University of Delaware
Disaster Research Center

PRELIMINARY PAPER
#258

FINANCIAL CRISES IN THE
CONTEXT OF DISASTER THEORY:
RECENT U.S. CASE STUDIES

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1997
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The discussion here focuses on the organized response to financial crises which occurred during the 1980's in the United States. In particular, the Continental Illinois Bank Crises, the Ohio Savings and Loan Crises, and the Stock Market Crises of 1987 are examined. The case studies allows the consideration of those events in the context of expanding disaster theory to a wider range of events. It will also allow the examination of how financial crises are similar to or different from more conventional notions of disaster.

Stallings (1998) has recently argued that the study of disaster should return to a higher level of abstraction which would enable it to focus on the broad processes of social order, rather than on narrow localized events. Arguing that disaster are fundamentally disruptions in social routines, he suggest that routines are action and interactions which are repeated in social life and that these provide the structure for individual lives and, in aggregate, constitute the structure of social systems. What is important is “to identify and to study those routines where disruption is deemed serious enough that mechanisms have been worked out to address them”. (P. )

Using the logic that understanding the mechanisms for addressing exceptions tells us something about the routines they are intended to restore also provides understanding about the processes of social order.

Somewhat consistent with this approach. R. Dynes (1998), in developing a more organizationally based topology of disaster rooted in the local community, suggested the following definition “A disaster is a normatively defined occasion in a community when extraordinary efforts are taken to protect and benefit some social resource whose existence is perceived as threatened.”. The focus here, however, is not on the local community as a social system but on the network of financial institutions viewed from the national level. In Dynes’
typology, he notes that some disasters have to be conceptualized as sector/network "disaster" when demands are primarily confined to one sector (institutionalized area) and have little significance for the broad range of locally based emergency organizations. That focus is chosen here to center on the financial sector and to consider the role of financial institutions in dealing with three major national financial crises of the 1980's.
BACKGROUND

Placing financial crises in the context of disaster theory requires certain background comments. The rationale for that placement is that financial crises as well as conventional disasters share outcomes which are characterized by social disruption. Financial crises lead to the loss of financial assets, including wealth and property, and thus for reduced expectations for the future for individuals, families, communities and nation-states. Such crises often have a gradual onset, occur with little prior warning, have diffused consequences and can have long duration.

There is a significant literature on financial crises based on historical case studies as well as current economic conditions written by economists, financial theorists and by policy analysts (For one summary, see Kindleberger, 1989). Within this literature, there are a number of "conclusions", some of them quite contradictory, which have relevance for understanding the evolution of planning and action for financial crises.

First, it is usually counted that each financial crises is unique, however, at the same time it is argued that a more generalized theory can account for most of them. Depending on the time period and location, financial crises are very diverse, in terms of the timing, the source of monetary expansion and the object of speculation. (See, for example, Kindleberger, 1989, Appendix B for an outline of crises from 1720 to 1987). Certainly each case has its uniqueness. On the other hand, many scholars have emphasized a generalized theory of financial crises which can be formulated in the following manner: Given some displacement in the economic system, which could be created by crop failure, the introduction of new technology, a change in regime, or a war, there are changed opportunities for investment and profit. This new opportunity attract
new investors which, in turn, leads to an expansion of credit to allow for investment in these new opportunities. These new opportunities means that there is a movement of people and money away from “rational” or traditional activities, usually termed a “panic”. The increased demands for money to move into new areas places new demands on lending institutions, such as banks, to increase the money supply. New investments can initially lead to increased profits which provides positive feedback and thus attracts new investors. This phase of seeking profits is often described as "manias" which implies the actions are irrational or it can be described as a "bubble" which anticipates future collapse. As the boom continues, interest rates and prices continue to rise. At some stage, some insiders decide to take profits and sell out. However, many previous borrowers will not be able to pay off their loans with prices at that level. The inability to pay off loans, in turn, undercuts the financial institutions which have provided the increase and banks refuse to loan additional money.

