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Abstract:

The frequency and intensity of financial crises witnessed in the past decades is of growing concern to policymakers. Questions are increasingly raised about the nature of these crises, and the policies needed both to prevent them from occurring in the first place and, once occurred, to limit their severity and contagious spread to other countries. Naturally, any discussion of the appropriate policy response must be based on an analytical understanding of contagion, as given by a model of that phenomenon. The contagion literature does not directly model the inherent dependencies involved in the spread of crises. We argue that a transmission model may be more appropriate, and we propose a stochastic process from epidemic theory where the population of countries is explicitly structured and the crisis can be transmitted both locally and globally. The approach is illustrated using historical data. The results indicate an increasing trend for global transmission over time. Policy implications are also addressed via a naturally implied control mechanism.