



## Economic Approaches to Financial Stability: A Theoretical Review and Analysis of Banking Determinants

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**Abstract :** This article provides a comprehensive theoretical analysis of the concept of financial stability. Starting from the observation that there is no universal definition, it examines the different conceptual approaches, traces the explanatory theories of financial instability from the classics to modern schools of thought, and analyzes the determinants of stability with a focus on the banking sector. The article incorporates a specific methodological section and presents the main measurement tools. It highlights the particular implications for emerging economies, where banking stability constitutes the cornerstone of overall financial stability.

**Keywords:** Financial Stability, Financial Instability, Financial Crises, Economic Theories, Banking Sector, Emerging Economies.

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### 1 Introduction

Since the 1980s, global financial liberalization has triggered a rapid expansion of the financial sector, accompanied by significant economic benefits for many countries. However, this period has also been marked by recurrent episodes of dramatic economic slowdown caused by the heavy burdens of financial crises. These experiences have transformed the perception of financial stability, elevating it from a technical concern to a central objective of economic policy, now placed on par with price stability.

The uniqueness of the concept of financial stability lies in its dual nature of being both essential and elusive. Unlike inflation, there is no universally accepted definition, nor a single indicator capable of measuring it with precision. This conceptual ambiguity reflects the multidimensional and systemic nature of the phenomenon: financial

stability is not merely the absence of crisis, but pertains to the resilience of a complex web of institutions, markets, and interconnections.

For emerging economies, where financial systems are often dominated by the banking sector and characterized by less mature institutions, the pursuit of financial stability presents specific challenges. Understanding its conceptual mechanisms, theoretical foundations, and determinants thus becomes essential for designing regulatory and supervisory policies suited to these particular contexts.

This article aims to structure the theoretical analysis of financial stability along three main axes: (1) an examination of its conceptual and definitional framework; (2) an analysis of the theoretical foundations of financial instability throughout the history of economic thought; and (3) the identification and discussion of the key determinants of stability, with a particular focus on the banking sector in emerging economies.

## **2 The Conceptual Framework :**

### **2.1 The Definitional Challenge and Evolving Perspectives**

A fundamental paradox characterizes the literature on financial stability: while it is a major policy objective for many central banks and regulatory authorities, no universally accepted definition exists. As several authors note, many institutions publish financial stability reports while carefully avoiding providing a precise definition, thereby acknowledging the "imperceptible nature of a coherent definition" (Padoa-Schioppa, 2002).

This difficulty stems from the very nature of the concept. Financial stability is not a property of an individual actor, but an emergent characteristic of a complex system. It pertains to the interrelations among institutions, markets, infrastructures, and regulatory frameworks. Furthermore, it possesses an essential normative dimension: what level of risk, what frequency of failures, are "acceptable" in a system considered "stable"?

The historical evolution of perspectives on financial stability reveals a significant shift in the conceptualization of the term. Initially considered a natural byproduct of sound macroeconomic policies, it has gradually become an explicit public policy objective, especially following the systemic crises of the 1990s. Central banks, traditionally focused on price stability, have broadened their mandates to explicitly or implicitly include financial stability among their goals.

### **2.2 Approaches Through Stability: From Physical Analogy to Functional Definitions**

A first approach, drawing from etymology and conceptual frameworks, borrows the notion of stable equilibrium from the physical sciences. In physics, a system is considered stable when it spontaneously returns to its equilibrium position after a moderate disturbance. Allen and Wood (2006) explicitly champion this analogy, viewing financial stability as a property of an economic system that "has a tendency to dampen shocks rather than amplify them." From this perspective, an economy is financially stable when it withstands a disturbance (an economic shock, a major bankruptcy) without descending into systemic instability.

This mechanistic view, while instructive, proves inadequate for capturing the specificity of the modern financial system. Schinasi (2004) thus offers a more functional definition: financial stability is "a condition in which the economic mechanisms for pricing, allocating, and managing financial risks are functioning well enough to contribute to the performance of the economy." It is, therefore, the system's capacity to perform its fundamental functions (resource allocation, risk management, facilitating payments) even in the presence of shocks.

Padoa-Schioppa (2002), for his part, emphasizes the system's robustness, defining financial stability as "a condition that allows the financial system to withstand shocks without giving way to cumulative processes that impair the allocation of savings to investment opportunities and the processing of payments in the economy." This definition highlights the idea of resilience and the preservation of essential functions, while explicitly acknowledging the existence of a trade-off between the pursuit of stability and the tolerance of a certain level of risk necessary for the dynamic functioning of the system.