At the basis of the financial crises is speculation, which is characterized as irrational, as contrasted with those who seek “rational” profits. Therefore, it is assumed that there is little that social institutions can do to prevent, or control it. On the other hand, financial pressures create the political need to do something, especially in those societies which have created democratic institutions. Thus there is the pressure to act. Even with such pressure, there is disagreement as to the direction of governmental action. One direction would suggest that by limiting the money supply this would prevent people from acting irrationally. Another direction would be to increase the money supply which would avoid the shortage which causes both individuals and lending institutions to fail. A final consideration is what has become known as the “lender of last resort” which is, in effect, what entity or agency has final responsibility for handling the money supply.
LEGISLATIVE BACKGROUND

In a series of laws passed during this century, Congress gave federal financial organizations responsible for the health of the financial system a variety of policy tools to provide liquidity to help prevent or contain a financial crisis. These include open market operations, access to the Federal Reserve’s discount window, and deposit insurance.

Before the Federal Reserve was established in 1913, periodic financial panics lead to many bank failures, associated business bankruptcies, and general economic contractions. In establishing the Federal Reserve, Congress gave it three important tools to carry out responsibilities as lender of last resort and regulator of the supply of money: open market operations, foreign currency operations, and discount window lending. Open market operations enable the central bank to buy sell government securities, influencing the quantity and growth of legal reserves and thereby enhancing or diminishing liquidity to the overall banking system. The Federal Reserve can undertake foreign currency transactions to counter disorderly conditions in exchange markets. Discount window lending is a line of credit facility provided by the Federal Reserve primarily to depository institutions and occasionally to other institutions whose financial distress might harm the economy. The line of credit must be secured by adequate collateral, which is determined by the Federal Reserve.

In the Banking Act of 1933, Congress created the federal deposit insurance fund to better protect depositor savings and reduce the number on bank deposits. At the time of the Continental bank and Ohio savings and loan crises, federal deposit insurance was administered by two separate entities, the Federal Deposit Insurance Corporation (FDIC) and the Federal Savings and Loan Insurance Corporation (FSLIC). FDIC and FSLIC provided deposit insurance for the nation’s banks and savings and loans, respectively. The insurance funds of these entities were
funded primarily through assessments on members. Both funds enjoyed the full faith and credit of the U.S. government. In exchange, federally insured depository institutions would be subject to strict regulatory supervision and examination and limited in the types of activities they could pursue.

**PATTERNS OF AGENCY RESPONSIBILITY**

In the 1980's, as today, federal financial agencies had congressionally determined roles in financial crisis management. Table 1.1 highlights the major responsibilities of the federal agencies. The Federal Reserve and the Department of the Treasury, the nation’s finance ministry, had broad responsibilities for the health of the financial system. Three agencies—the Federal Reserve, Office of the Comptroller of the Currency (OCC), and Federal Deposit Insurance Corporation (FDIC)—were responsible for ensuring the safety and soundness of federally chartered banks and for federally insured savings associations was assigned to the Federal Home Loan Bank Board (FHLBB). The National Credit Union Administration supervises insured credit unions. Since Congress permitted banks and savings and loan associations to operate under a state or national charter, responsibility for supervisory oversight of those institutions often involved federal and state regulators. With many self-regulatory organizations (SRO), the Securities and Exchange Commission (SEC) and Commodity Futures Trading Commission (CFTC) were responsible for market integrity and investor protection in the securities and futures markets, respectively. State regulators were responsible for oversight of insurance companies.

Financial crises of the 1980's strained the basic regulatory framework for protecting the nation’s financial system. Despite their deposit insurance mechanisms, the savings and loan industry turned to the federal government in the 1980's for assistance. The nation’s experience with financial crises has increased public awareness that the federal government, and therefore the
American taxpayer, is the ultimate lender of last resort. This means providing liquid funds to those financial institutions in need, especially when alternative sources of funding have dried up. That is, the federal government is the entity the international financial community and financial markets regard as a major source of funds to provide liquidity in a crisis. Ultimately, the U.S. government bore the cost of several crises.

The experience of banks and savings and loans in the 1980's provided ample evidence of the seriousness of the risks involved in concentration of certain types of financial exposure particularly when insufficient capital is held to protect against risk exposures. The failure of policy maker and regulators to efficiently contain the savings and loan crisis proved costly to American taxpayers. Through FIRREA, Congress created a new agency the Resolution Trust corporation to resolve failed savings and loans, liquidate their assets, and pay off insured depositors. The collapse of the savings and loan industry resulted in taxpayers incurring a large expense estimated, as of 1996, to be about $132 billion.

