

Discussion

1. General Discussion

Discussion of Bordo and Eichengreen's paper focused on the apparent differences in the severity of currency crises over time. Some participants shared the view that changes to an economy, other than to the extent of its capital controls, could affect the depth and duration of currency and financial crises. For example, the flexibility of labour markets may partly determine the effect of an external crisis on output. These participants argued that by downplaying such considerations, the paper's demarcation of history according to the global regime governing capital flows may give a misleading impression of the reasons why currency crises are more severe under some regimes than others.

One factor complicating comparison of crises is that different shocks or macroeconomic imbalances will affect economic growth differently, even if they all cause currency crises. For example, uncontrolled budget deficits were a key feature of many Latin American currency and financial crises. But they were not present in east Asia, where problems were more diverse. This inevitably compromises comparison of the east Asian and Latin American experiences.

In general discussion of the propagation of shocks, the role of capital controls was stressed. One participant conjectured that the lower frequency of international capital market crises under the Bretton Woods system might generate support for a return to restricted capital flows and fixed exchange rates. Other participants argued that this would be impractical and that there was, in any case, no clear evidence that capital controls had been of net economic benefit at the time.

One participant added that financial markets are now more important to the efficient allocation of capital than in the early postwar years. It was argued that with the slowing of trend growth in the industrialised world since the early 1970s, the efficient allocation of resources relies increasingly on capital being free to move into those sectors and countries where it is most profitably employed. In general, international capital controls are a costly impediment to this process.

When evaluating the effects of currency crises on output, it is useful to separate the initial shock from the factors which determine how it is propagated through the economy. These were thought to include the exchange rate regime, the degree to which international bank lending is diversified (particularly in emerging markets), and the change in the nature of capital flows, with the so-called democratisation of capital, which may see international capital originate from a wider variety of sources.

Some participants inferred from the paper that currency crises have indeed been more frequent and severe in the aftermath of capital account liberalisations, and they wondered about the implications of this for macroeconomic policy. One felt that the east Asian experience justified more vigorous expansionary macroeconomic policies in immediate response to crises, and that the paper made a case for limited capital controls to reduce countries' vulnerability to crises.