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FINANCIAL CRISES OF THE LAST TWO DECADES AND THE ISSUES TO BE ADDRESSED

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Abstract

Within the last two decades, the world has seen many financial crises which have spread around the globe and affected both developing and developed countries. Although each had its own particularities, there are some similar patters that stand out, most being related to an over evaluated asset in a country or region and a sharp withdrawal of funds that led to the burst of the crisis. Looking into each of them, there are some common causes and addressing these may help prevent any future financial shocks.

INTRODUCTION

Ever since the births of the financial world, there have been diverse developments that changed the landscape and brought turmoil among the participants. As the role, the interconnections and the magnitude of the financial architecture increased over time, more parties with a lesser involvement got linked to the system and started sharing both benefits but also the risks of a crisis. Nowadays, most of the world is connected through the capital flows and problems affecting one country are spreading to the entire region and even to a global scale.

Financial crises have appeared since the 17th century, the first recorded one being the tulip mania in the Nederland in 1637, when speculators bid up the prices of rare tulip bulbs to stratospheric levels (Roubini & Mihm 2010). While historians continue to debate the consequences of this bit of speculative fever (and some economists even deny it was a bubble, arguing that all bubbles are driven by fundamentals), it set the stage for larger bubbles whose destructive effects are not in doubt.

During the 19th century, both U.S. and England suffered several economic recessions with bank failures and financial markets in distress. The first part of the 20th century was no different, and once could emphasize the Great Depression or the '73 oil crises that led to the stock market crash.

Starting with the last 2 decades, the crises intensified and increased significantly in magnitude. Since the Mexican crisis in 1994 and 1995 the financial markets have frequently been hit by severe crises. Starting with 1945 there has been no decade with as many financial crises as the 1990s and beginning of the 2000s (Dieter, 2002). Adding to this the latest US subprime crisis, which some considered to be a "black swan" event and the European sovereign debt crisis, makes it more obvious that the turmoil can affect anyone, even countries which were prior to the crises considered to be models.

Financial Crises

The financial crises of the past 2 decades have intensified the debate on a new international financial architecture. Both emerging and developed countries were hit by the crisis and due to the globalization and increased linkages throughout the world the intensity and effects have been harsher and harsher.

The Asian crisis was particularly prominent. It was not limited to only one economy, but affected an entire area. Additionally, there were almost no warnings in advance. Both this inability to forecast and the dimension of the biggest economic crisis since World War II at that point have caused concern. However since 1998 some other additional financial crises hit developing countries. The crisis in Russia in 1998, the Brazilian crisis in 1999, the Turkish crisis in 2001 and finally the default of Argentina show that financial markets are characterized by frequent instability. In particular, the case of Argentina proves the risks associated with the implementation of a currency board, a system staunchly defended by the International Monetary Fund in the aftermath of the Asian crisis. Following this, the crisis in the US and the contagion that was passed to the EU revealed that no country or region is immune to financial turmoil and the effects can have a huge impact on the entire world.

The financial crises of the late 1990s underscored the linkages between macroeconomic developments and financial system soundness. Indeed, fragile financial institutions, inadequate bank regulation, poor supervision and lack of transparency were at the heart of these crises (IMF, 2005). Increased sophistication of financial products and deregulation in the developed countries also showed that limits should exist in order for the world financial system to operate coherently.

Mexico's Financial Crisis (1994-1995)

The 1994 economic crisis in Mexico, also known as the Mexican peso crisis, was generated by the rapid devaluation of the Mexican peso. This happened under the presidency of Ernesto Zedillo in his earliest period. Approximately a week of intense currency crisis was stabilized when US President Bill Clinton and other international organizations granted Mexico a $50 billion loan.

The crisis is also known in Spanish as 'el error de diciembre' — The December Mistake. The impact that the Mexican crisis had on the region was labelled Southern Cone and Brazil the Tequila Effect (Carrizosa, Leipziger & Shah, 1996).