THREE CASE STUDIES

The focus here will be on three financial crises which were national in scope and response. They were situations of rather rapid onset where quick decisions had to be made since they posed the potential for significant disruption. They were also situations where there was involvement by diverse federal and nonfederal agencies and where federal agencies acted within their statutory authority. Three significant events were selected for intensive case studies- the Continental Illinois bank crises of 1984; the Ohio Savings and Loan crises of 1985 and the Stock Market Crash of 1987. The empirical base for the study was dependant on agency records, letters, minutes of meetings and other documents and over 70 interviews with involvement.
THE CONTINENTAL ILLINOIS BANK CRISIS

The Continental Bank crisis began on May 8, 1984 when Continental Illinois National bank in terms of assets, experienced the beginning of a sudden run on its deposits. Beset by rumors about its difficulties, Continental faced a liquidity crisis of major proportions. Federal agencies agreed that Continental’s failure would threaten the immediate health of many smaller banks whose deposits it held. This crisis illustrated that a financial crisis could develop as a result of a major financial institution having a high loan concentration in a few business sectors, such as oil or real estate.

Initially, the Federal Reserve encouraged bank lending and provided massive amounts of liquidity support. Federal banking agencies crafted a multi part strategy to (1) stop the run and (2) sell or arrange to recapitalize the bank. They announced that the FDIC would place a temporary $2 billion subordinate note in the bank, that the ultimate resolution of Continental’s problems would not subject depositors or general creditors to loss, and that the Federal Reserve would continue to provide liquidity support through the discount window. Other money center banks participated by taking $500 million of the subordinated note. This successfully slowed the run. Unable to sell the bank, FDIC permanently resolved Continental’s problems several months later with a capital infusion of $1 billion into Continental’s holding company and the purchase of $5.1 billion of its poor-quality loans. Treasury resolved a disagreement among the bank agencies about the treatment of shareholders. In consultation with the Department of Justice, Treasury settled disagreements regarding the treatment of bondholders.

THE OHIO SAVINGS AND LOAN CRISIS
The 1985 Ohio savings and loan crisis was the most widespread run on depositor institutions since the Great Depression. The run was set off by the collapse in March, of Home State Savings Bank, the largest of Ohio’s 71 privately insured savings and loan institutions. A concern of the Federal Reserve was that the run could spread to other states with private insurance funds and ultimately to federal insured savings and loans. Because the 71 thrifts were not federally regulated, federal agency officials said they lacked immediate access to important crisis-related information. At the Ohio Governor’s request, the Federal Reserve provided liquidity support to qualified thrifts experiencing heavy withdrawals. Federal Reserve officials and staff also worked closely with the Ohio Governor, sometimes engaging in non-routine activities.

Federal Reserve officials helped the state monitor the run, collect information, respond to questions from the public, and find a permanent solution to the instability. Ultimately, the run was contained through a state-declared bank holiday, temporary limits on withdrawals, and state-mandated conversion of most of Ohio’s privately insured thrifts to federally insured status. The Federal Home Loan Bank of Cincinnati provided the thrifts with federal deposit insurance. By the middle of June 1985, most thrifts had reopened with federal insurance, and confidence had been restored in nearly all of the institutions.

