Threats to International Financial Stability

EDITED BY RICHARD PORTES
AND ALEXANDER K. SWOBODA

centre international d'études monétaires et bancaires

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Centre for Economic Policy Research

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Preface

On 11–13 September 1986, fifty academics, bankers and officials met in Geneva for an international conference on 'Risk, International Financial Markets and Public Policy' organized by the International Center for Monetary and Banking Studies. This volume contains the proceedings of that conference under the title *Threats to International Financial Stability*.

Although the conference was organized by the International Center for Monetary and Banking Studies, this publication is the product of a cooperative effort with the Centre for Economic Policy Research. This cooperation grew naturally out of early contacts between the two Centres' directors, and we hope that this will be but the first instance of an ongoing collaboration. The views expressed by participants are their own and not necessarily those of the institutions with which they are affiliated nor of either Centre.

We have incurred many debts of gratitude in the organization of the conference and in the preparation of this volume. Our greatest debt is to the participants in the conference: to the authors, who provided provocative papers and revised them promptly; to the discussants, who let themselves be provoked and brought their experience to bear on sometimes difficult intellectual issues; to the other participants, who made for a most stimulating and lively general discussion; to session chairmen (P. H. Cassou, R. Dale, B. Dennis, J. l'Huillier, L.-E. Thunholm, S. Ogata and R. Zecher), who managed to keep that discussion civilized but never dull; to our panelists for their insights; to Joan Pearce for taking on the heroic task of summarizing the panel and general discussion; and to Markus Lusser for his keynote address which provides this volume's conclusion.

We also would like to thank the Ford Foundation for providing the essentials, financial support for the conference, and Thomas Bayard of the Foundation's staff, whose early interest in the project constituted a

much appreciated encouragement. We should also like to record our appreciation to the International Center for Monetary and Banking Studies which supplied the remaining financial support.

Organizing the conference would have been impossible without the untiring help of Martine Nguyen-Phuoc, the administrator of the International Center for Monetary and Banking Studies. Rapid changes in financial markets and their global economic and political implications made timely publication of these conference proceedings especially important. The speed achieved is due largely to the efforts of Stephen Yeo, Administrative Director for Research and Publications of the Centre for Economic Policy Research, and of the production editor, John Black of the University of Exeter.

To all, our thanks. We hope that they, and our readers, will like the final product.

RICHARD PORTES
ALEXANDER K. SWOBODA

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Ernst Baltensperger *University of Bern*
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Introduction

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The debt crisis, the extraordinary pace of financial innovation, policy conflicts among major industrialized countries, the enormous variability of exchange rates and interest rates, and the growing interdependence of national banking systems all represent threats to international financial stability. Such threats are of course not new. Before Mexico in 1982, there were Franklin National and Herstatt in 1974–5, and the Credit Anstalt in 1931. The more recent episodes, which also include Ambrosiano, Continental Illinois and Johnson Matthey, have not resulted in either national or international financial crises, and shades of the 1930s have remained shades.

To understand why and to assess the likelihood of a recurrence of a deep international financial crisis, we must consider three questions. The first concerns the extent and nature of the shocks that buffet the system. Do they originate in asset markets, more specifically foreign exchange markets, goods markets, or both? Are they the result of outside shocks, particularly from policy, or do they arise as bubbles endogenous to asset markets? Second, are international financial markets resilient in the sense that they tend to dampen shocks or, on the contrary, fragile in the sense that they tend to amplify and propagate disturbances?

Answering this question requires an understanding of the nature and role of the institutions that characterize any international financial regime in its historical manifestation. This immediately raises the third set of issues, namely questions concerning appropriate policy responses and the design and regulation of institutions, both private and public. Should there, for instance, be an international lender of last resort? Under what circumstances, if any, are controls over capital movements appropriate?

There are three reasons why it seemed appropriate for the International Center for Monetary and Banking Studies to organize the conference that took place on 11–13 September 1986 in Geneva and for

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