According to the United States General Accounting Office in a report published in February 1996, Mexico's financial crisis originated in the growing inconsistency in 1994 between Mexico's monetary and fiscal policies and its exchange rate system. Due in part to an upcoming presidential election, the Mexican authorities hesitated to take actions in the summer of 1994. The inconsistencies could have been reduced by raising the interest rates or by devaluing the peso. This fundamental inconsistency in the policies was aggravated by the Mexican government, which failed to respond to several economic and political events, and in turn, created investor concern about the likelihood of a currency devaluation. In response to the investor fears, the Mexican government issued huge amounts of short-term, dollar-indexed notes. These were called "tesobonos". By the start of December 1994, Mexico had reached to be predominantly vulnerable to a financial market crisis because its foreign exchange reserves had fallen to $12.5 billion while it had tesobono obligations of $30 billion maturing in 1995 (United States General Accounting Office, 1996).

While the crisis took place under President Zedillo, one attributes the causes to Carlos Salinas's outgoing administration. The policy of his government in respect to the currency put an unbelievable strain on the nation's finances; the resulting economic bubble gave Mexico a prosperity not seen in a generation. For this period of rapid growth which was coupled with a low inflation persuaded some political thinkers and the media to state that "Mexico was on the verge of becoming a First World nation." (Estrada, 1998) and actually, it was the initial one of the newly industrialized nations to be admitted into the OECD in May, 1994. It was a known fact that the peso was overvalued, but the size of the Mexican economy's vulnerability was either not well known or downplayed by Salinas de Gortari's docile policies and media. The weaknesses were however further worsened by additional unanticipated events and macroeconomic mistakes of his government.

1994 was the last year of the 6-year administration of Carlos Salinas de Gortari who, following the tradition that PRI had on every year of elections launched an amazingly high spending, which translated into a historically soaring deficit. So that this deficit could be financed (a 7% of GDP current account deficit), Salinas issued the Tesobonos, which were attractive debt instruments that were denominated in pesos but indexed to dollars. Mexico experienced (common to those days) lax banking or corrupt practices; moreover, some members of the Salinas family (though only Raúl, his brother, got to be imprisoned) gathered enormous illicit payoffs (Hufbauer & Schoot, 2005). Luis Donaldo Colosio, the most-likely-to-win candidate, was assassinated in March of that year; a couple of months later José Francisco Ruiz Massieu, who was the person in charge of the investigation, was also murdered.

Mexico's devaluation of the peso in December 1994 precipitated a crisis in Mexico's financial institutions and markets that continued into 1995. The confidence of the investors fell down as investors sold Mexican equity and debt instruments, while the reserves of foreign currency at the Bank of Mexico were insufficient to meet the demand of investors seeking to convert pesos into dollars. As a reaction to this crisis, the USA structured a financial assistance package of up to $48.8 billion in funds from the United States, Canada, the International Monetary Fund (IMF), and the Bank for International Settlements (United States General Accounting Office, 1996). The multilateral assistance package was intended to enable Mexico to avoid defaulting on its debt obligations, through which the country would overcome the short-term liquidity crisis and would also prevent the spreading of the crisis to other emerging markets.

Mexican businesses with debts to be paid in pesos, or that relied on supplies bought from the USA, was rapidly affected, with some mass industrial lay-offs and several suicides that were promoted in the media. Companies whose decision-makers attended the meeting at Zedillo's office were spared the nightmare and alerted, started to rapidly buy dollars and renegotiated their contracts into the local currency. To make matters worse, the devaluation announcement was made in the middle of the week (Wednesday), and for the rest of the week foreign investors fled the Mexican market without any government action to prevent or discourage it until the following Monday when it was too late.

The December Mistake caused so much outrage that Salinas exiled himself in Ireland (he was campaigning worldwide for WTO head at the time). The country's GDP contracted approx. 7% in 1995 – the worst decline in the country's history in a single year – and the incident became the first in a longer list to come.

The Asian Crisis (1997-1998)

The East Asian financial crisis was a period of economic unrest that started in July 1997 in Thailand and affected currencies, securities markets, and some other prices of assets in several Asian countries. Among these, there were several considered East Asian Tigers. This is also usually referred to as the East Asian currency crisis (Hughes, 1999).