This crisis showed that a financial crisis occurring in a financial institution that is not federally insured could involve the federal government in a financial rescue. This case also illustrated the linkage that had developed between securities markets and financial institutions. Factors that helped contain the Ohio savings and loan crisis included the joint leadership of the Ohio Governor’s Office and the Federal Reserve, provision of liquidity by the Federal Reserve Cleveland Bank, innovative action by the state of Ohio and federal regulators, and collaboration between federal and state regulators.
<table>
<thead>
<tr>
<th>Federal Agency</th>
<th>Responsibility</th>
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<tbody>
<tr>
<td>CFTC</td>
<td>Regulates the commodity futures and options markets and seeks to ensure fairness and integrity in the marketplace. Responsible for ensuring the economic utility of futures markets-price discovery and offsetting price risk-by encouraging their integrity and protecting market participants against manipulation, abusive trading practices, and fraud. Oversight includes exchanges, some off-exchange instruments, and market participants.</td>
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<tr>
<td>FDIC</td>
<td>Promotes and preserves public confidence in banks and protects the money supply by providing deposit insurance to commercial banks, savings banks, and savings and loan associations. FDIC’s mission is to maintain stability in the national financial system by insuring bank depositors and reducing the economic disruptions cause by bank failures.</td>
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<tr>
<td>FHLBB</td>
<td>Supervised the Federal Home Loan Bank System and the Federal Savings and Loan Corporation (FSLIC) and regulated federally chartered savings and loan associations and federally chartered savings banks, supervised savings and loan holding companies, and shared with the states the supervision of FSLIC-insured state-chartered savings and loan associations.</td>
</tr>
<tr>
<td>Federal Reserve System</td>
<td>A U.S. central bank, makes and administers policy for the nation’s credit and monetary systems. Through discount window operations and supervisory and regulatory banking functions, helps to maintain the banking industry in sound condition capable of responding to the nation’s domestic and international financial needs and objectives. Regulates and supervises bank holding companies and state-chartered banks that are Federal Reserve members.</td>
</tr>
<tr>
<td>OCC</td>
<td>Part of the Department of the Treasury that regulates about 2,700 national banks. Approves organizational charters, promulgates rules and regulations, and supervises the operations of national banks through examinations. Examinations assess the financial condition of banks, the soundness of their operations, the quality of their management, and their compliance with laws, rule, and regulations.</td>
</tr>
<tr>
<td>SEC</td>
<td>Administers federal securities laws that seek to provide protection for investors; ensures that securities markets are fair and honest; and, when necessary, provides the means to enforce securities laws through sanctions.</td>
</tr>
<tr>
<td>Treasury</td>
<td>A major policy advisor to the president that formulates and recommends domestic and international economic, financial, tax, and fiscal policies; serves as a financial agent for the U.S. government, and manufactures coins and currency.</td>
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Source: GAO
THE STOCK MARKET CRISIS OF 1987

The stock market crisis began on October 19th, 1987, when a large and rapid sell-off of equity securities lead to mechanical and liquidity problems in trading and financial systems at stock, options, and futures exchanges and associated clearing organizations. Credit relationships between financial firms and banks were also strained. The market break was extraordinary in terms of the speed and extent of falling prices and skyrocketing trading volume. This crisis showed that the size and potential impact of increased linkages between the equities markets and futures markets could change the character of a financial crisis.

Difficulties also occurred in the clearance and settlement system and in bank extensions of credit to securities firms. European and Pacific rim financial centers experienced similar declines. Federal officials were most concerned that the U.S. system ford allocating credit would be halted. To keep markets open and functioning as they should, federal officials and agencies took various actions in accordance with their individual authorities and responsibilities. For example, the White House and Treasury collaborated in making public announcements to foster confidence in the markets. Treasury discussed with finance ministries in London and Tokyo and other financial centers the importance of providing liquidity support to their markets. The Federal Reserve also discussed with other central banks the importance of providing liquidity support. The Federal Reserve provided prompt and sizable liquidity through open market operations. Around noon on October 20th, the market was plummeting and uncertainty existed about whether NYSE could remain open. However, buying activity in one stock index futures contract around noon signaled the turnaround of the markets. By the end of the week, markets were calmer, but some officials involved in trying to manage the crisis believed that luck played a major role in the recovery.

Factors that contributed to containing the crisis included the complementary leadership of
the financial exchanges, the Treasury Department, and the Federal Reserve; the early offer of
liquidity by the Federal Reserve to keep the markets functioning; swift and innovative action by
federal financial regulators; and the collaboration of the private and public sectors.

**LEGISLATIVE AND AGENCY CHANGES**

Congress, of course, has oversight responsibility for all federal agencies. While legislative
changes are not automatic after a major financial crises, in the ling ruin, congressional committee
hearing can highlight subsequent legislative modifications, which usually focus on the most
publically visible issue to emerge. In addition, agencies often make modifications in their own
procedures based on more recent experience.

