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FINANCIAL LIBERALIZATION IN THE DEVELOPING COUNTRIES AND ITS EFFECT ON BANKING SYSTEMS AND BANKING CRISES

Abstract:

Financial deregulations or financial liberalization can be referred to a variety of changes in the law which allows financial institutions more freedom in how they compete. Whether deregulations are beneficial or harmful to the economy has been widely debated.
This paper investigates the effect of financial globalization on the incidence of systemic bank crises in developing countries by using measures of the financial openness. The liberalization trend in the global scale starting with the Washington Consensus has been influential on financial markets and the banking sector. Financial liberalization and uncontrolled expansion of international capital movements has led to the diversification and acceleration of the global financial crisis. Thus, “financial deregulations” which offered as a solution to the debt crisis experienced in the 1980s has led to a new financial crisis in 2010's. An increase in foreign debt liabilities contributes to an increase in the incidence of crises, but foreign direct investment and portfolio equity liabilities have also the opposite effect.
This paper discusses how financial liberalization could contribute to financal crises and macroeconomic instabilitiy in the developing countries. For this aim, we analyze empirically a database from developing countries to test the effect of financial openness on macroeconomic indicators. As the dependent variable, we use a variable which take the value of one in the year of a banking crisis. To estimate the indicators of financial crises, main explanatory variables which are employed in the specifications are financial openness, current account balances, exchange rate regime, inflation, trade openness and percent change in GDP. In the introduction to this paper examines the process of liberalization. Second part; banking system and its features are analyzed during the Global financial Crisis. In the third section the historical development of financial crisis and measure of financial liberalization are discussed.In the final part of the paper of financial liberalization and financial crisis the relationship between macro-economic indicators are examined.

Keywords:

Financial deregulations, financial openness, banking crisis, global financial crisis,

JEL Classification: G01, F43, E44

1. Introduction

The global economic crisis has displayed the fact that there is a need for changing in the relationship between the government and the economy; moreover, it introduces expectations toward regulating financial sectors and market economy. If it is taken into account the liberalization process prior to the global crisis, one may expect that the government interventions and regulations will come into prominence to eliminate the problems created by the Global Crisis and also to take measurements for possible crises.

Since the beginning of the debt crisis in 1982, which started with Mexico's default, Latin American countries have been living in accordance with the structural adjustment programs and poverty reduction strategies initiated by the International Monetary Fund (IMF) and the World Bank. Based on the promotion of market adjustment, the reduction of the size of government and an increasing openness to foreign investment, these policies were codified by Williamson (1990) and his Washington consensus in a program that prescribed the ten commandments of the neoclassical economic bible. Washington Consensus as originally stated by Williamson included ten broad sets of relatively specific policy recommendations (Wayenberge, 2008; 307):

i. Fiscal policy discipline, with avoidance of large fiscal deficits relative to GDP;

ii. Redirection of public spending from subsidies (especially indiscriminate subsidies) toward broad-based provision of key pro-growth, pro-poor services like primary education, primary health care and infrastructure investment;

iii. Tax reform, broadening the tax base and adopting moderate marginal tax rates;

iv. İnterest rates that are market determined and positive (but moderate) in real terms;

v. Competitive exchange rates;

vi. Trade liberalization: liberalization of imports, with particular emphasis on elimination of quantitative restrictions (licensing, etc.); any trade protection to be provided by low and relatively uniform tariffs;

vii. Liberalization of inward foreign direct investment;

viii. Privatization of state enterprises;

ix. Deregulation: abolition of regulations that impede market entry or restrict competition except for those justified on safety, environmental and consumer protection grounds, and prudential oversight of financial institutions;

x. Legal security for property rights.

The potion administered to developing countries by the international financial institutions (IFIs), beginning in the early 1990's, however differs from Williamson's initial recipe on two points: the definition of a competitive exchange rate and the degree of financial liberalization. For Williamson, a competitive exchange rate presupposes an intermediate regime that would be quicker to avoid an overvaluation of the national currency which would penalize exports. Whereas in the 1990's international financial institutions were promoting extreme exchange regimes, that is to say totally fixed (as in the case of a currency board) or entirely flexible.

The process of financial liberalization is based on three fundamental aspects: (i) The liberalization of the internal financial sector which encompasses the liberalization of interest rates, loans and the competition between banks as well as the reduction, even elimination of reserve requirements. (ii) The liberalization of financial markets, that is to say the suppression of barriers to the holding of titles by foreign investors and the elimination of obstacles to the repatriation of capital and the payment of dividends, interests and profits. (iii) The opening of capital accounts, that is, the possibility for financial institutions to grant loans to foreign sources, the elimination of the control of exchanges and the liberalization of capital flow. It is essentially the realization of this last point that founds the second Washington consensus (Berr and Combornous, 2007, 526).

Concerning financial liberalization, Williamson expressed on numerous occasions (Williamson 2000-2004) his opposition to the liberalization of capital account even if he is favorable to the suppression of barriers to foreign direct investment. More generally, Williamson regretted that the usage that has been made of the Washington consensus does not correspond to his initial project. Financial liberalization is a major element of the policies championed by international financial institutions in the 1990's, thus giving birth to a "second" Washington consensus. Whereas the "first" Washington consensus (of the 1980's) stressed policies of stabilization and structural reforms, the second encourages the opening of capital account in order to attract foreign savings that is supposed to favor economic growth (Berr and Combornous, 2007, 526).

The second Washington consensus appears at the beginning of the 1990's. Whereas the Brady plan seems to have solved the debt crisis and capital was again flowing toward numerous developing countries (which then became emerging countries). IFIs, after having devoted their attention in the 1980's to stabilization and structural reforms, begin to stress economic growth. But, rather than returning to indebtedness, IFIs assert that it is the attraction of foreign savings that encourages growth. This new strategy, which involves the opening of capital account, marks a second step in the implementation of the Washington consensus because it implies full-scale financial liberalization. From then on, the second Washington consensus will be composed of 10+1 measures (Berr and Combornous, 2007, 528):

i. Budgetary Austerity; a balanced budget must be attained in the medium-term as significant budget deficits are the source of inflation, balance of payments crises and volatile capital. Unofficially, the return to a balanced budget aims to limit state indebtedness so that the repayment of the public internal debt does not replace that of the external public debt that must also be moderated.

ii. Reduction of public expenditures to limit the size of government; from a neoclassical perspective, the quest for a balanced budget and a reduced role of the government requires a decrease in government spending rather than an increase in fiscal pressure. Subsidies should also be reduced in order to avoid market distortion.

iii. Promotion of an orthodox monetary policy based on the liberalization of interest rates; interest rates must be market-determined and real interest rates must be positive and moderated in order to attract international capital necessary to finance development, without compromising investment and the repayment of the public debt.

iv. Promotion of exports; Although Williamson and the IFIs differ in terms of which exchange regime to adopt, they nevertheless agree that the promotion of exports is the best way to favor growth while maintaining the deficit of the balance of payments on current account at a level that can be sustainably financed.

v. Trade Liberalization; in its initial version, the Washington consensus simply envisages (in the logic of the promotion of exports) the liberalization of commercial exchange. This involves limiting, even eliminating, all tariff and nontariff barriers.

vi. Competitiveness of foreign direct investment; although Williamson does not suggest a total liberalization of capital movement, action must nevertheless be taken against the barriers that curb the entry of foreign direct investment.

vii. Privatization; there is a large consensus on this point as private firms are assumed to be better managed than public ones. Privatization also aims to help reestablish a balanced budget and to reduce public investment, thus decreasing the size of government.

viii. Deregulation; the objective is to abolish, or if not reduce, the barriers to markets, therefore the elimination of regulations which slow economic initiative and free competition.

ix. Fiscal reform; the objective is twofold. It involves an increase in the number of taxpayers by enlarging the fiscal base through a broadening of value added tax and the reduction of marginal tax rates.

x. Property rights; involves reinforcing property rights and ensuring a legal framework for the defense of private interests.

xi. Financial liberalization (10+1); the beacon of the second Washington consensus. Whereas Williamson makes it clear that the liberalization of capital movement is not a priority, it was, however, imposed in the 1990’s under the pressure of IFIs, representing the final stage of financial liberalization.