A recurring element in several definitions is the central notion of confidence. Crockett (1997) and Foot (2003) stress that financial stability implies a sufficient level of confidence in institutions and markets for economic agents to continue participating in them normally. Stability is therefore not only an objective property of the system but

also a perception of the actors within it. This subjective dimension is crucial, as it can create self-fulfilling dynamics: a loss of confidence can precipitate a crisis, even in the absence of major fundamental imbalances. Finally, Patat (2000) proposes a multidimensional definition that emphasizes "the solidity of the linkages existing between the different components" of the financial system. This systemic approach is particularly relevant in the era of financial globalization and increasing interconnections among institutions, markets, and jurisdictions. It recognizes that vulnerability can stem not only from the weakness of individual components but also from the fragility of their interlinkages.

### **2.3 Approaches Through Instability and the Financial Crisis**

Given the difficulties in positively defining stability, many authors adopt a complementary approach: defining stability by its absence, by studying the manifestations and causes of instability. This approach has the advantage of being based on observable and measurable phenomena.

Financial instability is thus defined by Chant et al. (2003) as "the set of conditions in financial markets that harm or threaten to harm an economy's performance by affecting the workings of the financial system." Mishkin (1997) specifies that it corresponds to mechanisms that "disrupt the financial system and prevent it from performing its role" of allocating funds to productive investment opportunities.

Davis (2003) and Ferguson (2002) highlight the concrete manifestations of instability: a weakening of the incentives for investment, considerable fluctuations in asset prices, a distortion in the functioning of the credit market, and a significant deviation of spending from the economy's productive capacity. These definitions establish an explicit link between financial disruptions and their consequences on the real economy, thereby justifying public authority intervention.

The most acute manifestation of instability is a financial crisis. The literature traditionally distinguishes two definitional currents. The first, with monetarist inspiration (Friedman and Schwartz, 1993), adopts a restrictive definition that only recognizes a financial crisis in the presence of a banking panic and a significant contraction of the money supply. The second, associated with Kindleberger and Minsky, proposes a broad definition that includes asset market crashes, chain defaults, foreign exchange market disruptions, and various combinations of these phenomena.

A synthetic and commonly used definition today views a financial crisis as "a severe financial instability" that "endangers at least one of the three key functions of the financial system: the allocation of credit and capital, the circulation of means of payment, and the valuation of financial assets" (Plihon, 2018). This definition has the advantage of explicitly linking the crisis to the disruption of systemic functions and introducing the notion of systemic risk—the risk that the failure of an institution or the disruption of a market spreads to the entire financial system.

## **3 Theoretical Foundations of Financial Instability**

### **3.1 Classical Theories: From Cycles to Overproduction Crises**

The first systematic theories of crises are situated within the analysis of economic cycles and emphasize real rather than financial imbalances. These approaches, developed in the 19th and early 20th centuries, remain relevant for understanding the underlying dynamics of economic fluctuations.

Clément Juglar (1862, 1863), a pioneer of business cycle analysis, identifies the crisis as one of the three phases of the business cycle (prosperity, crisis, liquidation). For him, crises originate in "excessive speculation and the thoughtless expansion of industry and commerce," fueled by an overextension of credit. The regularity of crises makes them a quasi-natural phenomenon of capitalist development, as evidenced by his famous observation: "The renewal and succession of the same facts, under special circumstances, in all times, in all countries, and under all regimes." Juglar even considered crises to be "a potential source of stability," participating in a process of purification and rebalancing of the system.

Albert Aftalion (1909) developed a theory of overproduction crises based on temporal mismatches between production and consumption. His analysis highlights the accelerator mechanism: the initial expansion of consumption stimulates investment in capital goods, but when consumption slows, the production of these goods

exceeds demand, leading to falling profits and a halt in investment. This mechanism describes an endogenous cycle where prosperity contains the seeds of crisis within it, through erroneous expectations and production lags. Karl Marx (1894) analyzes crises as manifestations of the internal contradictions of capitalism. The "main source of all crises lies in the limited consumption of the masses, compared to the capitalist tendency to develop the productive forces without limits." This fundamental contradiction between production capacity and consumption capacity generates crises of value realization that are both inevitable and necessary for the expanded reproduction of the system. Marx also insists on the deceptive nature of prosperity periods that "camouflage the true state of the financial system," making the crises all the more brutal when they occur.

### **3.2 Keynes's Contribution: The Instability of Effective Demand and the Role of Expectations**

John Maynard Keynes (1936) represents a fundamental break with the idea that market economies spontaneously tend toward full employment. For him, crises primarily result from the sudden collapse of the marginal efficiency of capital, meaning the anticipated returns on investments.

