

Chapter Six

The Risks Associated with Financial Liberalisation and Portfolio Capital Flows:

An Analysis of the 1990s Financial Crises

Summary

Chapter Six investigates financial crises as a major risk factor of financial liberalisation. The two major components of the 1990s financial crisis are addressed, namely the currency crises and the banking crisis.

In the context of the currency crisis, the three generations of currency crisis theory are reviewed. Both the second and the third generation theories offer convincing reasons for the 1990's financial crises. The currency peg provides a significant incentive for over-borrowing of banks and corporations, leading to the crisis.

Banking crises are investigated using models of the 1990s. Three explanations are reviewed; the boom-burst cycle, interest rate liberalisation and portfolio mismanagement. The upsurges of portfolio capital flows gave a characteristic dimension to the 1990s financial crisis. The final section of this chapter discusses research in developing "early warning systems" for financial crises.