On the other hand Washington Consensus and liberalization reveals three important facts for global economy, developing countries and transition economies. (Stiglitz, 2008; 282):

i. Capital markets are very volatile;

ii. The cost of economic crises is quite high and these costs are increasing with each passing period.

iii. Reduction of the risks associated with interest rate increases only in terms of well-functioning financial markets is concerned. Developing and uncontrolled, deregulated global financial markets, increase the cost of borrowing at alevel that involve risks.

As a result of economic growth by the deregulation or financial liberalization can arguably be performed. However the government needed to play an important role in the application of the regulation should be considered. At this point some examples reflect the features of the recent economic crises. For example, the most important cause of the East Asian Crises, the implementation of than the regulation is very soft. Similarly the U.S. economy during the Global Crisis faced problems is the fact that the soft regulation.

2. Analyses of Banking System and Financial Crisis

In general, the financial structure in free market economies forms on four elements as financial system, trade banks, investment banks and trade security and insurance companies. Undoubtedly banks consists the largest part of financial structures (Llewellyn, 2000; 312).

Theoretical and empirical studies display that efficiency of banking system has positive impact on economic developing. The well-functioning banking system is essential for economic developing. Theoretical and empirical studies display that emphasis the importance of law systems, cultural structures. On the other hand some studies argue that the law systems of countries to have a little effect with relative to regional and global strategies. Addition to some studies finds the cultural and religion differences as important on differences in the financial systems. Moreover explain differences at financial systems with countries approaches to regulating and controlling the banking and financial systems (Babenroth at all, 2009; 177).

Financial liberalization in the developed countries was closely related to developments. However, it also contributed to the generation of savings which were in excess of investment exante. Financial liberalization in the developed countries increased the flexibility of banking and financial institutions when creating credit and making investments, and permitted the proliferation of institutions like hedge funds which, unlike the banks, were not subject to much regulation. It also encouraged “securitization”, or capital flows in the form of stocks and bonds, rather than loans, and “financial innovation”, involving the creation of a range of new financial instruments or derivatives such as swaps, options and futures, virtually autonomously created by the financial system. These instruments allowed players to trade in the risks associated with an asset without trading the asset itself. Finally, it increased competition and whetted the appetite of banks to earn higher returns, thus causing them to search out new recipients for loans and investments in economic regions that were hitherto considered to be too risky (Ghosh, 2005; 6).

Financial liberalization serves as a panacea to financial constraints in a financially repressed economy. Under the financial repression regime, the monetary authorities impose high reserve requirements, bank-specific credit ceilings and selective credit allocation, mandatory holding of treasury bills and bonds issued by the government, and finally a non-competitive and segmented financial system. Theories of financial repression associated especially with “Mckinnon and Shaw” postulated that administrative control of financial markets by the government distorts interest rate thereby lowering it. The resultant effect of this is that savings is discouraged, consumption is encouraged and the quantity of investment is crippled. It is strongly argued that financial liberalization can have strong positive effects on economic performance. However, after the prescribed financial liberalization, the domestic economy has failed to experience impressive performance such as attraction of foreign investment or halt capital flight. Financial liberalization generates tremendous financial booms and busts in the short-run, but these booms and busts have not intensified in the long-run. The debate over the macroeconomic effect of financial liberalization on developing economies remains a controversial issue. The stability of the economy should first be taken into consideration before implementing financial liberalization measures. Strong macroeconomic policies should be pursued to maintain and stabilize the economy. The regulatory and supervisory framework for the financial sector should be strengthened. One way to achieve this is by laying down strict prudential rules and regulations to stabilize and strengthen the banking industry. (Sulaiman et al, 2012; 17).

2.1. Structural Features and Functions of Banking System

Structural features mainly express two characteristics as institutional and economic. Institutional structure comprises functional classification and shareholder definitions of banks, while economic structure is related to financial system in which performed

activities and to oligopolistic structure which indicates competition imperfection (Günal, 2007; 333). Undoubtedly the most important function of the bank system is to provide capital accumulation for source needs of real economy. Especially in times of the financial crises, this classical function does not work properly. Banking systems start to serve to finance deficits of holdings which related to banks, and deficits of public budgets (Günal, 2007; 335). Problems in the banking system lead to bankruptcies and high costs of bail outs for governments. On the other hand, using the banking credit mechanisms by governments with respect to social policies is also important problem in banking sector (Rosengren, 2000;117).

Main factors which lead to financial crises and banking system imperfections are the weak competition in the sector, oligopolistic tendencies, incomplete audits, existence of public banks and their importance in the system. In general, banking systems' main features of developing countries are as following; financial markets controlled by public banks, the low level depth of financial markets, imperfections in the market functioning. Although developed countries have also public banks, these banks have different mission definitions (Tunay ve Uzuner, 1998; 263).

The US and UK do not have public banks; moreover, UK has a banking system which belongs to foreign banks in the large part. The distinction of trade-investment banking is especially a structural characteristic of UK banking system. In Germany, France, and Italy, the public banking is important element of the system. Some EU countries such as Spain and Greece which have similarities with Turkey have also large volume of public banking (Tunay ve Uzuner, 1998; 263).

Turkish banking system has heavily oligopolistic tendency, and public-financed banks may direct the whole sector despite of their low financial performance. More importantly, with decreasing the volume of specialized credits, it can be said that social goals of public banking are disappearing most countries included Turkey (Tunay ve Uzuner, 1998; 263).

2.2. The Financial Crisis and Banking System

Beginning of 1990s, most developed countries has completed the term of liberalization and the process of Washington Consensus. During this process, it was thought that temporary macroeconomic stability has decreased banking risks. But this approach has created a risk appetite by changing the risk detecting (Goodhart, 2008; s. 332). On the other hand, the diversity in the financial instruments in the last quarter has also triggered the financial crisis (Goodhart, 2008; s. 336). Typically, financial sector liberalization in developing countries has been associated with measures that are designed to make the central bank more independent, relieve "financial repression" by freeing interest rates and allowing financial innovation, and reduce directed and subsidized credit, as well as allow greater freedom in terms of external flows of capital in various forms (Ghosh, 2005; 1).

It is clearly known that liberalization and deregulation enhance the competition and trigger the financial innovations. However, this fact may create important banking problems ever in European developed countries. European banking sector has a higher intensify rate than US. Intensify rates in banking sectors are between 30 percent and 80 percent in EU except of Germany. This rate in the US was 22 percent in 1998. Moreover France and Germany have important level of public banking. These factors have created fragilities and failures in European banking systems. For example, the crises have been experienced in Spain in beginning of 1980s, in Scandinavian countries in 1990s (Vives, 2001; 58-65).