The Keynesian mechanism comprises several innovative elements:

The recognition of radical uncertainty about the future, which distinguishes his thinking from traditional probabilistic approaches.

The volatility of entrepreneurs' "animal spirits," those non-rational impulses that guide investment decisions.

The possibility of sudden shifts in expectations, not necessarily linked to changes in economic fundamentals.

The role of the interest rate as a determining but insufficient variable for stabilizing investment.

Keynes particularly emphasizes that "the crisis does not represent merely a situation characterized by a rise in the interest rate" but results from "the sudden collapse of the marginal efficiency of capital." This collapse can be so powerful that no reduction in the interest rate is sufficient to revive investment, a situation he terms the "liquidity trap."

Keynesian theory also establishes a crucial link between saving and investment. In a monetary economy, saving and investment are decided by different agents for different reasons, which can generate persistent imbalances. Instability is therefore endogenous to the capitalist system, linked to the very nature of decision-making in an uncertain environment.

### **3.3 Minsky's Financial Instability Hypothesis: Stability is Destabilizing**

Hyman Minsky (1992) expands and systematizes the Keynesian approach by proposing a comprehensive theory of financial instability. His central hypothesis, which has become famous, is that "stability is destabilizing": a prolonged period of economic and financial stability encourages agents to adopt increasingly risky behaviors.

Minsky distinguishes three types of financing structures, forming a continuum of increasing risk:

Hedge Financing: Cash flows cover both the interest and the principal of the debt.

Speculative Financing: Cash flows cover the interest but not the principal, requiring periodic refinancing.

Ponzi Financing: Cash flows do not even cover the interest, requiring increased borrowing or the sale of assets.

During an economic expansion, the financial system gradually shifts from "Hedge" structures toward "Ponzi" structures.

The crisis erupts when an event (even a minor one) reveals the underlying fragility, triggering a rush to deleverage and a fall in asset prices. Propagation mechanisms (contagion, forced sales, collapse of confidence) amplify the initial shock. Minsky's theory thus provides a powerful framework for understanding financial cycles and the endogenous nature of crises, particularly relevant for analyzing speculative bubbles and their bursting.

### **3.4 Monetary and Credit Theories: The Role of Monetary Imbalances**

A set of theories emphasizes the role of money and credit in the genesis of instability, offering perspectives that complement Minsky's analysis.

Milton Friedman and Anna Schwartz (1963) champion a rigorous monetarist approach: crises primarily result from monetary policy errors, particularly inappropriate contractions of the money supply. Their famous study of the Great Depression attributes it largely to the mistakes of the Federal Reserve, which they argue allowed a catastrophic monetary collapse to occur.

Irving Fisher (1933) developed the theory of debt-deflation, whose mechanism involves several interlinked stages:

- Initial over-indebtedness of economic agents.

- Forced sales to repay debts.
- Fall in asset prices and general deflation.
- Increase in the real burden of debt (nominal debts remain fixed while prices and incomes fall).
- A new wave of forced sales...

This vicious circle explains why some recessions transform into deep and prolonged depressions. Fisher emphasizes the combination of over-indebtedness and deflation as the primary cause of major depressions.

Maurice Allais (1999) and other radical critics identify the creation of money ex nihilo through bank credit as the fundamental source of instability. Allais even describes this mechanism as the "cancer" of the financial system. This criticism aligns with older proposals by Léon Walras (1898) and Irving Fisher (1935), who advocated for a 100% reserve system to prevent monetary creation by banks, believing that only such a radical reform could durably stabilize the financial system.

Knut Wicksell (1898) and Henry Thornton (1802) analyze cumulative processes through the gap between the natural rate of interest (which equilibrates savings and investment) and the market interest rate. A persistent gap between these two rates leads to cumulative expansions or contractions of credit, prices, and economic activity. This approach would deeply influence subsequent economic thought, notably that of Keynes, and provides a framework for understanding how inappropriate monetary policies can generate inflationary or deflationary imbalances.

### **3.5 The Role of Institutions: A Foundational Perspective**

An institutionalist school of thought, inspired notably by Thorstein Veblen (1909), emphasizes that the quality of institutions is a fundamental determinant of financial stability. This perspective complements purely economic analyses by demonstrating that financial stability fundamentally depends on the politico-institutional framework within which the financial system operates.

Empirical research by Demirgüç-Kunt and Detragiache (1998, 2002) shows that a weak institutional environment (weak rule of law, high corruption, poorly protected property rights, ineffective supervision) significantly increases the probability of banking crises.

Acemoglu, Johnson, and Robinson (2003) develop a broader analysis linking extractive institutions (which concentrate power and wealth in the hands of an elite) to macroeconomic instability. Insufficient institutional quality fosters short-term political choices, misallocation of resources, corruption, and vulnerability to shocks. Their work demonstrates that institutional differences explain a significant part of the variation in the frequency and severity of financial crises across countries.

