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The RISK of ECONOMIC CRISIS

Edited and with an Introduction by
Martin Feldstein

Benjamin M. Friedman

E. Gerald Corrigan • Irvine H. Sprague
Norman Strunk • Joseph A. Grundfest

Paul Krugman

C. Fred Bergsten • Rudiger Dornbusch
Jacob A. Frenkel • Charles P. Kindleberger

Lawrence H. Summers

Hyman P. Minsky • Paul A. Samuelson
William Poole • Paul A. Volcker

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The Risk of Economic Crisis



A National Bureau
of Economic Research
Conference Report

The Risk of Economic Crisis

Edited and with an Introduction by

Martin Feldstein



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Preface

As I note in the introductory chapter to this volume, the danger of a financial and economic crisis is more prominent in the thinking of policy officials and business leaders than in the research of professional economists. But although the United States has been fortunate in recent decades not to experience the kind of massive economic collapse that occurred from time to time until the worldwide depression of the 1930s, there is no doubt that the possibility of another such financial and economic crisis cannot be dismissed.

In an effort to stimulate more economic research on the causes and the possible ways of reducing the likelihood of such crises, the National Bureau of Economic Research began a series of interrelated studies. The research dealt with financial institutions, securities markets, international capital markets, and cyclical fluctuations in economic activity. Several researchers examined the antecedents of the economic decline of the 1930s. Others looked at recent problems like the less developed countries' (LDCs') debt situation and the fluctuations of exchange rates.

The findings of these studies have generally been reported in NBER working papers and subsequently published in professional journals. In addition, papers prepared as part of this project were presented at two special NBER conferences and published in separate volumes. The first group of papers on volatility in securities markets was organized by Professor Sanford Grossman and published in a special issue of *The Review of Financial Studies* (vol. 3, no. 1 [1990]). The second group of papers on financial market risks more generally was organized by Professor R. Glenn Hubbard and published in an NBER volume, *Financial Markets and Financial Crises* (University of Chicago Press, 1991).

The present volume is based on a special NBER conference that I organized in October 1989. Unlike most other NBER conferences, the participants in this meeting included not only academic researchers but also nonacademics

who have played key policy roles in the past and current senior policy officials and staff. These individuals are or have been associated with the Federal Reserve System, the Federal Deposit Insurance Corporation, the International Monetary Fund, the Congressional Budget Office, the U.S. Treasury, the Council of Economic Advisers, the White House Domestic Policy Office, the Canadian Treasury Department, the Office of the British Prime Minister, and other organizations that must deal with the possibility of financial and economic crises.

The meeting was divided into three parts, the first dealing with the origin of financial crises, the second with the international aspects of financial crises, and the third with the impact of financial crises on the economy more generally. Three NBER economists prepared nontechnical papers that served as a background for the group's deliberations: Professor Benjamin Friedman on financial crises, Professor Paul Krugman on international aspects, and Professor Lawrence Summers on the economic consequences of financial crises. Each discussion session at the conference was initiated by brief personal statements from four individuals who have held key positions in the relevant area or senior academic figures who have written extensively on related issues.

This volume presents the background papers, the personal statements of the panelists, and a summary of the discussion.

I am grateful to all of the participants in this project for their contributions: the authors of the background papers for their analyses, the panelists for sharing their personal experiences and perceptions with us, the current policy officials for helping us to place the discussion in the current economic context, and Professor Douglas Elmendorf for preparing the summary of the discussions.

Financial support for the project on economic crises was provided by The Seaver Institute, The Ford Foundation, and the Lilly Endowment. Without their help, this project would not have been possible. I am grateful also to the members of the NBER staff for their assistance with all of the details involved in the planning and execution of the several meetings and conferences that were part of this project and for their work in the preparation of this volume, particularly to Kirsten Foss Davis, Ilana Hardesty, Mark Fitz-Patrick, Andrew Samwick, Kathi Smith, and Carolyn Terry.

Martin Feldstein