According to Krugman three questions in terms of financial crisis is decisive (Krugman, 1999, 469): First is the question of prophylactic measures: what can we do to prevent such crises in the future? Second is the question of policy in the crisis: how can the crisis be halted or at least limited? Finally there is the question of what to do once the crisis has occurred: how does one rebuild the economy? Third question the most important. “What we hope is the current question: once the crisis has happened, how does one get the economy going again? To date most actual efforts have focused on bank restructuring and recapitalization; but if this model is on the right track, this will not be sufficient. The main problem at this point, the model (like many practitioners) suggests, is that the firms and entrepreneurs who drove investment and growth before the crisis are now effectively bankrupt and unable to raise capital. If this is right, the key to resuming growth is either to rescue those entrepreneurs or to grow a new set of entrepreneurs—or both. A likely source of new entrepreneurs is, of course, from abroad: a welcome mat for foreign direct investment might be just what the doctor ordered” (Krugman, 1999, 469).

“Panic” is very important at defining the financial crises. The basic example of the economic crises can be identified with bank bankruptcies. Bank customers’ panic attacks to draw back the deposits can commonly observed during the crisis. Banking bankruptcies are common characteristic in most crisis as Thailand, Indonesia, Mexico, Argentine, Turkey, and after 2008 in the US and European countries. In the financial crises, more important than the number of bankruptcies are moral hazard, financial corruption and lower level of confidence (Krugman, 2003; 100).

Explaining the financial crises, argue that liberalization of financial flows has created economic instability and point out political interventions and economic instabilities instead of liberalization. On the other hand inflation to trigger the financial crises and the system’s unproductivity. Some authors argues that constraints on trade bank activities and imperfect standards of regulations have led to crises. Research and reports displays the reason for the crisis to be the restrictive regulations, imperfections in democracy and private property. While some reports point out that government-owned banks increase fragility in the system, the other find the corruption as important (Ünal ve Açıkalın, 2008; 20).

The Global Crisis of 2008 called as a financial one, although there are some other factors such as oil and good prices, inflation. Before the crisis, high level of growth, increased capital flows and financial stability led to uncontrolled growth in banking system because of excessive risk appetite and willingness high profits. More importantly, regulatory authorities were insufficient to realize risks and financial innovations in the system (Pelin Ataman Erdönmez, 2009; 85). In the US, the liquidity crisis which appeared in 2008 affected negatively the banks’ balance. Eventually the government had to inject the liquidity into the markets (Topbaş, 2009; 56). Developments in the process of the global crisis displayed that the typical regulations was insufficient (Rajan, 2009; 71).

The negative developments in the financial system not only led to consolidations but also eliminate investment banking in especially the US. European countries also experienced government bail outs toward banking system (Erdönmez, 2009; 86). Measures can generally be classified into eight titles despite of differences country-specific. Abolishing deposit guarantee, bank recapitalizations, liquidity injections, providing government guarantees to bank credit debt, nationalizations, the allocation of funds to be commercial bonds, regulations on mortgage bonds, regulations on toxic assets (Erdönmez, 2009; 86). Innovations and developments in financial companies

and trade mechanisms make more complex implicating of regulations. In this innovative environment, the best way to modernize financial regulations is to transfer responsibilities toward private investors from administrative structures (Flannery, 2000; 111).

Although the confidence in the banking system injured with the global crisis, and regulative efforts were inadequate against the innovative instruments, the regulations are important for future possibilities of crises and should be renewed toward even non-banking institutions such as mortgage and financial companies. For financial stability, the banking sector should efficiently be watched and monitored (Emek, 2000; 80). According to Ghosh (2005); if the development project is to continue at all in large parts of the world where it remains essentially partial and incomplete, some government control over the financial sector remains essential. This, in turn, means that strategies that are only concerned with the “sequencing” of liberalization measures are asking the wrong question. The real question should be: Which financial controls should be maintained, restored or introduced in order to ensure a viable, stable and socially desired pattern of development? (Ghosh, 2005; 17).

2.3. The Literature on Financial Liberalization and Financial Crisis

The banking systems’ high losses will be taken in charge by the monetary authorities or by international financial institutions. In the same line of thinking, Stiglitz (1985) believes that information inequality between investors resulted in a stowaway behaviour. Still, Stiglitz assumes that imperfect market conditions lead to a bad adjustment of savings to investment. This state of affairs tends to raise crises risk. Mehrez and Kaufmann (1999) assume that low-transparency and highly-corrupt economies are more likely to be threatened by financial instability. They concluded that the probability of a banking crisis diminishes when there is a low corruption level (Jedidi, 2011; 73). Kaminsky and Reinhart (1999) agree that; liberalization policy saw an increase in the real interest rate for capital entries and ended in drastic balance of payments crises of the banking systems. In a volatile and an instable macroeconomic environment, banks are expected to take excessive risks which may end up in financial crises at times of an instable economic period. Other things being equal, the financial system becomes instable and likely to be threatened by crises when it develops, risking a slackening of economic growth.

Studying financial liberalization and banking crises, Aizenman, (2001), Chung (2003), Wilmarth (2004), Tornell et.al (2004), Ranciere et. Al (2006), Daniel and Jones (2007) Lee and Shin (2008), Jonung (2008), Ben Gamra and Plihon (2008), Lim Mah-Hui and Maru (2010) and Angkinand et. Al (2010) suggest that financial liberalization may induce financial instability and banking crises. This would make the financial system unable to finance the real economy. Consequently, decrease in capital investments and innovation prevail. (Jedidi, 2011; 72).

Table 1. shows that different analyses in different time on the financial liberalization and financial crises.

Table 1. The Literature on Financial Liberalization

Articles and Publication dates	Conclusions
Stiglitz and Weiss 1981	when facing uncertainty, banks tend to limit their interest rates and rationalise demand for credits in order to avoid risk

	aversion and incite customers to take risks once credits are granted.
Kaminsky and Reinhart 1999	studying a sample of 25 countries, find out that financial liberalization may lead to banking crises. This negative impact only prevails during the three or four years immediately following the liberalization process.
Mackinnon 1988	According to Mackinnon (1988) for the developing countries where the institutional environment is weak and where a banking monitoring system is absent and where macroeconomic uncertainty prevails, investors tend to morally behave.
Mehrez and Kaufmann (1999)	low-transparency and highly-corrupt economies are more likely to be threatened by financial instability. To test this hypothesis, Mehrez and Kaufmann used data from a sample of 53 countries during the 1977-1997 period. They concluded that the probability of a banking crisis diminishes when there is a low corruption level
Demirguc-Kunt and Detragiache (1999)	Using a sample of 53 countries during the 1980-1995 period, test the impact of financial liberalization on banking vulnerability. This analyses show that banking crises are very likely in a liberalized financial system.
Miotti and Plihon 2001	The authors assume that banking crises in some emerging countries are essentially explained by the presence of an excessive speculative risk. Miotti and Plihon made it clear that deficient banks are those witnessing high levels of profitability generated from speculation operations before the crisis.
Chung 2003	When investors trust in the support of monetary authorities and in the financial and banking systems started to be shaken, foreign investors decided to reduce their commitments towards these countries, mainly by selling their stocks. This scenario led to a change and a financial crisis mutually feeding on each other: depreciation of change rate raised the value of banks' indebtedness in local currency, which forced banks to sell their portfolios to secure their need for liquidity.
Kamulainen and Lukkarila 2003	Kamulainen and Lukkarila reach the conclusion that among the 31 emerging countries studied, the vulnerability to crisis is higher within contexts involving large liabilities, which triggered sudden capital outflows.
Reinhardt-Rogoff 2004	Reinhardt-Rogoff classification system which is based on market data rather than official statements, ranges from on efor countries without a separate legal tender through various arrengement of pegs and crawling bands to freely denoted by 13.
Tornell at al 2004	Tornell prove that for emerging countries trade openness often comes with financial openness. This latter may provoke financial vulnerability and leads to a greater incidence of crises. Likewise, the positive effect on economic growth is strongly felt.