Other studies complete this picture. Ghosh and Ghosh (2002) show how weak governance makes economies more susceptible to the effects of macroeconomic imbalances. Alesina and Wagner (2003) establish that countries with weak institutions are less capable of maintaining credible exchange rate regimes, which contributes to monetary and financial instability. Shimpalee and Breuer (2006) identify specific institutional factors (quality of bureaucracy, ethnic conflicts, political tensions) that influence the likelihood of crises.

This institutional approach has important implications for emerging economies, where institutional weaknesses are often pronounced. It suggests that transferring regulatory technologies (such as Basel standards) may have limited effectiveness if not accompanied by a parallel strengthening of fundamental institutions.

## **4 Determinants of Financial Stability**

### **4.1 The Primacy of the Banking Sector**

In emerging economies, the distinction between banking stability and financial stability is often tenuous, even artificial. As noted by Popovska (2014), in countries with underdeveloped financial markets, "banks are the main pillar of financial stability and the overall stability of the economy." This centrality of the banking sector is explained by several structural characteristics:

- **Predominance of Bank Financing:** In most emerging economies, banks remain the primary source of financing for businesses and households, as capital markets are often narrow and illiquid.
- **Systemic Importance of Large Banks:** A few large banks, sometimes state-owned, often dominate the sector, creating concentrations of risk and strong interdependencies with the real economy.

- Central Role in Monetary Policy Transmission: The effectiveness of monetary transmission channels depends largely on the health and behavior of the banking sector.
- Vulnerability to External Shocks: Banks in emerging economies are often exposed to currency risks (dollarization/euroization of balance sheets) and the volatility of international capital flows.

This configuration makes banking stability a crucial intermediate objective for achieving overall financial stability in emerging economies. The determinants of banking stability therefore hold particular importance there.

#### **4.2 Capital Requirements:**

U.S. GAAP accounting standards were accused of contributing to the 2007-2009 financial crisis because their incurred loss model for loan provisions prevented banks from building reserves in a forward-looking manner. The need to strengthen reserves during the crisis weakened regulatory capital ratios, further destabilizing the banking sector. Thus, accounting standards affected stability through their impact on bank capital.

Capital requirements are crucial. They strengthen the international competitive position of banks and protect them against risky decisions, given their specific and systemic nature. Since the failure of a single bank can harm the entire system, the Basel Committee, as early as 1988, universally recognized the protective role of capital against failure and for loss absorption.

The impact of these regulatory requirements is the subject of broad theoretical debate. The liberal school of thought opposes external regulation, advocating for the self-equilibration of markets. Proponents of efficient markets favor microprudential regulation but suggest that capital requirements should be delegated to the banks themselves, as the best judges of their own risks. Conversely, the neo-Keynesian paradigm recommends binding regulation and macroprudential supervision, considering instability as endogenous to financial markets and criticizing the information asymmetry induced by self-regulation.

The literature on the impact of capital on stability is extensive and mixed. Many studies emphasize its stabilizing role: a high level of capital allows for more deposits, strengthens credit portfolio selection, protects against moral hazard, and cushions shocks, serving as a signal of solvency. Tartani (2002) considers that an adequate level of capital can be a genuine tool for banking soundness. Van and Roy (2003) showed that the expansion of capital requirements among G10 banks (1988-1995) was accompanied by a decrease in credit risk. Furlong and Keeley (1989) and Keeley (1990) establish that strict requirements reduce excessive risk-taking, as a bank seeking to maximize its value prefers to raise capital rather than sell risky assets, which limits the exposure of the deposit insurance system. Bolt and Tieman (2004) indicate that strict requirements also make banks more selective in granting credit, limiting their exposure to default risk.

Nevertheless, other studies challenge these findings. Blum (1999) and Koehn and Santomero (1980) argue that increasing capital does not guarantee stability and can even be harmful by encouraging the expansion of banking risks. Besanko and Kanatas (1993) explain that strict requirements could reduce incentives for monitoring, deteriorating portfolio quality. Hakenes and Schnabel (2011) link their effect to competition: they are only stabilizing when competition itself is destabilizing. They can thus dampen loan competition and intensify moral hazard. Moreover, Blum (1999) argues that they can weaken bank profits, exposing the bank to default risk. Koehn and Santomero (1980) add that they can create a climate of excessive confidence, encouraging a shift of portfolios towards riskier assets, increasing the probability of failure. Finally, Saadaoui (2010) finds that capitalization does not influence the risk level of banks, due to a propensity for risk-taking, poor quality of capital, or weak incentives to comply with standards.

