



The Volatility Machine: Emerging Economics and the Threat of Financial Collapse

By Michael Pettis

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This book presents a radically different argument for what has caused, and likely will continue to cause, the collapse of emerging market economies. Pettis combines the insights of economic history, economic theory, and finance theory into a comprehensive model for understanding sovereign liability management and the causes of financial crises. He examines recent financial crises in emerging market countries along with the history of international lending since the 1820s to argue that the process of international lending is driven primarily by external events and not by local politics and/or economic policies. He draws out the corporate finance implications of this approach to argue that most of the current analyses of the recent financial crises suffered by Latin America, Asia, and Russia have largely missed the point. He then develops a sovereign finance model, analogous to corporate finance, to understand the capital structure needs of emerging market countries. Using this model, he finally puts into perspective the recent crises, a new sovereign liability management theory, the implications of the model for sovereign debt restructurings, and the new financial architecture.

Bridging the gap between finance specialists and traders, on the one hand, and economists and policy-makers on the other, *The Volatility Machine* is critical reading for anyone interested in where the international economy is going over the next several years.

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Editorial Review

Review

"A welcome departure from the sterile academic debate on the subject of financial crises." -- *Institutional Investor, June 2001*

From the Back Cover

"Michael Pettis brilliantly demystifies the complexities of global finance, banking and capital markets crisis. Volatility in markets may never be our friend, but how to live with it and manage the uncertainty and risks to global economic security requires a careful reading of this pathbreaking book."

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"The Volatility Machine makes refreshing use of the role of corporate finance theory in examining a country's capital structure and assessing its financial vulnerability."

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"This valuable book leads us away from the stale debate on the international financial architecture with a simple and powerful message: proper management of a country's external balance sheet is the key to avoiding financial distress. This is a book that belongs on the bedside table of every financial minister."

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"Finally, here is a readable book that explores thoroughly the proposition that EM sovereigns default on their external debt, not because they are dissolute, but as often as not because they are vulnerable to adverse shocks emitted by the rich countries. Michael Pettis's pathbreaking ideas should undoubtedly attract the attention of finance and treasury ministers and their economic advisors as well as all students of development economics."

- Michael Adler, Professor of International Finance Graduate School of Business, Columbia University

About the Author

Michael Pettis is a Managing Director at Bear Stearns, a New York investment bank and an adjunct professor at Columbia University where he teaches courses in international finance. He has been involved in emerging markets, both as an investment banker and as a sovereign adviser, since 1987. In addition, he has written extensively on the subject, on specialized financial topics, and on policy.

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