Dellas and Hess 2005	The authors assume that a boosted financial development tends to make emerging stock markets more sensitive to external financial and macro-economic influences. Accordingly, the effects of external shocks may transfer to the real activities through stock markets. Financial channels are additional ways through which shocks may be transferred.
Wilmarth 2004	Wilmarth cautions that financial instability may be accompanied by instability of real and financial assets prices. Assets price bubbles initiate with a financial liberalization or a decision of raising economy-targeted credits issued by a central bank.
Rancière et al 2006	Applying their econometric model on a sample of 60 countries over the 1980-2002 period, Rancière conclude that the direct effect of financial liberalization on growth by far outweighs the indirect effect via a higher propensity to crisis.
Daniel and Jones 2007	Daniel and Jones, who examine the reasons of financial crises, note, among other things, that poorly designed banking system often lead to financial stress.
Lee and Shin 2008	Lee and Shin (2008), in a study conducted on a sample of 58 countries over the 1980-1999 period, note that the direct positive effect of liberalization dominates the indirect negative effect of the crisis.
Ben Gamra and Plihan 2008	The authors underline that the impact of financial liberalization policy on the banking system stability highly depends on liberalization modalities. The degree, priorities and rhythm of this latter may influence banking crises. A study of 22 emerging countries over the 1970-2002 period confirmed this thesis.
Chinn-Ito 2006-2010	High levels of financial openness, when only coupled with high levels of financial development reduces output volatility in emerging markets but developing countries which are net receivers of hot money, in the form of cross country bank lending or portfolio flows, experience high output volatility
Rachdi 2010	Rachdi notes that a financial liberalization policy undertaken in an under developed institutional environment characterized by its poor banking supervision is likely to enhance proliferation of banking crises. The author's conclusions are based on the application of a multivaraite logit on a sample of 12 emerging countries during the 1980-2003 period.
Angkinand 2010	Angkinand find out a U-shaped relationship between liberalization and the likelihood of crisis. Indeed, the results of a study of a 48-country sample over the 1973-2005 period point out that the strength of capital regulation and supervision determines the relationship between liberalization and banking crises. Accordingly, with very weak regulation and supervision, the probability of banking crises increases with liberalization.
Lim Mah-Hui and	Lim Mah-Hui and Maru note that capital international flows

Maru 2010	are a source of risk for world economy, mainly for Singapore which they studied. Several financial crises affecting developed and emerging countries succeeded during the last two decades. These crises are fed with the new practices adopted by financial markets agents. These new practices, based essentially on indebtedness to finance economic activities, resulted in the creation of new interconnections between financial markets and unstable countries.

Demirguc-Kunt and Detragiache (1999) findings corroborate the thesis that a solid institutional environment with low levels of corruption may reduce the negative effect of financial liberalization on banking crises. Likewise, Rachdi (2010), Angkinand et. al (2010), find out that the strength of capital regulation and supervision determines the relationship between liberalization and banking crises. Stock markets growth may as well moderate some of these risks, yet it may intensify the real effects of these shocks. In this line of thinking, Dellas and Hess (2005) agree on the fact that a solid financial context reduces sources of instability. Differently put, financial liberalization may not degenerate when some external conditions are absent.

Chinn and Ito (2006 and 2010) find that high levels of financial openness, when only coupled with high levels of financial development reduces output volatility in emerging markets but developing countries which are net receivers of hot money, in the form of cross country bank lending or portfolio flows, experience high output volatility (Ersoy, 2011, 36).

Daniel and Jones (2007), who examine the reasons of financial crises, note, among other things, that poorly designed banking system often lead to financial stress. Chung (2003) shows that in the South East Asian countries, banks have changed, creating wide gaps between political authorities and bank managers. When investors trust in the support of monetary authorities and in the financial and banking systems started to be shaken, foreign investors decided to reduce their commitments towards these countries, mainly by selling their stocks. This scenario led to a change and a financial crisis mutually feeding on each other: depreciation of change rate raised the value of banks' indebtedness in local currency, which forced banks to sell their portfolios to secure their need for liquidity (Jedidi, 2011; 72).

Lim Mah-Hui and Maru (2010) note that capital international flows are a source of risk for world economy. For instance, in Mexico in 1995, in Thailand, South Korea and Malaysia in 1998, the Gross Domestic Product (GDP) decreased by 7 percent provoking a wave of unemployment and social problems. These crises are fed with the new practices adopted by financial markets agents. These new practices, based essentially on indebtedness to finance economic activities, resulted in the creation of new interconnections between financial markets and unstable countries. Wilmarth (2004) cautions that financial instability starts with a financial crisis. Ben Gamra and Plihon (2008) underline that the impact of financial liberalization policy on the banking system stability highly depends on liberalization modalities. The degree, priorities and rhythm of this latter may influence banking crises. A study of 22 emerging countries over the 1970-2002 period confirmed this thesis (Jedidi, 2011; 73).

Tornell et.al (2004), Rancière et. al (2006), Lee and Shin (2008) discussed the effects of liberalization policy on the one hand on banking crises and on the other hand on economic performance in terms of economic growth. Tornell et. al (2004) prove that for emerging countries trade openness often comes with financial

openness. This latter may provoke financial vulnerability and leads to a greater incidence of crises. Likewise, the positive effect on economic growth is strongly felt. Applying their econometric model on a sample of 60 countries over the 1980-2002 period, Rancière et. al (2006) conclude that the direct effect of financial liberalization on growth by far outweighs the indirect effect via a higher propensity to crisis. Similarly, Lee and Shin (2008), in a study conducted on a sample of 58 countries over the 1980-1999 period, note that the direct positive effect of liberalization dominates the indirect negative effect of the crisis (Jedidi, 2011; 73).

3. The Relationship of Financial Liberalization and Financial Crises

3.1. The Historical Process of the Financial Crises

This paper investigated the incidence of financial crises in a sample of 6 emerging markets over the period of 1980–2013. Table 2 lists the years of systemic banking crises for each country in our sample. There are a total of 30 separate crises. Several countries had more than one crisis episode, with Argentina accounting for four. It exhibits a rise during the debt crisis of the 1980s, and a subsequent decline towards the end of the decade. The number of crises rose again at the time of the Mexican crisis and then again during the Asian crisis (Joyce, 2011; 879).

Table 2. Banking Crises in the Global Economy

Countries	Systemic Banking Crises
Argentina	1980-1982, 1989-1990, 1995, 2001-2002
Brasil	1990, 1994-1999
Chile	1976, 1981-1983
Colombia	1982-1987, 1998-2001
Egypt	1980-1983
Hungary	1991-1995
Indonesia	1997-2002
Israel	1977-1983
Korea	1997-1983
Malaysia	1997-2001
Mexico	1981-1991, 1994-2000
Morocco	1980-1982
Peru	1983-1990
Philippines	1983-1987, 1997-2002

Poland	1992-1995
Sri Lanka	1989-1993
Thailand	1983-1987, 1997-2002
Turkey	1982-1985, 2000-2002
Venezuela	1994-1995
Zimbabwe	1995-1996

Source: Joseph P. Joyce, 2011; “Financial Globalization and Banking Crises in Emerging Markets”, Open Econ. Rev., 22, 875–895.