After the continental case, FDIC began to monitor state charted banks which were
members of the Federal Reserve system and instituted weekly meetings with officials of the
federal bank supervision agencies to exchange information about emerging bank problems. In
1987, Congress passed the Competitive Equality Bank Act of 1987 (P.L.100-86) which gave the
FDIC bridge bank authority to facilitate the disposition of failed banks (The bridge bank is to
assume the assets and liabilities and to carry on the business of the failed bank until it is acquired
or merged.) The FDIC Empowerment Act of 1991 established cost constraints for regulating and
resolving financial difficulties of banks. Before, the FDIC could fully protect all cost of the bank
if it were deemed essential to the community. The new act narrowed the circumstances when the
FDIC could act in this way. Only in situations in which a bank failure posed a risk to the national
financial system, could the FDIC fully protect depositors. Without external approval, up to the
Secretary of Treasury, the FDIC can protect only insured funds and depositors.
In the Ohio Savings and Loan case, while there were a number of changes in Ohio Laws, two federal laws were enacted to address problems which surfaced during that crises—fraudulent sales activities of government securities and disclosure to depositors about their depository institution insurance coverage. The Government Securities Act of 1986 (P.L. 99-571) created tighter regulation of government securities brokers and dealers, like ESM Government Securities. Home State had been heavily exposed to this failed securities dealer through repurchase agreement transactions. Also the Federal Deposit Insurance Corporation Improvement Act of 1991 (P.L. 102-242) required that all state chartered banks, thrifts and credit unions without federal deposits insurance to conspicuously disclose that fact to existing and prospective customers.

After the Stock Market Crises of 1987, there were a number of agency studies of the event, and the Market Reform Act of 1990 included a number of suggested changes. In particular, SEC was granted additional authority to suspend trading on a temporary basis and were also given emergency authority to restore order to securities markets. SEC, CFTC and securities and futures exchanges implemented coordinated circuit breaker mechanisms that provide a 30 minute trading halt of all securities and derivative instruments after a 350 point DJIA (Dow Jones Industrial Average) decline in a day and a 1-hour halt after a 550 DJIA decline. A teleconferencing system linking financial markets and regulators was implemented. Computer capacity was increased both at exchanges and at broker dealers. A three day business settlement period became standard, eliminating two days of potential participant default. In addition, the FDIC Improvement Act of 1991 clarified that the Federal Reserve could lend from its discount window without any legal constraints on the use for which the credit was being put to use. Borrowers must show that they need to loan to remain in business and have secure collateral. All
of these legislative changes were based on perceived problems which emerged from the last financial crises.

COMMENTS ON THE “DISASTER CYCLE” IN FINANCIAL CRISES

It is useful to view financial crises from the vantage point of what research in other emergencies, such as natural disasters, would suggest as good practice. There does exist body of literature abased on other emergency situations which provides a context for evaluating the previous (See, for example, Drabek and Hoetmer, 1991, Dynes, 1994: Dynes, Quarantelli, and Kreps, 1981; Quarantelli 1994 Tierney, Perry and Gillespe, 1998). That literature is usually structured in terms of the working out of a time sequence involving actions taken in preparedness, response, recovery and mitigation.

In terms of preparedness, federal agencies routinely collect extensive information on the activities of financial institutions which can provide early warnings of potential financial crises. However, information essential to one agency is often not easily available to other agencies so that critical patterns may not be recognized. Too, information on financial institutions is usually based on routine reporting and are not easily adaptable to sudden changes in the status of those institutions. Also, information on the derivative effects from financial crises, in the larger economy are often difficult to collect in a timely fashion. Information collected can often identify institutions at risk but in the case of banks, cannot predict the onset of massive withdrawals or in the case of stock market, cannot predict the initiation of massive selling. In other words, information useful to anticipate a crises is dispersed among various agencies and there are gaps in that information.

In general, pre-crisis planning is agency specific. Planning efforts are often not well documented, in part because some fear that the knowledge of that planning would provide an
impetus for others to “panic.” On occasion, agencies have initiated pre-crises meetings to anticipate certain consequences. Within federal agencies - Treasury has the political leadership and the Federal Reserve has containment mechanisms. In general, there is no common emergency operating center among federal agencies which is systematically used in financial crises, although various agencies have created “war rooms” as a communication focus. On occasion, such as in the Ohio case, field operational offices ave been created. Also on some occasions, public information about the details and meaning of financial crises have been coordinated, as evidence by the actions of the Federal Reserve Bank of Cleveland in the Ohio crises. Coordinated action, however, is essential since no one federal agency possesses authority over the range of possible actions. The beginnings of a more effective coordination had its roots in the Stock Market Crises of 1987 and was to more adequately implemented in the Crises of 1997. After the Stock Market Crises of 1987, the idea emerged to create a top policy coordinating group. Called the President’s Working Group on Financial Markets, it is chaired by the Secretary of Treasury and its other members are chairs of the Federal Reserve, SEC, CFTC, the Director of the National Economic Council, and can involve other officials and those from the private sector depending on the situation. This group was active in the Stock Market Crises of 1997.