The crisis was initiated by two rounds of currency depreciation that have been occurring since the beginning of the summer in 1997. The first round was an abrupt drop in the value of the Thai baht, Malaysian ringgit, Philippine peso, and Indonesian rupiah. After the aforementioned currencies stabilized, there was a second round that commenced with downward pressuring on the Taiwan dollar, South Korean won, Brazilian real, Singaporean dollar, and Hong Kong dollar. The authorities in those countries responded to the weakness in their currencies by selling foreign exchange reserves and raising interest rates. As an effect, the economic growth slowed and interest-bearing securities became more attractive than equities (Nanto, 1998). The currency crises also have revealed severe problems in the banking and financial sectors of the troubled Asian economies.

Indonesia, South Korea and Thailand were the countries most affected by the turmoil. Hong Kong, Laos, Malaysia and the Philippines were also hit by the crisis. Mainland China, Taiwan, Vietnam and Singapore were relatively unaffected. Also, Japan was affected to a small extent by this crisis but was going through its own long-term economic difficulties. However, all the aforementioned countries saw their currencies dip significantly relative to the US dollar and the nations that were hit the hardest saw extensive currency losses.

Many factors may have contributed to the onset and spread of the Asian crisis, but the major consensus is that the main ingredient was financial fragility (Lane, 1999). This involved four related aspects. First, a great deal of financial institutions and corporations in the countries affected had borrowed in foreign currencies without adequate hedging in place, thus making them exposed to currency depreciation. Also, the most part of the debt was short-term while assets were longer-term, this mismatch generating the likelihood of a liquidity attack. The consequences of this would be comparable to those of a bank run. Third, the equity and real estate prices in these countries had risen substantially before the start of the crisis, raising the probability of a sharp deflation in asset prices. Moreover, credit was in many instances allocated badly, contributing to gradually more visible issues at banks and other financial institutions before the crisis sprung.

The Asian countries attracted a high amount of the total capital inflow that entered the developing countries by keeping up high interest rates and experiencing in the same time a very increased growth level, between 8%-12% of the GDP. But this also attracted a vast quantity of “hot money” that played a central role in the events to come.

But each of the countries, although being similar in many respects, had also some specificities. Thailand, a country that had experienced an average of 9% growth in those last 10 years, was hit by massive speculative attacks on 14 and 15 May 1997 against the local currency, the baht. From 1985 until 2 July 1997, the baht was pegged to the US dollar at 25. But it dropped very swiftly and lost half of its worth. The baht attained its lowest value of 56 to the dollar in January 1998. Also, the Thai stock market dropped 75% in 1997. On 11 August, the IMF unveiled a rescue package for Thailand with more than 16 billion dollars and after nine days it supplemented another 3.9 billion. The baht has only reached pre-crisis highs of 36.5 to the dollar in November 2006.

In Philippines, after Thailand triggered the crisis, the central bank was forced to intervene heavily to defend the peso, almost doubling the overnight rate. But the peso fell significantly and the GDP contracted. In Hong Kong, the collapse of the Thai baht on July 2, 1997 took place one day after the United Kingdom handed sovereignty to the People’s Republic of China. In October, the Hong Kong dollar, which was pegged to the US dollar came under speculative pressure since the inflation rate in Hong Kong was significantly higher than that of the US but the government managed to keep the currency pegged to the US dollar. Also it ended up buying shares of various companies and becoming the largest shareholder of some of the companies and defended them from speculative short-sellers.

Malaysia also had to witness the ringgit losing 50% of its value and the decrease of the stock market and so the output of the economy declined plunging the country into its first recession. In South Korea, the world's 10th largest economy at that time, the excess debt led to major failures and take-overs (the car market is a very relevant example). Also in Indonesia, the rupiah and Jakarta Stock Exchange reached historical low values resulting in a crisis. After riots throughout the country with more than 500 people dying just in Jakarta (www.indoindians.com) president Suharto was forced to resign. In China, non-convertibility of the renminbi (RMB) protected its value from currency speculators and even if the GDP growth slowed sharply the crisis was not felt as badly as in other Asian countries.

In response, the IMF offered to step in the case of each nation and offer it a multi-billion dollar "rescue package" to enable these nations to avoid default. Nevertheless, the support granted by IMF was conditional on a series of drastic economic reforms but many of which were considered to be after the crisis ended, wrong choices for most of the countries.