Figure 1. Number of Financial Crises per years in Global Economy

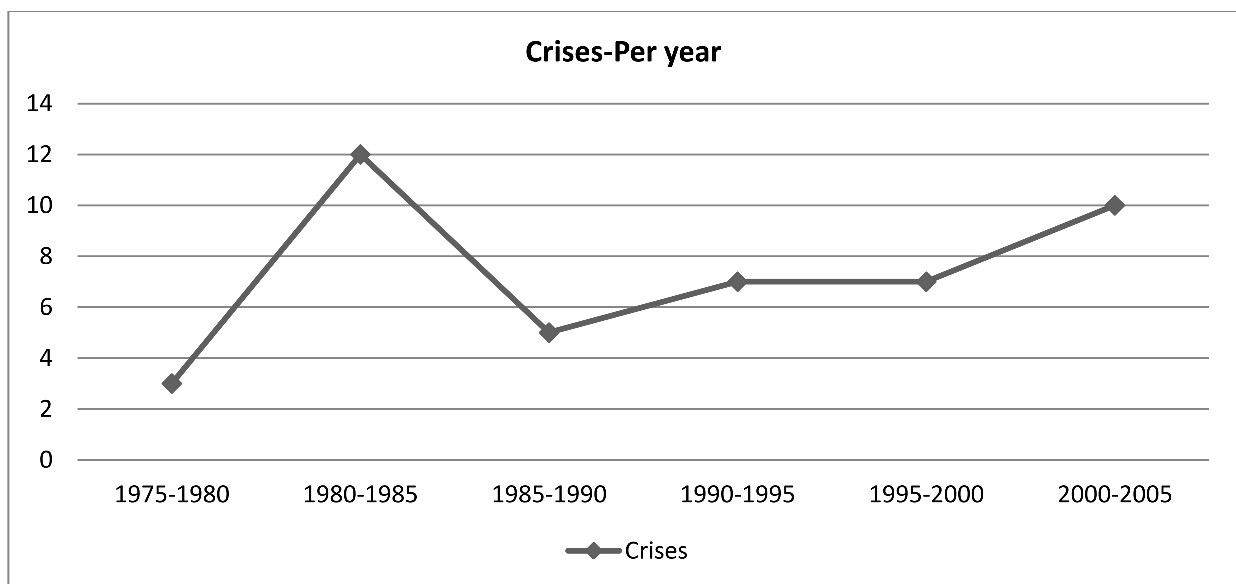

Figure 1. show that number of financial crises in different countries. The frequency of financial crises is increasing, especially in the period after 1980.

3.2. Measures of Financial Liberalization

Financial liberalization refers to measures directed at diluting or dismantling regulatory control over the institutional structures, instruments and activities of agents in different segments of the fi nancial sector. These measures can relate to “internal” and “external regulations” (Ghosh, 2005; 2). “Internal financial liberalization” typically includes some or all of the following measures, to varying degrees:

i. The reduction or removal of controls on the interest rates or rates of return charged by financial agents. Of course, the central bank continues to influence or administer that rate structure through adjustments of its discount rate and through its own open market operations. But deregulation typically removes interest rate ceilings and encourages competition between similarly placed financial firms aimed at attracting depositors on the one hand and enticing potential borrowers to take on debt on the other. As a result, price competition squeezes spreads and forces financial firms (including banks) to depend on volumes to ensure returns.

ii. The withdrawal of the state from the activity of financial intermediation with the conversion of the “development banks” into regular banks and the privatization of the publicly owned banking system, on the grounds that their presence is not conducive to the dominance of market signals in the allocation of capital. This is usually accompanied by the decline of directed credit and the removal of requirements for special credit allocations to priority sectors, whether they are government, small-scale producers, agriculture or other sectors seen as priorities for strategic or developmental easons.

iii. The easing of conditions for the participation of both firms and investors in the stock market by diluting or doing away with listing conditions, by providing freedom in pricing of new issues, by permitting greater freedoms to intermediaries, such as brokers, and by relaxing conditions with regard to borrowing against shares and investing borrowed funds in the market.

iv. The reduction in controls over the investments that can be undertaken by financial agents and, specifically, the breaking down the “Chinese wall” between banking and non-banking activities. Most regulated financial systems sought to keep separate the different segments of the financial sector such as banking, merchant banking, the mutual fund business and insurance. Agents in one segment were not permitted to invest in another for fear of conflicts of interest that could affect business practices adversely. The removal of the regulatory walls separating these sectors leads to the emergence of “universal banks” or financial supermarkets. This increases the interlinkages between and pyramiding of financial structures.

v. The expansion of the sources from and instruments through which firms or financial agents can access funds. This leads to the proliferation of instruments such as commercial paper and certificates of deposit issued in the domestic market and allows for offshore secondary market products such as ADRs (American Depository Receipts—the floating of primary issues in the United States market by firms not based in the United States) or GDRs (Global Depository Receipts);

vi. The liberalization of the rules governing the kinds of financial instruments that can be issued and acquired in the system. This transforms the traditional role of the banking system’s being the principal intermediary bearing risks in the system. Conventionally, banks accepted relatively small individual liabilities of short maturities that were highly liquid and involved lower income and capital risk and made large, relatively illiquid and risky investments of longer maturities. The protection afforded to the banking system and the strong regulatory constraints thereon were meant to protect its viability given the role it played. With liberalization, the focus shifts to that of generating financial assets that transfer risks to the portfolio of institutions willing to hold them; the shift to a regime of voluntary adherence to statutory guidelines with regard to capital adequacy, accounting norms and related practices, with the central bank’s role being limited to supervision and monitoring.

“External financial liberalization” typically involves changes in the exchange control regime. Typically, full convertibility for current-account transactions accompanying trade liberalization have been either prior or simultaneous reforms, which are then complemented with varying degrees of convertibility on the capital account. Capital-account liberalization measures broadly cover the following, in increasing degree of intensity, but with a wide variety of patterns of implementation:

i. Measures that allow foreign residents to hold domestic financial assets, either in the form of debt or equity. This can be associated with greater freedom for domestic

firms to undertake external commercial borrowing, often without government guarantee or even supervision. It can also involve the dilution or removal of controls on the entry of new financial firms, subject to their meeting pre-specified norms with regard to capital investments. This does not necessarily increase competition, because it is usually associated with the freedom to acquire financial firms for domestic and foreign players and extends to permissions provided to foreign institutional investors, pension funds and hedge funds to invest in equity and debt markets, which often triggers a process of consolidation;

ii. Measures which allow domestic residents to hold foreign financial assets. This is typically seen as a more drastic degree of liberalization, since it eases the possibility of capital flight by domestic residents in periods of crisis. However, a number of countries that receive “excessive” capital inflows that do not add to domestic investment in the net and are reflected in unnecessary accumulation of foreign-exchange reserves, have turned to such measures as a means of reducing pressure on the exchange rate;

iii. Measures that allow foreign currency assets to be freely held and traded within the domestic economy (the “dollarization” of accounts). This is the most extreme form of external financial liberalization, which has been implemented only in very few countries.

The progress of financial liberalization is reflected in the Chinn-Ito Index, which measures openness in capital account transaction. The higher value of the index, the greater the degree of openness of an economy to cross-border capital transactions (Perez-Caldentey and Vernengo, 2012, 12). The index was initially introduced in Chinn-Ito (Journal of Development Economics, 2006). KAOPEN is based on the binary dummy variables that codify the tabulation restrictions on cross-border financial transaction reported in the IMF’s Annual Report on Exchange Arrangements and Exchange Restrictions (AREAER). The data file contains the Chinn-Ito index series for the time period of 1970-2011 for 182 countries (Notes on the Chinn-Ito 2011 Update, 2011).