#### **4.3 Liquidity:**

Excessive bank liquidity creation is identified as an important risk factor for financial stability, a phenomenon particularly concerning in emerging economies subject to volatile capital flows.

Acharya and Naqvi (2012) model how an influx of deposits can lead banks to lower their lending standards and fuel asset price bubbles. This mechanism is reinforced in contexts where banking competition is strong and short-term incentives outweigh long-term prudence.

Berger et al. (2013, 2017) empirically document that abnormally high levels of bank liquidity creation preceded several major crises, including the 2007-2008 crisis. Liquidity thus appears to play a procyclical role: abundant during expansions, it dries up abruptly at the onset of a crisis, amplifying the financial cycle.

The 2007-2008 crisis demonstrated how these two dimensions can reinforce each other in a vicious circle: funding difficulties lead to asset sales, which depress asset prices and worsen balance sheets, which in turn makes funding even more difficult. For banks in emerging economies, this vulnerability is often exacerbated by currency and maturity mismatches.

#### **4.4 Bank Concentration:**

The relationship between bank concentration and financial stability gives rise to two competing hypotheses, the implications of which are significant for emerging economies (where concentration is often high).

##### **The "Concentration-Stability" Hypothesis:**

Banks with market power generate high profits ("franchise value") which they have an interest in preserving by avoiding excessive risks (Keeley, 1990).

Concentration facilitates regulatory supervision by reducing the number of entities to monitor (Allen and Gale, 2000).

Large banks are better able to diversify their risks geographically and across sectors (Levine et al., 2007).

Concentration reduces problems of information asymmetry by facilitating long-term relationships between banks and clients (Chan et al., 1986).

##### **The "Concentration-Fragility" Hypothesis:**

Market power allows banks to increase interest rates on loans, thereby raising the risk of borrower default (De Nicolo et al., 2009).

Banks that are "too big to fail" benefit from an implicit subsidy that encourages risk-taking (Mishkin, 1999).

Concentration can reduce innovation and system efficiency, creating rigidities.

Large banks may have less diversified portfolios than expected, concentrating their risks in certain sectors or regions (De Nicolo et al., 2006).

Hellmann et al. (2000) add an important nuance by analyzing the impact of competition on "franchise value." Excessive competition can erode bank profits, reducing their franchise value and incentivizing them to take on more risk to maintain profitability. This analysis suggests that a certain degree of concentration (and thus profits) can be beneficial for stability.

For emerging economies, this debate is crucial. High concentration is often a historical and structural reality. The question is not so much whether it is good or bad in itself, but rather how to regulate it to capture potential benefits (ease of supervision, stabilizing profits) while limiting the risks (excessive market power, moral hazard of systemic banks).

#### **4.5 Size and "Too Big To Fail":**

The relationship between bank size and their stability is analyzed through two opposing theories. Agency theory predicts a negative relationship, positing that managers may seek to increase the bank's size for their personal benefit (compensation, prestige), at the expense of stability. Conversely, stewardship theory assumes a positive relationship, considering that large banks possess institutional quality that fosters a more stable financial environment. This relationship is essentially studied through the lens of the Too Big To Fail (TBTF) doctrine.

The TBTF doctrine originated from the bailout of Continental Illinois in 1984. U.S. monetary authorities explicitly acknowledged then that they would not allow one of the country's largest banks to fail. Since then, the term TBTF refers to institutions whose failure would threaten the entire financial system and the real economy, and who can therefore expect government assistance.

Regarding its contribution to the 2007-2008 crisis, the presence of the TBTF doctrine before the crisis is debated. On one hand, its existence is evidenced by the funding advantage enjoyed by large banks (higher credit ratings, lower refinancing costs), which encouraged their expansion and the complexity of the sector. On the other hand, signs suggest its relative absence, notably the significant prudential regulatory efforts (Basel I and II Accords) deployed after the failures of the 1980s and the resilience of some large banks without direct aid during the crisis.

However, while the TBTF doctrine may have amplified the crisis by encouraging the growth and complexity of the sector, it was not its sole cause, as evidenced by regulatory progress and cases of banks that survived without public support.

#### **4.6 Bank Profitability and Financial Stability**

The global financial crisis of 2007-2009 and the subsequent period of low interest rates revived policymakers' interest in the importance of bank profitability for financial stability. The existing literature on bank profitability and its impact on financial stability yields mixed results.

First, regarding profitability and risk, some researchers have found that high profitability leads to higher "charter value" (i.e., expected long-term profitability) and thus lower risk-taking by banks (Berger et al. 2008).

