Introduction

Private capital flows are moving freely around the world and are playing an increasingly important role in individual countries as well as in the global economy. They can either promote economic development or suddenly provoke economic instability and create serious crises. A recent example is the Mexican currency crisis that erupted in December 1994.

The latest Mexican crisis has caused concern that similar crises may occur in the future. Policy-oriented researchers and high-level policymakers are therefore puzzling out how new Mexico-style crises can be prevented or better managed, and how the risks can be shared more equally between governments and markets. In the light of these challenges, the Forum on Debt and Development (Fondad) and De Nederlandsche Bank held a seminar to stimulate creative and practically-oriented thinking about the prevention and management of currency crises.

A small group of eminent academics, policymakers and bankers was invited to discuss in four subsequent sessions the following questions: (i) Could the Mexican authorities have prevented or better managed the crisis? (ii) What would be the ways in which future currency crises à la Mexico could be prevented? (iii) How can future currency crises be managed better? (iv) What would be viable long-run strategies, and do short-run measures fit in with such objectives?

Each of the four sessions began with the presentation of a paper written by well-known experts Ariel Buira, Peter Kenen, Stephany Griffith-Jones, and Charles Wyplosz (with Barry Eichengreen as a co-author). The papers were followed by commentaries by Charles Siegman (US Federal Reserve Board), Jack Boorman (International Monetary Fund), William White (Bank for International Settlements), and Coen Voormeulen (De Nederlandsche Bank), and by plenary discussions. These three ingredients - the papers, commentaries and discussions - constitute the content of this book.

The first paper, by Ariel Buira, reviews the three main hypotheses that have been advanced to explain the Mexican crisis: Was it the result of an unsustainable current account, of lax economic policies, or of unpredictable political events? Buira, who as a Deputy Governor of the Bank of Mexico has been closely involved in the events, gives a full and in-depth account. He also considers some broad issues that the Mexican crisis raises.

In the second paper, Peter Kenen addresses the more general issue of how the disruption to national economies that results from fluctuations in cross-border flows can be minimised. In particular, he raises the question of how governments can protect their economies *ex ante* from the volatility of capital flows and what they can do *ex post* to minimise the effects of that volatility when they must

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confront it. Kenen also looks at the ways in which international institutions, especially the International Monetary Fund, can help governments cope with fluctuations in cross-border flows.

In the third paper, Stephany Griffith-Jones considers the new features of recent and possible future currency crises. Griffith-Jones focuses in particular on the growing importance of global institutional investors and suggests how the flows that originate from these global investors and go to emerging markets could be regulated. Griffith-Jones also examines some of the current proposals for currency crisis management.

In the fourth paper, by Charles Wyplosz and Barry Eichengreen, the authors draw out some lessons from exchange rate crises that have occurred over the last thirty years in a large number of industrial countries. In particular, they look at the consequences for the choice of exchange rate regime. According to Wyplosz and Eichengreen, the old debate was about adopting either a fixed or a freely floating regime. Current world economic developments point, however, in their view, to a different choice. The long-run tendency is toward a tripartite monetary world centred around the currency zones of the United States, Western Europe and Japan, Wyplosz and Eichengreen argue. And, given the liberalisation of capital movements, the debate will therefore be forced to make a drastic choice between either a full floating or a complete elimination of exchange rates by establishing a (regional, and eventually world) currency union.

This book arises from a three-year research project set up by Fondad, which aims to explore how regional integration as well as multilateral cooperation can be promoted, in a mutually reinforcing manner, at the same time. At a conference held in 1995 in Santiago de Chile - reflected in our publication *Regionalism and the Global Economy: The Case of Latin America and the Caribbean* - the Mexican currency crisis was one of the hot topics. We are grateful to De Nederlandsche Bank for enabling us to organise another, thorough debate on the lessons to be learned from Mexico-style currency crises by co-sponsoring a seminar at its premises in Amsterdam. We are also grateful for the continuing and solid support of the Dutch Ministry of Foreign Affairs. Special thanks go to Stephany Griffith-Jones and Coen Voormeulen who have been of great help in preparing the seminar from which this book results.

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