Table 3. Chinn-Ito Index Update 2011 for Selected Countries

Countries	**KAOPEN**
Argentina	-0,81
Brazil	-0,11 down
Chile	1,38 down
Egypt	1,65 down
Hungary	2,44
Indonesia	-0,11 down
Korea	0,94 up
Mexico	1,12

Poland	0,06
Turkey	0,06

Source: Chinn-Ito Index, 2011, "Notes on the Chinn-Ito Financial Openness Index Update", http://web.pdx.edu/~ito/chinn-Ito_website.htm

The Chinn-Ito index is the first principal component four indicators, and ranges in value from -1,8 in the case of "full control" to 2,6 in the case of "complete liberalization (Joyce, 2011, 881). KAOPEN compared to that as of 2009. There are 54 countries that score the "most financially open" value of 2,44 as of 2011 whereas there are 13 countries with "least financial open" score of -1,86 (Notes on the Chinn-Ito 2011 Update, 2011).

3.3. The Main Indicators of Financial Liberalization

Two type indicators used to be in measures of financial openness. **De jure** indicators are aggregated from lists of regulatory restrictions to different types of capital transactions. Among the problems with these measures are the need to aggregate partly judgemental assessments of policy restrictions on disparate types of capital flows, and their incapacity to capture the degree of enforcement of existing regulations. The alternative is to use the evidence on actual flows to measure capital market integration. These **de facto** measures raise the complementary of overstating the degree of capital controls, as cross-border flows depend on a number of factors unrelated to actual policy intent – economic and political circumstances (domestic and abroad), differential risk and liquidity, legal barriers, home bias, and so on (Esteves, 2011, 3).

De facto measures come in two flavours – price and quantity. Price measures attempt to assess financial integration from price differentials in financial assets across space. Quantity measures, on the other hand, focus on the size of flows or stocks of foreign assets normalised by the size of the world economy. Rather than just measuring these quantities, some approaches have proposed to use the correlation between domestic savings and investment as a measure of financial integration. In well integrated countries, investment will not be constrained by domestic savings, as they are able to tap into the pool of international capital; so that this correlation should decrease with financial liberalization (Esteves, 2011, 3).

The classification system is based on the members' actual, de facto arrangements is identified by IMF Annual Reports on Exchange Arrangements and Exchange Restrictions (AREAER), which may differ drom their officially announced, de jure arrangements. The system classifies exchange rate is arrangements primarily on the basis of the degree to which the exchange rate is determined by the market rather than by official action, with market-determined rates being on the whole more flexible. De facto system distinguishes among four major categories (IMF, 2013,4); hard pegs, soft pegs, floating regimes and the other managed.

In this paper used measures of each country's actual trade or financial openness. We include the rate of real GDP growth (Table 4), which is expected to lower the incidence of financial crises. The inflation rate (Table 5), which reflects macroeconomic volatility and should have the opposite effect, is calculated as the natural log of one plus the change in the Consumer Price Index. Current account balance (Table 6), which is believed to have played an important role in fomenting financial crises and has been indicted by some observers as the proximate cause for

the crises experienced by various emerging markets over the last decades. We also used to be unemployment rate (Table 7), which is reflects social problems in developing countries.

4. Macroeconomic Indicators on Effects of Financial Liberalization in Financial Crises

In this section, we review macroeconomic evidence on the effects of financial liberalization in the two dimensions – macroeconomic volatility and financial volatility or financial crises. Similarly in this section, we review macroeconomic evidence on the effects of financial liberalization in the three dimensions – growth, macro stability and macro economic volatility.

Measuring the extent of a country's integration into global financial markets is an important but complicated issue. In particular, the distinction between de jure and de facto integration appears to matter a great deal in understanding the macroeconomic implications of financial liberalization. It is notable that whereas the majority of cross-country empirical studies are unable to find robust evidence in support of the growth benefits of capital account liberalization, studies tend to find more positive results. At the same time, using either approach, there is little systematic evidence that capital account liberalization, by itself, increases vulnerability to financial crises (Mirdala, 2006, 454).

Table 4. Gross Domestic Product for Selected Countries.

(Constant Prices, Percent Change)

(1980-2013)

	Argentina	Brazil	Hungary	Mexico	Poland	Turkey
1980	0,7	9,9	0,2	9,4	-6	-0,7
1981	-5,7	-4,4	2,8	8,5	-10	4,3
1982	-3,1	0,5	2,8	-0,5	-4,8	3,4
1983	3,7	-3,4	0,7	-3,4	5,6	4,7
1984	2	5,3	2,6	3,4	-0,3	6,8
1985	-6,9	7,9	-0,2	2,1	3,8	4,2
1986	7,1	7,5	1,5	-3,1	3,4	6,9
1987	2,5	3,6	4,0	1,7	2,3	10,0
1988	-1,9	0,2	-0,06	1,2	3,2	2,1
1989	-7,0	3,2	0,7	4,1	3,8	0,2
1990	-1,3	-4,1	-3,4	5,1	-7,1	9,2
1991	10,4	1,0	-11,8	4,1	-7,0	0,9
1992	10,2	-0,4	-3,06	3,5	2,0	5,9
1993	6,2	4,6	-0,5	2,5	4,2	8,0
1994	5,8	5,3	2,9	4,7	5,2	-5,4
1995	-2,8	4,4	2,5	-5,7	6,7	7,1
1996	5,5	2,1	0,1	5,8	6,2	7,0
1997	8,1	3,3	3,1	6,9	7,8	7,5
1998	3,8	0,03	4,0	4,7	4,9	3,0
1999	3,3	0,2	3,1	2,6	4,5	-3,3
2000	-0,7	4,3	4,2	5,2	4,2	6,7
2001	-4,4	1,3	3,7	-0,6	1,2	-5,6
2002	-10,8	2,6	4,5	0,1	1,4	6,1
2003	8,9	1,1	3,8	1,4	3,8	5,2

2004	8,9	5,7	4,7	4,2	5,3	9,3
2005	9,1	3,1	3,9	3,0	3,6	8,4
2006	8,4	3,9	3,8	5,0	6,2	6,8
2007	8,6	6,0	0,1	3,1	6,7	4,6
2008	6,7	5,1	0,8	1,4	5,1	0,6
2009	0,8	-0,3	-6,7	-4,7	1,6	-4,8
2010	9,1	7,5	1,0	5,1	3,8	9,1
2011	8,8	2,7	1,5	3,9	4,5	8,7
2012	1,9	1,0	-1,6	3,9	1,9	2,1
2013	4,2	2,2	1,1	1,0	1,5	4,2

Source: IMF, World Economic Outlook Database, April 2014.

The composition of capital inflows has a substantial influence on the growth benefits of financial liberalization for developing countries, although the evidence is far from decisive. Studies based on both macroeconomic and microeconomic (industry- or firm-level) data find that equity market liberalizations have positive effects on output growth. Interestingly, despite the general consensus that foreign direct investment (FDI) is the form of capital inflow most likely to spin off positive growth benefits, these benefits are harder to detect in aggregate data than is the case for equity flows. Fortunately, recent work using micro data is starting to confirm that FDI flows do have significantly positive effects on output and productivity growth, especially through spillover effects associated with vertical linkages. Overall, studies using micro data are better able to detect the growth and productivity gains stemming from financial integration as well as the distortionary effects of capital controls (Mirdala, 2006, 454).

In addition to the traditional channels such as efficient allocation of capital and expanded international risk-sharing opportunities, the growth and stability benefits of financial liberalization are also realized through a broad set of “collateral benefits” - financial market development, better institutions and governance, and macroeconomic discipline. These collateral benefits affect growth and stability dynamics indirectly, implying that the associated macroeconomic gains may not be fully evident in the short run and may be difficult to uncover in cross-country regressions. Various threshold effects play important roles in shaping the macroeconomic outcomes of financial liberalization. Some key thresholds are related to the level of development of domestic financial markets, the quality of institutions and corporate governance, the nature of macroeconomic policies (including the exchange rate regime), and the extent of openness to trade. Recent research suggests that countries meeting these threshold conditions are better able to reap the growth and stability benefits of financial liberalization (Mirdala, 2006, 454).