Others suggest that high profitability could loosen leverage constraints and lead to greater risk-taking. Furthermore, high profits during prosperous times could be an indicator of systemic risk during a crisis (Meiselman et al. 2018).

This observation aligns with the findings of Natalya, Ratnovski, and Vlahu (2015), who found that high profitability allows a bank to borrow more and increasingly engage in high-risk activities.

More recently, some researchers have found that the impact on financial stability depends on the type of non-interest income (Kohler 2014).

### **5 Measuring Financial Stability: Tools and Indicators**

Policymakers and researchers primarily use two quantitative measures to assess the financial stability of banks: the Z-score and the CAMELS system.

#### **5.1 The Z-score**

The Z-score is a measure developed from Roy's (1952) "safety-first" principle. It indicates the distance to insolvency by combining accounting measures of profitability, leverage, and the volatility of returns. This ratio is inversely related to the probability of a bank's insolvency, with a higher score corresponding to a lower risk.

It is calculated using the formula  $Z = (\mu + K) / \sigma$ , where  $\mu$  is the average return on assets (ROA),  $K$  is equity as a percentage of total assets, and  $\sigma$  is the standard deviation of ROA, measuring volatility. Under the assumption of normally distributed returns, the Z-score represents the number of standard deviations by which profits must fall to deplete equity, thus constituting a robust measure of bank soundness.

#### **5.2 The CAMELS System**

The CAMEL rating system was initially applied by U.S. supervisory authorities starting in 1979 to assess the stability of financial institutions. Subsequently, the International Monetary Fund (IMF) and the World Bank generalized its use internationally as a tool for assessing the soundness of the banking sector, extending the acronym to CAMELS to include a sixth dimension: Sensitivity to market risk.

The six components of CAMELS evaluate:

Capital Adequacy

Asset Quality

Management Efficiency

Earnings and Profitability

Liquidity

Sensitivity to Market Risk

This framework constitutes a pertinent and comprehensive method, enabling supervisory authorities to systematically assess the stability and financial health of banks.

### **6 Methodology**

This article is based on a theoretical and conceptual analysis of financial stability. The method employed is a systematic, comparative, and synthetic review of foundational and contemporary academic literature on the subject. The approach follows a three-step procedure:

Inventory and Analysis of Definitions: Identification and comparison of different definitional approaches to financial stability and instability to extract their common conceptual cores and divergences.

Structured Examination of Explanatory Theories: Classification and comparative analysis of the main economic theories seeking to explain the origin of financial crises and instability, from the classical to the modern schools of thought.

Identification and Study of Determinants: Compilation, based on the literature, of the factors influencing financial stability, with particular attention to micro-banking determinants (capital, liquidity, concentration, size) and their theoretically ambiguous impact.

The objective of this methodology is to produce an organized and critical synthesis of existing theoretical knowledge, aiming to clarify concepts, highlight explanatory mechanisms, and identify key causal relationships debated in the literature, without aiming for empirical testing.

## 7 Results of the Theoretical Analysis

The systematic analysis of the literature enables the identification of clear theoretical results, organized along several axes.

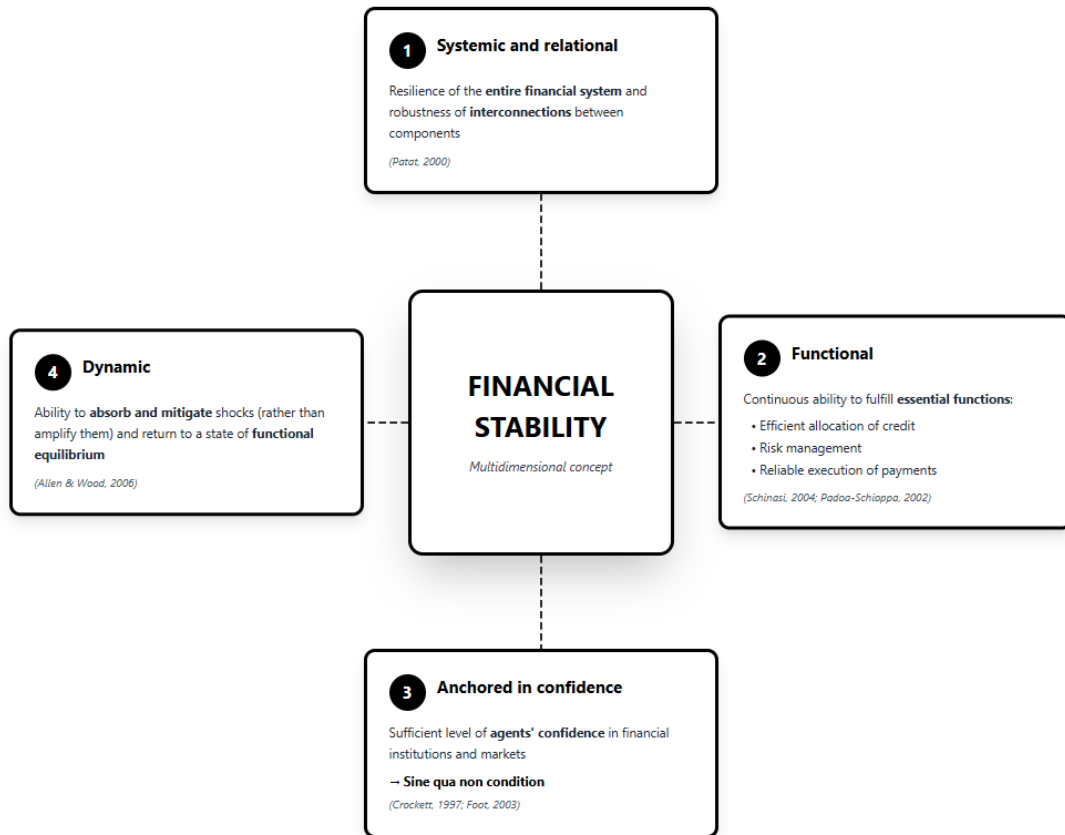
### 7.1 Result 1: A Multidimensional and Systemic Definition