The Asian financial crisis plunged the countries affected into deep recessions that brought rising unemployment, poverty, and social disturbance. The commencement, spread, and persistence of the crisis also challenged some basic assumptions: the countries most strongly affected were "tiger economies" that had few of the weaknesses usually associated with countries that turn to the IMF for assistance. These included fiscal surpluses, high private saving rates, and low inflation; and in the majority of the cases their exchange rates did not seem out of line (Lane, 1999), but the financial fragility revealed itself. Many nations learned from this and they started building up exchange reserves as a hedge against attacks and also pan Asian currency swaps were introduced in the event of another crisis.

The Russian financial crisis (1998)

After the Asian crisis, international investors were reluctant to lend to emerging countries, leading to holdbacks of the economy in developing countries in many parts of the world. The global recession of 1998, exacerbated Russia's financial crisis. Due to the subsequent decline in world commodity prices, countries which were greatly dependent on the export of raw materials, such as oil, were amid those most harshly hit (Petroleum, metals, natural gas and timber accounted for more than 80% of Russian exports, having the country exposed to swings in world prices. An important source of government tax revenue was oil (Goldsworthy & Zakharova, 2010). The powerful negative shock sharply reduced the price of oil, which reached a low of $8/barrel towards the end of 1998, leading to a financial squeeze in OPEC nations and other oil exporters (Karl, 2007). The sharp decline in the price of oil had severe consequences for Russia and contributed to the financial crisis in 1998.

The financial crisis in Russia that began in November 1997 and ended with the dramatic ruble devaluation in August – September 1998 was not as unexpected after the series of crises in East Asia as it was obvious to many economists that the policy of building up state debt coupled with slow progress in fiscal reform was bound to be unsustainable (Medvedev & Kolodyazhny, 2001). Mostly unexpected was the scale of the devaluation of the national currency, which was not forecasted by even the most pessimistic analysts. In summer 1999, the Russian government found itself to be unable to service its debt, acquired in the form of state bonds (GKOs and OFZs) under high domestic interest rates, and simultaneously keep the exchange rate within the official band. Uncontrolled ruble devaluation and unilateral restructuring of the domestic GKO-OFZ debt undermined the stability of the Russian banking system.

The Russian crisis is considered as mainly a government debt crisis (Medvedev & Kolodyazhny, 2001); however, alternative views also exist. In particular Montes & Popov (1999) argue that the primary cause of the crisis was overvaluation of the domestic currency. Nevertheless, all researchers agree that the timing of the crisis was largely determined by the actions of foreign investors in the domestic financial market. It is well known that Russia abolished capital controls under the pressure of the International Monetary Fund, which was widely criticized as making the domestic economy dependent on world financial markets.

Major Russian banks have been on the brink of collapse, the Rouble devaluated and there was a collapse in the value of traded equity stock in Russian companies. Also Russia received different loans from foreign banks and also from the IMF but Russia's problems still remained until a sound reform would be made.

Brazil's Financial Crisis

The Asian crisis spilled over quickly, via Russia, to Brazil - thus, to Latin America. The economic policies of Brazil were similar to those put forward in East Asia, with high interest rates kept to attract capital, having the purpose of defending the fixed exchange rate tied to the US dollar. The effect had been a substantial inflow of volatile capital, which amplified Brazil's vulnerability to the financial problems of the world, like those that would occur soon after the Asian crisis. In 1998 during the summer, the Russian crisis increased fears about the health of the Brazilian economy and $20 billion left the country (Campodonico & Chiriboga, 2000). In spite of the negotiation of a support loan organized by the US Treasury and the International Monetary Fund, the outflows continued and Brazil had to devalue its currency. The government allowed the floating of the real and discarded the linkage to the US dollar.

By February 3 the Real had tumbled by 32 percent (in comparison to the beginning of January when the devaluation began) and was trading at R$1.79 per U.S. dollar (Langley & Bolling, 1999). To increase market confidence and stop any panic on stock and bond markets around the world, the decision was taken to completely abandon the mini-band. As part of the package and to discourage investors from withdrawing funds from the country, the Central Bank of Brazil announced that short-term interest rates would increase from 29 to 39 percent. The pace of dollar flight declined, although reportedly a total of $7-8 billion left the country in January 99.