Since financial crises develop rather than “happen”, a collective response is always tentative and cautionary. This is particularly true, given the limited range of actions considered appropriate. By and large, one common prescription is to do nothing to let the institution or market readjust. A second prescription is to close or limit access to financial institutions or markets which would calm the “panic”, the so-called “circuit breakers”. A third alternative is to take action to increase access to liquidity to reassure depositors or creditors. Considering these options or combinations of them often takes time and the choices are not as predetermined as the
responses to other rapid onset disasters agents. The process necessary to develop a response among diverse agency interests can be interpreted by members of interested public as signaling equivocation. If a solution, involves the private sector or state and local officials, the time necessary may be extended. Too, financial crises initiated at the state level usually delays federal involvement, although some of these crises may be anticipated earlier by federal data.

In any case, over time, financial crises are “solved” and some of those solutions do become embedded in legislative action, in an attempt at mitigating future financial crises. One persistent difficulty is the limited learning which does occur because of the infrequency of crises. In federal agencies, many of the direct participants in one crises, especially political appointees, will not be involved in subsequent crises, so learning is not easily transferable, especially if there is a reluctance to develop written contingency planning.

Given those problems, there can be no doubt that as a consequences of the financial crises of the 1980's, federal agencies today are in a much better position to deal with financial crises. There is, throughout all agencies, a recognition of the value of planning. There is an increasing effort to share data among agencies. When an crises occurs, there is extensive informal cooperation and coordination among the agencies, less a matter of plan than a matter of personal contacts. There is a increasing level of cooperation between the political and financial dimensions of crises, especially between the Federal Reserve and the Treasury. There is positive value given to interagency coordination and also to the importance of timely and accurate public information. All of these aspects have been encouraged by experience in previous financial crises.
CONTINUING ISSUES

It is clear that financial crises in the future in the United States will increasingly focus on the stock market, rather than on bank failures. The increasing importance of the stock market is indicated by a growing amount of the assets of the U.S. Households invested in equities. For example, in 1986, 17.6% of household assets were in equities and in 1996, this had increased to 31.1% and the total value of domestic equities increased from 39.6 billion in 1987 to 86.7 billion in 1997. Given that context, there are certain persistent contradictions which will make emergency planning for financial crises difficult. These involve unresolved problems concerning the causation, the remedy and the scope of financial crises.

1. The underlying assumptions about investor behavior is questionable. From the very beginning of attempts to understand financial crises, much of that explanation has adopted a vocabulary of collective “irrationality”. Concepts, such as panic, manias, and contagion, are rooted in 19th century social psychology. (Nye, 1975) Those conceptions, drawn primarily from French scholars, had their origins in attempts to understand crowd behavior, especially popular behavior which emerged after the French revolution. That vocabulary was used most readily by those who distrusted emerging democratic institutions, In other words, it was useful vocabulary for elites to explain the irrational behavior of the “masses”. It was claimed that, in certain situations, the “people” would “regress” down on the evolutionary scale and become a threat to social order. Too, such descriptions placed blame on the irrational actions of the common people while displacing blame away from the corporate and or government institutions. In short, this vocabulary implies that, while markets are rational, individuals behave irrationally and thus create financial crises. Such concepts of “irrationality” are no longer considered useful in contemporary social psychology although they tend to be perpetuated in many popular and some economic
analysis of financial crises. The continued use of these explanations of irrationality has several consequences. First, it prevents a more adequate explanation of the economic behavior to emerge. Second, with the increasing participation of individuals, especially in the United States, in the stock market, this necessitates an explanation for the spread of such irrationality. Third, with such an increase in participation, it makes it increasingly difficult to apply an elitist explanation. Fourth, if irrationality is the major cause of financial crises, then rational planning is impossible. In short, 19th century perceptions of "crowd" behavior in terms of panic provide little explanatory power to explain crises in the 1990's except to displace blame.