The examination of definitions reveals that there is no single, universally accepted definition of financial stability. However, synthesizing the various approaches allows for the delineation of its conceptual contours. Financial stability emerges as a concept that is:

- **Systemic and Relational:** It pertains not to the stability of an isolated institution, but to the resilience of the entire financial system and the soundness of the interconnections between its components (Patat, 2000).
- **Functional:** It is defined by the system's ongoing capacity to perform its essential functions: efficient allocation of credit and capital, risk management, and reliable execution of payments (Schinasi, 2004; Padoa-Schioppa, 2002).
- **Anchored in Confidence:** A sufficient level of confidence among agents in financial institutions and markets is a prerequisite (Crockett, 1997; Foot, 2003).
- **Dynamic:** It corresponds to the property of a system to absorb and dampen shocks rather than amplify them, and to return to a functional equilibrium state (Allen & Wood, 2006).

Thus, financial instability is defined as the disruption of these functions, threatening real economic performance, and a crisis is its acute manifestation characterized by systemic risk.

**Figure 1.** The Four Dimensions of Financial Stability.



*Conceptual Synthesis: Absence of a universal definition, but convergence on four key dimensions.*

## 7.2 Result 2: The Predominance of Endogenous and Monetary Explanations for Crises

The review of explanatory theories reveals an evolution toward models highlighting causes endogenous to the financial system.

Minsky's Financial Instability Hypothesis (1992) stands out as the most integrative theoretical framework for explaining financial cycles. Its central finding is that "stability is destabilizing." A prolonged period of stable growth encourages an endogenous transition of financing structures from "Hedge" to "Speculative" and then to "Ponzi" types, rendering the system inherently fragile and vulnerable to a downturn.

The monetary and credit channel is central. The theories of Fisher (debt-deflation), Wicksell (the gap between the natural and monetary interest rates), and the critiques on "ex-nihilo" money creation (Allais, Walras) converge to identify excessive credit expansion and monetary imbalances as amplifying and often triggering factors of crises. Institutional quality is a fundamental determinant. The work of Demirgüç-Kunt & Detragiache (1998) and Acemoglu et al. (2003) theoretically and empirically establish that a weak institutional environment (poor governance, fragile rule of law, lax supervision) significantly increases the probability and severity of banking and financial crises.

## 7.3 Result 3: Banking Determinants with Ambiguous and Contingent Effects

The analysis of the micro-banking determinants of financial stability reveals that their effects are neither unequivocal nor universal, but depend on the regulatory and institutional context.