IMF and the US Treasury organized negotiations for a loan support but still a crisis had began and it was just taking off in the region.

The Brazilian crisis spread quickly to other countries from Latin America and billions of dollars went out of the region in only a few weeks, deterring the trade exchange with the US. As a result, Latin American countries endured one of their worst economic recessions.

The Financial Crisis in Turkey

The Turkish economy has been hit twice by economic crises, each triggered by financial rumours and political concerns. The first crisis, sparked in November 2000 when the government announced plans to investigate 10 banks, significantly reduced investor confidence, pushing interest rates up to an annualized 2,000 percent in December (Safavian & Osborne, 2001). Investors switched out of lira-based assets, causing a severe shortage of short-term credit, exacerbating the situation. Just as recovery seemed imminent, a crisis yet more damaging swept through the nation's troubled financial markets. In February, a public rift between Prime Minister Ecevit and President Sezer unnerved sensitive financial markets, triggering a second short-term credit crunch and the loss of billions of dollars in foreign exchange reserves (generally used by the central bank to defend the lira). Turkey was forced to abandon its crawling peg currency regime (where the lira's value was allowed to fluctuate between a predetermined band that grew with inflation) and float the lira. After this, the Turkish lira began floating freely, and lost over 80 percent of its value.

South Africa's Crisis

For more six months in 2001, the South African economy was hit by a sharp drop of the

exchange rate vis-à-vis Dollar and Euro. On 2nd January, 2001, the exchange rate was Rand 7.56 to the Dollar and on 2nd July 8.01. At the end of December 2001, the South African currency was only traded at over 12 Rand to the Dollar (US Federal Reserve Bank, 1996). With such a strong devaluation, the macroeconomic data of South Africa should provide at least a partial explanation but unfortunately they do not.

The weakness of the currency was the result of a sudden and collective drop of investor confidence. The political developments in Zimbabwe, the already existing pressure on the Rand as the measures that were introduced by the Central Bank to make speculation more difficult reduced the amount of foreign exchange traded and made the Rand more vulnerable or maybe contagion from the adverse developments in other emerging market economies could be some reasons for what happened but the causes why the Rand lost 37% against the dollar that year making it one of the most undervalued currencies in the world (The Economist, 2001), are still unclear.

As Investec's global head of foreign exchange trading (in South Africa), Patrick de Villiers, presented it, the currency slide in the last quarter of 2001 was caused mainly by negative sentiment.

Argentina's Financial Crisis

The crisis in Argentina was the product of a convergence of events, some outside Argentina's policy process, others linked in a direct way to its political and economic background. Although it is not easy point out the exact time that Argentina's economic situation turned into a crisis, one can emphasize that in the initial part of 2001, economic, political and social events had taken a significant turn for the worse.

The crisis that erupted in Argentina in 2001 raises many questions as to what went wrong and what lessons can be learned. No one doubts now that the Argentine authorities made serious errors, however the international community also shares some blame for the crisis. The IMF backed Argentina's economic programmes with money and advice throughout the ten years that the convertibility regime (linking the peso to the dollar) was in place. Argentina was highly praised as an exemplary case of a country adopting the type of structural reforms that international financial institutions and private markets have been pushing over the past two decades (Allen et. all, 2003). Argentina opened itself enthusiastically to world financial markets, which backed the country with significant resources. The risks involved were minimized by all these institutions and agents until very late in the process.

Argentina quickly lost the confidence of investors and the flight of money away from the country mounted. In 2001, the population panicked and began withdrawing large sums of money from their bank accounts, exchanging pesos into dollars and transferring them abroad, causing a run on the banks. The government then enacted a set of measures that effectively froze all bank accounts for a year, permitting for only small amounts of cash to be withdrawn.