On the other hand GDP (Table 4) shows a significant decrease, especially in the post-crisis period. For example, GDP turned positive in Hungary, has been negative in the after Global Financial Crisis period (2007-2010). Hungary’s GDP amounted to -6.7 percent in 2009. Similarly, after the 2001 Financial Crisis in Turkey has been -5.7 percent of GDP. Therefore, most affected by the financial crisis, GDP is macroeconomic indicators.

Table 5. Inflation for Selected Countries.
(Average Consumer Prices, Percent Change)
(1980-2013)

	Argentina	Brazil	Hungary	Mexico	Poland	Turkey
1980	100,7	90,2	9,2	26,4	9,4	110,6
1981	104,7	101,7	4,5	27,9	21,2	36,3
1982	164,7	100,5	7,01	59,1	100,8	31,1
1983	343,8	135,0	6,4	101,8	22,1	31,3
1984	626,7	192,1	8,6	65,4	75,6	48,3
1985	672,1	225,9	7,0	57,7	15,1	44,5
1986	90,0	147,1	5,2	86,4	17,7	34,6
1987	131,3	228,3	8,6	131,9	25,2	38,8
1988	342,9	629,1	15,7	113,5	60,2	73,6
1989	3079,4	1430,7	16,9	19,9	251,1	63,2
1990	2313,9	2447,7	28,9	26,6	585,8	60,3
1991	171,6	447,3	34,2	22,6	70,3	65,9
1992	24,9	1022,4	22,9	15,5	43,0	70,0
1993	18,5	1927,3	22,4	9,7	35,3	66,0
1994	4,1	2075,8	18,8	6,9	32,2	105,5
1995	3,3	66,0	28,3	35,0	27,8	89,5
1996	0,1	15,7	23,4	34,3	19,9	80,2
1997	0,5	6,9	18,3	20,5	14,9	85,6
1998	0,9	3,1	14,1	15,9	11,8	84,7
1999	-1,1	4,8	10,0	16,5	7,3	64,8
2000	-0,9	7,04	9,7	9,4	10,1	55,0
2001	-1,06	6,8	9,1	6,3	5,5	54,2
2002	25,8	8,4	5,2	5,0	1,9	45,1
2003	13,4	14,7	4,6	4,5	0,8	25,3
2004	4,4	6,5	6,7	4,6	3,4	8,5
2005	9,6	6,8	3,5	3,9	2,1	8,1
2006	10,8	4,1	3,8	3,6	1,0	9,5
2007	8,8	3,6	7,9	3,9	2,4	8,7
2008	8,5	5,6	6,0	5,1	4,2	10,4
2009	6,2	4,8	5,2	5,2	3,4	6,2
2010	10,4	5,0	4,8	4,1	2,5	8,5
2011	9,7	6,6	3,9	3,4	4,2	6,4
2012	10,4	5,4	5,7	4,1	3,7	8,8
2013	10,6	6,2	1,7	3,8	0,9	7,4

Source: IMF, World Economic Outlook Database, April 2014.

Inflation, especially in terms of macroeconomic and monetary stability is an important indicator. In the pre-crisis period, the inflation rate is increasing in developing countries. For example, in Brazil before the 1990 crisis showed a significant in the inflation rate of 1430.7 percent. This rate reached 2447.7 percent in 1990.

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Table 6. Current Account Balance in Selected Economies. (Percentage of GDP) (1980-2013)

	Argentina	Brazil	Hungary	Mexico	Poland	Turkey
1980	-1,2	-8,6	-4,8	-4,4	-15,5	-3,2
1981	-3,3	-6,8	-5,9	-5,3	-15,7	-1,9
1982	-3,4	-8,9	-2,2	-2,6	-6,7	-1,09
1983	-2,3	-4,6	-0,8	3,2	-8,7	-2,3
1984	-2,1	0,02	0,1	1,9	-8,8	-1,7
1985	-1,07	-0,09	-2,1	0,3	-10,2	-1,1
1986	-2,6	-2,1	-5,6	-0,8	-8,9	-1,4
1987	-3,8	-0,4	-2,5	2,4	-10,5	-0,6
1988	-1,2	1,2	1,9	-1,1	-11,0	1,3
1989	1,3	0,2	-1,9	-2,3	-1,8	0,6
1990	3,3	-0,8	1,1	-2,4	1,9	-1,2
1991	-0,2	-0,3	1,1	-4,09	-0,3	-0,03
1992	-2,8	1,5	0,9	-5,8	0,9	-0,4
1993	-3,4	-0,1	-10,8	-4,6	-1,2	-3,2
1994	-4,2	-0,3	-9,5	-5,6	5,2	0,2
1995	-1,9	-2,3	-3,5	-0,4	0,6	-2,3
1996	-2,4	-2,7	-3,8	-0,6	-2,08	-0,9
1997	-4,1	-3,4	-4,3	-1,5	-3,6	-1,0
1998	-4,8	-3,9	-7,09	-3,1	-4,0	0,7
1999	-4,1	-4,3	-7,7	-2,4	-7,4	-0,3
2000	-3,1	-3,7	-8,6	-2,7	-6,0	-3,7
2001	-1,4	-4,1	-6,07	-2,4	-3,1	1,9
2002	9,0	-1,5	-6,9	-1,9	-2,7	-0,2
2003	6,3	0,7	-8,0	-1,1	-2,5	-2,4
2004	1,7	1,7	-7,4	-0,9	-5,2	-3,6
2005	2,5	1,4	-7,4	-1,0	-2,3	-4,4
2006	3,3	1,2	-7,2	-0,8	-3,8	-6,05
2007	2,5	0,1	-7,3	-1,4	-6,2	-5,8
2008	1,8	-1,7	-7,3	-1,8	-6,6	-5,5
2009	2,4	-1,4	0,2	-0,9	-3,9	-1,9
2010	0,2	-2,2	0,2	-0,3	-5,1	-6,2
2011	-0,5	-2,1	0,4	-1,05	-4,8	-9,6
2012	-0,05	-2,4	1,0	-1,2	-3,5	-6,1
2013	-0,9	-3,6	3,1	-1,7	-1,8	-7,8

Source: IMF, World Economic Outlook Database, April 2014.

Overall current account balance in all developing countries “deficit” is realized the form. However in times of crisis the country is a rise in the deficit figures. For example, Turkey is classifieds as a “fragile” economy due to deficit. In 2001, Turkey experienced a severe financial crisis. Indeed in Turkey in the pre-crisis and crisis of balance of payments deteriorates. 0.7 percent in 1998, the current account balance amounted to -3.7 percent before 2001 Crisis. Hence this is an important indicator of the financial and economic crisis “deficit”. On the other hand current account balance capital account liberalization also is high correlation with.

Capital account liberalization is believed to have played an important role in fomenting financial crises and has been indicted by some observers as the proximate cause for the crises experienced by various emerging markets over the last decades. Interestingly, there is little empirical evidence to support the view that capital account liberalization by itself increases vulnerability to crises. While crisis episodes receive most of the attention, however, they are just particularly sharp manifestations of the more general phenomenon of macroeconomic volatility. Here the results are less favorable - there is no evidence that financial liberalization has delivered on the promised benefit of improved international risk sharing and reduced volatility of consumption (Mirdala, 2006, 454).