**Table 1.** Ambivalent Determinants of Financial Stability: Stabilizing vs. Destabilizing Effects

| Determinant                       | Potential Stabilizing Effects (Theses)   | Potential Destabilizing Effects (Antitheses)  | Conditionality / Synthetic Result  |
|-----------------------------------|--|---|--|
| High Capital Levels               | - Loss-absorbing cushion (Keeley, 1990).   | - Incentive to hold riskier assets to maintain profitability (Koehn & Santomero, 1980).                 | Non-linear and contextual effect. Impact depends on rule design, initial capital level, and competitive environment (Hakenes & Schnabel, 2011).              |
|                                   | - Reduction of moral hazard and incentive for prudent management (Furlong & Keeley, 1989). | - Can weaken profitability and credit supply (Blum, 1999).  |  |
| Bank Concentration                | - High "franchise value" discourages risk-taking (Keeley, 1990).                           | - Market power allowing for higher interest rates, increasing borrower burden (De Nicolo et al., 2009). | Two contradictory hypotheses (concentration-stability vs. concentration-fragility). The dominant effect depends on the quality of regulation and governance. |
|                                   | - Facilitates supervision and reduces information asymmetry (Allen & Gale, 2000).          | - Moral hazard linked to "Too Big To Fail" (Mishkin, 1999).   |  |
| Abundant Liquidity                | - Enables coping with shocks and withdrawals.  | - Fuels asset price bubbles and encourages lax lending standards (Acharya & Naqvi, 2012).               | Strong procyclical dimension. Excessive liquidity in the expansion phase is an early warning indicator of vulnerability.                                     |
|                                   |  | - Leading indicator of crises (Berger et al., 2013).  |  |
| "Too Big To Fail" (TBTF) Doctrine | - Prevents systemic contagion in case of a shock to a large bank.                          | - Implicit subsidy reducing funding costs and encouraging risk-taking (moral hazard).                   | Clearly destabilizing in the medium term. It creates perverse incentives and contributed to the amplitude of the 2007-2008 crisis.                           |
|                                   |  | - Distorts competition and encourages excessive growth.   |  |

Synthetic Result on Determinants: No single factor (capital, concentration, size) guarantees stability on its own. Their impact is mediated by the quality of the institutional and regulatory framework. Sophisticated regulation within a weak institutional environment can thus see its stabilizing effects nullified.

#### 7.4 Result 4: Primacy of the Banking Sector in Emerging Economies

The analysis confirms that for emerging economies, the equation for financial stability is largely reduced to that of banking stability. This result stems from the structure of their financial systems:

- Predominance of banks in credit intermediation, compared to underdeveloped capital markets (Popovska, 2014).
- High degree of concentration in the banking sector, placing significant systemic risk on a few institutions.
- Central transmission of macroeconomic shocks to the real economy via the bank credit channel.

Consequently, micro-prudential surveillance tools (such as CAMELS) and the management of banking determinants are particularly crucial there, even more so than in developed economies with more diversified financial systems.

## 8 Discussion

The results of this theoretical analysis highlight several major points for discussion.

Firstly, the ambiguity of the determinants (capital, concentration) reveals the absence of a simple technical recipe to ensure stability. This theoretical ambiguity partly explains the difficulties encountered by regulators and the divergences in post-crisis reforms. It underscores that prudential rules (like Basel III) must be understood as necessary but insufficient frameworks, whose effectiveness depends on their implementation within a robust institutional environment.

Secondly, the result on the centrality of institutions (Determinant 2.3) has strong implications for emerging economies. It suggests that international efforts to transfer regulatory standards (such as the Basel Accords) could be futile, or even counterproductive, if they are not accompanied by a parallel and prioritized strengthening of domestic institutions (independent supervision, rule of law, anti-corruption measures). Institutional quality emerges as the fundamental prerequisite for the effectiveness of any technical regulation.

Thirdly, the confirmation of the procyclical and potentially destabilizing role of liquidity (Result 3.3) calls for integrating bank liquidity indicators into the macroprudential dashboards of central banks in emerging economies, beyond traditional solvency indicators.

Finally, the primacy of the banking sector in emerging economies (Result 4) implies that financial stability policies must have an explicitly bank-centric focus in these contexts, without however neglecting the prudent development of capital markets to diversify funding sources and reduce systemic risks.

## 9 Conclusion

This article has structured the theoretical analysis of financial stability and derived clear results from it. It demonstrates that financial stability is a systemic and functional concept, better defined by the resilience of the system in fulfilling its fundamental tasks than by the mere absence of crisis.

The main findings indicate that: (1) endogenous explanations of crises, particularly Minsky's hypothesis, provide the most powerful theoretical framework; (2) the banking determinants of stability (capital, concentration, liquidity) have ambiguous and contingent effects, crucially dependent on the institutional context; (3) the quality of institutions is a profound and cross-cutting determinant; (4) in emerging economies, financial stability is largely synonymous with banking stability, giving particular importance to micro-prudential surveillance tools.

The primary implication for economic policies, especially in emerging economies, is that the pursuit of financial stability cannot be reduced to the adoption of international technical standards. It requires an integrated approach combining a prioritized strengthening of institutions, prudential regulation adapted to the local context, and active macro-prudential vigilance, with constant attention to the procyclical nature of the financial system and specific risks such as domestic "Too Big To Fail."

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