After much deliberation, Duhalde abandoned in January 2002 the fixed 1-to-1 peso-dollar parity that had been in place for ten years. In just a few days, a large part of the value of the peso was lost in the unregulated market. A provisional "official" exchange rate was set at 1.4 pesos per dollar. There were many debates about why the peso had been linked to the dollar since the country's exports to US did not exceed 20%. Also the most important trading partner, Brazil had already devaluated its currency and thus making the Brazilian goods cheaper in comparison to the Argentinean ones.

After a few months, the exchange rate was left to float more or less freely. A massive devaluation took place, which in turn prompted inflation (since Argentina depended to a great extent on imports, and was not in the position to replace them locally at the time).

Many private companies were affected by the crisis. Agriculture was also affected. Rioting spread to major cities over deep budget cuts (Hornbeck, 2002) and there people died on the streets.

In 2002 when the default was declared, foreign investments left the country, and inflows of capital towards the country almost totally stopped. The Argentine government encountered severe problems trying to refinance the debt. The country had no auxiliary funds at the point, and the central bank's foreign currency reserves were almost depleted. The IMF offered different rescue packages but only in 2003, after Néstor Kirchner became president, the crisis was truly managed and sound policies were put into action.

The obvious lesson from this experience is that exchange rate regimes cannot be designed without careful consideration of both trade flows and socio-economic conditions of a country. In the case of Argentina the rigid exchange rate regime caused harm for two reasons: Firstly, only a very small part of exports went to the US, the country that provided the anchor currency, and a much greater part went to Brazil and the EU. Secondly, labour markets in Argentina were not nearly as flexible as they should have been for a sustainable currency board. Also, the IMF, who should have played a key role in the process, received again many criticism because of its policies, as it had also received before, during the other crises.

The US Subprime Crisis

The crisis that began in 2007 was the outcome of a built up in asset prices, particularly

the housing market and the structured securities that had as underlining assets the wrapped up mortgages.

After a period of boom, when most of the opinions pointed towards the great success of the free market and several deregulation pressures were constantly arising, the markets began to realise the extent of the bubble that had been created.

In mid 2006, the home prices had a peak after a prolonged period of rapid growth, however, they soon started to decline. As a result, with increasing interest rates, the borrowers' ability to refinance their loans started to diminish and mortgage delinquencies soared. Mortgage backed securities, including subprime mortgages which were held by various financial institutions at a global level also began losing their value.

The causes of the crisis include the inability of the homeowners to perform their payments, an overbuild up in the boom period, risky and complex products which were backed up by the mortgages, global trade imbalances, inappropriate regulations, the shadow banking system, agency ratings and the inability of the market to spot the inconsistencies that were building up.

The consequences were more than the financial world could have imagined. Lehman Brothers and other important financial institutions failed. Some other had to be rescued by the government, while many of the CEOs of the major players had to step down. AIG, the biggest insurer in US was bailed out, with many of the Credit Default Swaps backed by them being triggered.

The crisis had severe and long lasting consequences in both US and Europe, however the impact was felt by all of the world. A deep recession for the US, millions of jobs lost, a huge drop in the housing prices and financial institutions that had a global footprint being in distress were among the problems that the crisis had left. A vast literature on the events sprung quickly after and economists are still debating on the mixture of events and issues that led to this particular event.

The crisis in the European Union

This is an ongoing crisis that highlighted the impossibility of some countries in the Euro area to finance themselves without the aid of other institutions. As per the Maastricht Treaty, the deficit and debt levels were limited, however some countries went around the requirements using complex securities, inconsistent accounting and off-balance sheet transactions.

As a result of the US crisis, the problems in Europe came in the form of a sovereign debt crisis, although causes may vary from country to country. Initially, the governments were forced to bail out financial institutions which were in a similar situation with their US peers. Property bubbles in some countries also contributed to the problems.

Still, the fact that the Eurozone was a monetary union and not also a fiscal one, with different banking systems, showed that debt issued in EUR by a particular country was treated quite differently than the debt issued by a stronger partner from the Eurozone in the same currency.

In 2010, the European Financial Stability Facility (EFSF) and the European Stability Mechanism (ESM) were born due to measures aimed at increasing the financial support. Common actions by the European Commission, the European Central Bank and the International Monetary Fund, which became known as the Troika led to several bail outs for the most distressed countries. Greece, Ireland starting with 2010, Ireland in 2011, Spain and Cyprus in 2012, required assistance packages, while additional countries faced soaring yields in order to finance themselves.