2. There will be continuing tension between those who consider the market to be self-correcting and those who consider that the market, on occasion, merits intervention. This tension is both ideological as well as institutional. Certainly, within economic theory, financial crises have been an object of study and a topic for intellectual debate. In general, monetary theorists take the position that markets are rational, that there is no destabilizing speculation and that the government intervention only compounds economic mistakes. (See the discussion, Currency School vs. Banking School in Kindleberger, P. 60ff). Other economic schools posit a range of differences from that position. But, aside from economic theorists, most individuals employed in financial institutions view governmental intervention in the markets as unhelpful, if not destructive. Of course, those persons are also quite willing to see the government as the lender of last resort.

On the other hand, persons occupying positions within government agencies which have responsibility for financial institutions have within their organizational domains certain intervention responsibility. More importantly, political leaders who have to be responsive to their constituents are likely to find, in the future, an increasing number of their constituents involved in
financial crises as a consequence of the increase in mutual fund ownership. Thus, perhaps contrary to the status of economic theory and the reluctance of financial institutions to entertain governmental intervention, there will be increased political pressure for governmental intervention in future financial crises, and perhaps increased pressure for the government to become the lender of last resort in those situations.

3. The scope of financial crises is increasingly global. If one looks at the history of financial crises, initial concerns centered on community crises, then those which had state and regional implications, then national crises. Certainly, the emergence of a global economy creates a number of new problems for both planning and action in financial emergencies. In the Mexican Debt Crises in 1982, the U.S. government played an important part in dealing with those issues. In the Stock Market Crises of 1997, problems appearing in Thailand, Japan, and Hong Kong soon affected markets in South America, Europe and the United States. In general, international organizations, often created for different purposes, have increasingly become involved in financial crises.

Three key international organizations are the International Monetary Fund (IMF), The International Bank for Reconstruction and Development (World Bank), and the Bank for International Settlements (BIS). Both IMF and the World Bank were established following World War II and funded by subscriptions or quota shares from the United States and other members. IMF was established to promote international monetary cooperation and exchange rate stability and provide short-term lending to members experiencing balance-of-payment difficulties. Originally, IMF was to make medium-term loans of 3 to 5 years duration for balance-of-payments support. Its lending was to be based on a country's fiscal and monetary policies, exchange rates, and other macroeconomic factors. The World Bank, on the other hand, was to
provide developing countries long-term loans for development when private financing was unavailable. Over the past several decades, however, both IMF and the World Bank have provided longer term financial assistance to countries involved in economic adjustments. BIS, a central bank for central banks, is both a wholesale money market bank accepting deposits from central banks and a forum promoting cooperation among central banks. Established in 1930, BIS performs a variety of trustee and other banking functions, mainly for central banks and international organizations. With encouragement and guarantees from leading central banks, BIS has helped provide bridge financing to a number of central banks in Latin America and Eastern Europe pending disbursement of IMF and World Bank credits.

**SUMMARY**

Financial crises can be placed within the context of disaster theory since they created disruptions in social routines and mechanisms have been institutionalized to address the consequences of those disruptions. Treating financial crises here as a sector disaster, a description is provided of the evolution of action and responsibility of U.S. federal financial organizations. Case studies of the actions of those organizations in three crises of the 1980’s were presented—the Continental Illinois Bank Crises, the Ohio Savings and Loan Crises and the Stock Market Crises of 1987. Too, legislative modifications which occurred subsequently were also noted.

Significant improvements have been made in the federal response, especially in data collection, communication and information and in the development of pre-crises interagency coordination. In addition, both congressional oversight and organizational learning have lead to both legislative and agency modifications in the response and to mitigation.

Problems still remain, in part, because of the perpetuation of questionable theories of the
irrationality of the financial behavior of individuals. Too, there is institutional and ideological conflict as to the importance and necessity of federal intervention. Also, while past financial crises have never completely observed nation-state boundaries, the globalization of the economy may make intervention more necessary as well as more difficult.
FOOTNOTES

1. The selection process eliminated the Penn Central commercial paper crises, the Franklin National Bank insolvency and the Herstatt collapse of the 1970's as well as the silver crises, the Drysdale collapse government securities failure and the Drexel collapse of the 1980's.

2. Greater details of each case, including a chronology of selected events, can be found in General Accounting Office Financial Crises Management: Four Financial Crises in the 1980's, (GAO/GGD-97-96) Patrick Dynes was Project Manager. Discussion of the Mexican debt crises of 1982 not considered here since international agencies played a critical role in that event. The conclusions drawn here are the author's and not the General Accounting Office.
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