At times governments guarantee foreign lending at subsidised rates. This creates moral hazard and costs for the taxpayer. But, in addition, if banks engage in high-risk lending, they cash in on the benefits and pay taxes in low-tax, offshore locations. If they make losses they can subtract provisions from their taxable income. Roughly half of the loss is shouldered by the State in developed countries. It may, therefore, be useful to examine the proposition that banks cannot deduct from taxable income losses made on foreign lending, that is, on lending outside of domestic regulations or on losses realised in identified countries with a weak financial system.

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