Austerity measures from the countries produced severe social unrest, especially in Greece when in May 2011, more than 100,000 people gathered to protest in front of the parliament in Athens. Solutions are still sought, however the current financial set up from the Eurozone needs to be rethought. The hard decision making process together with a single currency for economies with different specifics need to have a common background and the decision makers within the EU should focus on solving these issues as soon as possible.

Overview of the causes for the crises

All the crises that have appeared, while different in nature have very many similarities and the pattern seems to replicate itself over the course of history. Starting with the inexplicable increase of the prices of tulip bulbs back in the 17th century to the unrealistic increase in home prices in the US up to 2006 (the European crisis that followed is considered to be a spill-over from the one in US), neither people around the globe, nor economists (with very few notable exceptions), have managed to identify the signs that let the build up of bubbles, which eventually burst into crises with huge economic impacts.

By performing an analysis of the previously enumerated crises, one can outline certain behaviours in respect to the causes that led to the events. The particular "assets" that were the starting basis of the crises are of particular importance as they can suggest what was the origin in each cases (Stoian & Becherescu, 2013).

The bulbs in the "tulip mania", stocks in the Great Depression, oil in the 73' oil crisis, currencies in the Asian crisis from 97', home prices in the US subprime turmoil were all "assets" that either were overvalued or rose unsustainably in price and led to the build up of bubbles that produced important effects when they burst.

Therefore, the causes that led to the crises can be split into two main categories: the particular ones, specific to each of the crises and the common ones, which we can identify in most crises and which can provide a solution to the prevention and better management of future financial issues.

Focusing on the common causes that let to the crises throughout history, one can highlight the unsustainable increase in the prices for a particular asset - a feature that applies to both advanced countries and also to emerging economies. For the EMEs, the structural weaknesses are also to be taken into account. Among these we can stress the limited financial development, the faulty governance structures, over-regulated markets, external liabilities denominated extensively into a foreign stronger currency or the fear of floating the exchange rate (Gourinchas & Obstfeld, 2011).

The increase in prices for that particular asset should trigger some flags for the regulators and authorities in that particular market in order to include some additional supervision and countercyclical measures in that area, so that a full scale event can be prevented.

Also, speculative actions without economic sustainability should be discouraged through specific measures as they exacerbate the booms, while creating panic by initiating the capital flight.

Issues to be addressed

By an analysis of the development in the crises that have occurred one can identify several common issues that should be addressed in order to prevent future failures in the financial system. All have appeared in different shapes in most of the recent crises.Namely, the following can be stressed out.

Asymmetric Information

This can be defined as the existence of more or superior information for one party in comparison to another, related to a particular transaction. This can lead to a harmful situation as one party can take advantage of the other party's lack of information.

As per Mishkin (1996), the asymmetric information view of financial crises, defines a financial crisis to be a nonlinear disruption to financial markets in which the asymmetric information problems of adverse selection and moral hazard become much worse, so that financial markets are no longer able to efficiently channel funds to those who have the most productive investment opportunities.

Adverse selection is an immoral behaviour that takes place before a transaction based on a surplus of information that one party has. A buyer does not know if a seller is selling the security because of a sudden need for liquidity, or because the seller is trying to get rid of the toxic assets, which can lead to market illiquidity (Kirabaeva, 2009).

Moral hazard occurs when a party protected from risk behaves differently than it would behave if it were fully exposed to the risk. Moral hazard occurs because an individual or institution does not take the full consequences and responsibilities of its actions, and thus, has a tendency to act less carefully than it otherwise would, leaving another party (usually the government) to hold some responsibility for the consequences of those actions. The 'too big to fail' is a very good example in the US subprime crisis.

Sudden stops

A sudden stop is an event in which local economies lose access to international capital markets, as foreign creditors become panicked due to financial turmoil (e.g. financial crises), thus stopping lending to local economies. Sudden stops are usually described as periods that include at least one observation where the year-on-year fall in capital flows is at least two standard deviations below its sample mean as per Calvo et al. (2004).