Table 7. Unemployment for Selected Countries,

(Percent of Total LaborForce) (1980-2013)

	Argentina	Brazil	Hungary	Mexico	Poland	Turkey
1980	3,0	6,5	0,6	1,2	na	7,2
1981	5,0	8,1	0,2	0,9	na	7,2
1982	4,5	6,4	0,1	4,2	na	7,6
1983	5,0	6,7	0,1	6,1	na	7,5
1984	5,0	7,1	0,1	5,6	na	7,4
1985	6,2	5,3	0,04	4,4	na	6,9
1986	6,3	3,6	0,2	4,3	na	7,7
1987	6,0	3,7	0,3	3,8	na	8,1
1988	6,5	3,8	0,4	3,5	na	8,7
1989	8,0	3,3	0,5	2,9	na	8,5
1990	7,6	4,2	2,08	2,7	6,3	7,9
1991	6,4	4,8	8,4	2,6	11,8	8,1
1992	7,1	5,8	9,3	2,8	13,6	8,4
1993	11,6	5,4	11,2	3,4	16,4	8,9
1994	13,3	4,6	10,1	3,7	11,4	8,5
1995	18,9	4,6	10,1	6,2	13,3	7,6
1996	18,7	5,4	9,8	5,4	12,3	6,6
1997	16,8	5,6	8,7	3,7	11,2	6,8
1998	14,7	7,5	7,1	3,1	10,5	6,8
1999	16,0	7,6	6,5	2,5	13,7	7,6
2000	17,1	7,1	6,0	2,2	16,09	6,4
2001	19,2	11,2	5,6	2,7	18,2	8,3
2002	22,4	11,6	5,9	2,9	19,9	10,3
2003	17,2	12,3	5,5	3,4	19,6	10,4
2004	13,6	11,4	6,3	3,9	18,9	10,2
2005	11,5	9,8	7,3	3,5	17,7	10,5
2006	10,1	9,8	7,5	3,5	13,8	10,2
2007	8,4	9,2	7,7	3,7	9,6	10,2
2008	7,7	7,8	8,0	3,9	7,1	10,9
2009	8,6	8,08	10,5	5,4	8,1	14,0
2010	7,7	6,7	10,8	5,3	9,6	11,8
2011	7,1	5,9	10,9	5,2	9,6	9,7
2012	7,2	5,4	10,9	4,9	10,08	9,2
2013	7,08	5,3	10,2	4,9	10,3	9,7

Source: IMF, World Economic Outlook Database, April 2014.

Unemployment rates are high in the pre-crisis and post-crisis in developing countries. For example, before the crisis in Argentina 1995, from 7 percent in 1992, the unemployment rate reached to 11.7 percent and after the crisis has reached this rate 18.7 percent. Similarly, unemployment rates before the 2001 Crisis in Turkey showed on upward trend and after the crisis had reached 10.4 percent. Thus the unemployment rate to some extent, while one of the leading indicators of economic crisis, post-crisis has become the most important socio-economic problems.

In this context turning to volatility more broadly, there has been a well-documented trend decline in macroeconomic volatility in most of the major industrial economies since the mid-1980s, although the reasons for this decline are still a matter of debate. Output volatility seems to have been on a declining trend in emerging market and developing economies as well. However, the existing evidence based on papers using a variety of regression models, different country samples and time periods leads to the conclusion that there is no systematic empirical relationship between financial openness and output volatility, which is, in a sense, consistent with the predictions of theory. Vulnerabilities, especially when the domestic financial system through which this capital is intermediated is underdeveloped, poorly supervised, and subject to governance problems (Mirdala, 2006, 445). The recent financial crisis exposed the lack of coordination between monetary and regulatory authorities. Adding an overarching layer of macro-prudential oversight world provide a more comprehensive view of emerging vulnerabilities, by bringing together monetary policy makers regulators and supervisors with a shared macro-prudential focus (Sutherland et al, 2012, 23).

Conclusion

Beginning of 1990s, most developed countries has completed the term of liberalization and the process of Washington Consensus. During this process, it was thought that temporary macroeconomic stability has decreased banking risks. But this approach has created a risk appetite by changing the risk detectin. On the other hand, the diversity in the financial instruments in the last quarter has also triggered the financial crisis. Typically, financial sector liberalization in developing countries has been associated with measures that are designed to make the central bank more independent, relieve “financial repression” by freeing interest rates and allowing financial innovation, and reduce directed and subsidized credit, as well as allow greater freedom in terms of external flows of capital in various forms.

Financial liberalization refers to measures directed at diluting or dismantling regulatory control over the institutional structures, instruments and activities of agents in different segments of the fi nancial sector. Capital international flows are a source of risk for world economy. For instance, in Mexico in 1995, in Thailand, South Korea and Malaysia in 1998, the GDP decreased by 7% provoking a wave of unemployment and social problems. These crises are fed with the new practices adopted by financial markets agents. These new practices, based essentially on indebtedness to finance economic activities, resulted in the creation of new interconnections between financial markets and unstable countries.

Two type indicators used to be in measures of financial openness. **De jure** indicators are aggregated from lists of regulatory restrictions to different types of capital transactions. Among the problems with these measures are the need to aggregate partly judgemental assessments of policy restrictions on disparate types of capital flows, and their incapacity to capture the degree of enforcement of existing

regulations. The alternative is to use the evidence on actual flows to measure capital market integration. These **de facto** measures raise the complementary of overstating the degree of capital controls, as cross-border flows depend on a number of factors unrelated to actual policy intent – economic and political circumstances (domestic and abroad), differential risk and liquidity, legal barriers, home bias, and so on. The classification system is based on the members' actual, de facto arrangements is identified by IMF Annual Reports on Exchange Arrangements and Exchange Restrictions (AREAER), which may differ drom their officially announced, de jure arrangements. The system classifies exchange rate is arrangements primarily on the basis of the degree to which the exchange rate is determined by the market rather than by official action, with market-determined rates being on the whole more flexible.

Explaining the financial crises, argue that liberalization of financial flows has created economic instability and point out political interventions and economic instabilities instead of liberalization. On the other hand, inflation to trigger the financial crises and the system's unproductivity. Some authors argue that constraints on trade bank activities and imperfect standards of regulations have led to crises. Research and reports displays the reason for the crisis to be the restrictive regulations, imperfections in democracy and private property. While some reports point out that government-owned banks increase fragility in the system, the other find the corruption as important. The Global Crisis of 2008 called as a financial one, although there are some other factors such as oil and good prices, inflation. Before the crisis, high level of growth, increased capital flows and financial stability led to uncontrolled growth in banking system because of excessive risk appetite and willingness high profits. More importantly, regulatory authorities were insufficient to realize risks and financial innovations in the system.

Measuring the extent of a country's integration into global financial markets is an important but complicated issue. In particular, the distinction between de jure and de facto integration appears to matter a great deal in understanding the macroeconomic implications of financial liberalization. It is notable that whereas the majority of cross-country empirical studies are unable to find robust evidence in support of the growth benefits of capital account liberalization, studies tend to find more positive results. At the same time, using either approach, there is little systematic evidence that capital account liberalization, by itself, increases vulnerability to financial crises.

Turning to volatility more broadly, there has been a well-documented trend decline in macroeconomic volatility in most of the major industrial economies since the mid-1980s, although the reasons for this decline are still a matter of debate. Vulnerabilities, especially when the domestic financial system through which this capital is intermediated is underdeveloped, poorly supervised, and subject to governance problems. The recent financial crisis exposed the lack of coordination between monetary and regulatory authorities. Adding an overarching layer of macro-prudential oversight world provide a more comprehensive view of emerging vulnerabilities, by bringing together monetary policy makers regulators and supervisors with a shared macro-prudential focus.

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