Capital flight

Capital flight occurs when assets or money rapidly flow out of a particular country, due to an event that has some economic consequences. Such events could be either an increase in taxes on capital or the government defaulting on its debt that alarms investors and causes them to decrease the value of the assets they posses in that country, or just to lose confidence in its economic strength.

The main effect is wealth disappearance, together with a sharp reduction in the exchange rate of the affected country (for variable exchange rate regimes this takes the form of depreciation, for fixed exchange rate regimes this leads to a forced devaluation from the original peg rate). Another consequence of capital flight is the sharp decreases in the purchasing power of the country's assets which creates problems for importing goods and for paying foreign debt.

Free rider problem

A free rider is someone who benefits from resources, goods, or services and does not pay the costs associated however can still take advantage (free ride off) of them. The investors acquiring a piece of information will not be able to benefit from the entire increase in value of their assets as other will also benefit, without having paid (Hardin, 2013). The primary mechanism by which societies can address this issue is through the governments and the regulations and enforcing that they promote.

Global Imbalances

In the current globalised world, the current account imbalances that may appear seem to be less and less taken accountable for the macroeconomic and financial stress, as the gross financial flows have started to outweigh in importance the net ones.

The factors that emphasise the global imbalances also imply that the gross international financial flows are at the heart of any assessment of risks related to the financial stability (Obstfeld, 2012).

An important view, especially related to the US Financial Crisis is that the excess of savings versus investments in the emerging markets (and one could outline the Asian countries, especially China) which was echoed in corresponding current account surpluses was a very important pressure factor on the world interest rates, which were driven down.

This was considered by some of the economists to be the main factor encouraging the credit boom, lowering the risk premia and increasing the prices of assets in the US, in the years preceding the crisis.

Still, the most import part of inflows coming into the United States came from Europe, while surplus countries (China, Japan, OPEC Countries) accounted for a much smaller portion. Furthermore, the latter group invested mostly in US bonds and other similar safe assets.

From this perspective, one could say that the global imbalances were not one of the main causes preceding the crisis; however they did fuel it by an important amount. Currently the global imbalances persist and they should be taking into account in the ever more interlinked world.

Deregulation

Most of the new financial instruments that are being "invented" do not fall under the regulations in place. This is one of the exact reasons why the new instruments are created, so that they can avoid certain regulatory requirements or prohibitions that would normally apply. Furthermore, in the boom period, one could notice a tendency towards deregulation and a pressure to relax the financial constraints, as the private sector is taking advantage of the momentum.

Still, most of the crises have shown that there is always a shortfall in this domain, and especially during a boom period, in order to lower the magnitude of cycles, the governments and regulatory bodies should impose additional controls in order to increase the prevention and decrease the potential risks.

CONCLUSIONS

Financial crises have occurred in many instances throughout history, still no actual solution has been found in order to prevent them. Most crises have taken the economic environment by surprise, although the built up of events and facts, together with a similar unfolding that have amplified the impact and effects can be traced in most of them.

The last two decades have proved that the countries are still seeking the right financial solutions, however as the world evolves, one can only learn from the previous mistakes and try to set up an architecture that can prevent future economic failures from happening.

One cannot anticipate the particular event, area or industry that may lead to the crises, however, by determining which were the common causes and the common developments that added to the creation and amplification of these financial turbulences can assist in a better anticipation and management and further help identifying solution in diminishing the effects.

Regulations imposed by national governments or rules created by international bodies that everybody should obey are the final act in order to prevent future financial disasters. As the world is moving towards a more globalized stage, with ever more increased interconnections between regions, states and companies, any disruption in a particular area is very likely to rapidly spread to a larger scale. However, in order to implement this, a very important role is to identify the main features of pre-crises, during the crises and after the crises events that have the most important influence and that create the negative effects which need to be eluded. These effects have shown that the financial turbulences can also have an important social impact which should not be disregarded.

By analyzing the history of crises, one can see that many of the fundamental principles remain the same, still the occurrence has not changed, and moreover the crises seem to appear more frequently and with a greater impact within the last decades. Therefore all common causes should be addressed in order to minimise the potential appearance and effects that a full scale financial crisis could have on the economic environment.

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