Mechanisms for Forming Currency- Financial Crises in Developing Markets

David Tereladze[1(✉)] and Ernie Hendrawaty[2]

[1] International Economics and International Corporate Finance North-West Institute of Management, Saint-Petersburg, Russia
tdavid@mail.ru

[2] Management Lampung, University Lampung, Lampung, Indonesia
ernie.hendrawaty@feb.unila.ac.id

Abstract. The subject of the study is the formation of monetary and financial crises in emerging markets. The author's classification of crises is proposed, and the main mechanisms for the formation of financial instability are also given. The article discusses the issues of cross-border international capital movement and the impact of this process on economic security and the sustainability of Russia's socio-economic development. An assessment of capital outflows was carried out between 1994 and 2018. It has been established that the ratio of attracted direct investments to the accumulated exported capital is not optimal; this conclusion is made on the basis of the appeal to global trends in international capital flows, as well as taking into account the Russian situation in this area. The article proposes several directions for improving state regulation of cross-border capital flows in Russia. This, according to the authors, will ensure the sustainability of socio-economic development and neutralize several threats to the country's economic security.

Keywords: Financial crisis · capital expansion · financial instability · foreign currency lending · financial dollarization · credit boom · capital outflow · financial security · national security · economic security · macroeconomic indicators · sustainability of socio-economic development

1 Introduction

The uncontrolled expansion of capital into the financial markets of developing countries presupposes an expansion of aggregate demand, leading to an increase in the external debt of the state and the private sector, which makes it possible to increase investment to a level exceeding the volume of domestic savings. This pattern allows achieving a higher rate of economic growth. However, the process of massive capital inflows can have negative consequences for an emerging market, if the trend changes in the opposite direction. The created imbalances in the financial system during the period of financial expansion have a destabilizing effect on the banking system and the stock market, thereby increasing the economy's susceptibility to external shocks. In this regard, the article devoted to the determination of the mechanisms of the formation of currency and financial crises in emerging markets seems to be quite relevant.

Nairobi et al. (Eds.): ICEBE 2022, AEBMR 241, pp. 157–169, 2023.
https://doi.org/10.2991/978-2-38476-064-0_18

W and its relatively short history of the emerging markets have experienced a series of monetary and financial crises associated with the withdrawal of foreign investments that affect individual countries and regions.

As a rule, before the onset of the crisis in emerging markets, there was a massive inflow of capital, leading to a strengthening of the exchange rate, loss of competitiveness of manufacturers, and due to a slowdown in product exports.

2 Literature Review

2.1 The Object of Study

The object of study of this article and is a cross-border movement of capital in emerging markets. By this term, economists understand the processes of capital movement between different countries, which arises as a result of the policy of liberalizing financial borders. This phenomenon cannot be given an unambiguous economic assessment. On the one hand, it is a consequence of the intensive development and integration of the economic system of the international division of labor, when various barriers to the movement of capital and labor force are removed in countries. On the other hand, it can be stated that this phenomenon is characterized by the processes of "separation" of the movement of capital from the processes that take place in the real sector of the economic system. In addition, it can be stated that the process of cross-border movement of capital also has its negative aspects, since this leads to an increase in the share of speculative capital and thereby reduces the stability of the world financial system as a whole.

2.2 Purpose of the Article

The conduct detailed analysis of the process s of cross-border capital flows in emerging markets, to give them a quality characteristic.

2.3 Materials and Methods

For the study, the official data of international statistics on cross-border capital movements were used, for the processing of which methods of economic, structural, functional and institutional analysis were used.

3 Research Result

From our point of view, the monetary and financial crisis is an attempt to resolve the imbalances accumulated in the financial system in previous periods. Traditionally, economists have identified three generations of financial crisis models that can be projected to emerging markets:

Models of the first generation (by P. Krugman) - in them the financial crisis is linked to the conflict of the government's macroeconomic policy and the existence of a fixed exchange rate. The source of financial shocks is the presence of a high state budget deficit, financed by domestic credit. Constant borrowing depletes the gold and foreign exchange reserves of the Central Bank, which subsequently cannot maintain the exchange rate [5].

As empirical studies have shown, using the first generation models it is possible to adequately describe the mechanisms of the formation of monetary and financial crises in emerging markets in the 1970s and early 1980s. For example, Blanco and Garber, using a modification of the Krugman model, showed that in the period 1973–1983, in Mexico, the probability of the "shadow" exchange rate exceeding the actual one was 2–5% in stable calm periods, and 20–30% in pre-crisis periods, respectively. However, in later periods, the end of the 80s, the beginning of the 90s, the tests carried out did not give an unambiguous result regarding the deviation of the shadow rate set by the state. This fact, in our opinion, is due to the fact that the mechanisms of the formation of crises in the 90s are different from the previous ones. First of all, the key role here is played by mutual financial ties between emerging markets, and, as a consequence, the presence of the contagion effect to external shocks. Therefore, second-generation models were developed, which became a kind of response to the crisis processes in emerging markets at the end of the 80s and the first half of the 90s.

Models of the second generation (by Obstfeld) pay considerable attention to a large number of factors in the mechanism of unfolding the monetary and financial crisis. According to these models, the monetary authorities make a decision to support the exchange rate, guided by a balance of benefits and costs (for example, an increase in interest rates to support the exchange rate may negatively affect the banking system, respectively, the costs will outweigh the benefits). In second-generation models, special attention is paid to the study of the contagion effect when the crisis is transmitted through financial channels to peripheral countries. The contagion effect was first seen on a large scale during the 1997 Asian financial crisis. A number of works analyzed the factors of the spread of financial crises. For example, in the work of Kaminsky and Reinhart, the mechanisms of the spread of the 1997 Asian crisis across countries are analyzed. Based on the results of the study, the authors concluded that the main factor in the transmission of the external shock was the fact that these countries had a common creditor - Japanese and European banks. During the crisis in one country, banks stopped lending to other countries.

Thus, we can conclude that the presence of a significant volume of corporate external debt makes developing countries vulnerable to capital outflows during financial instability, since creditors can begin to withdraw capital and demand early repayment of obligations [20].

Second-generation models can be used to describe the mechanisms of crisis phenomena in countries whose monetary authorities use a policy of a fixed exchange rate. For example, the Mexican crisis in 1994 was triggered by the official devaluation of the Mexican peso by 15%. However, at present, most developing countries use the policy of controlled floating, or free exchange rate formation of the national currency, therefore the possibility of using these models to describe the crisis phenomena is limited.

In the models of the third generation of financial crises, considerable attention is paid to the problem of capital outflow from the financial market. In particular, this effect is described in detail in the Haibing Zhu model. Here, the main cause of the crisis is the decline in the return on assets within the country. The model considers emerging markets, where the return on investment is much higher than in other developed markets. Domestic investors are in a state of uncertainty about future liquidity needs. The author examines the situation both in a closed economy and in the case of liberalization.

Capital account liberalization enables resident banks and companies to attract cheap financing from international markets. Additional financing allows you to invest in profitable projects, thus increasing the welfare of domestic investors. However, the dynamics of borrowing is influenced by global business cycles. While positive shocks in productivity have only a small positive effect, negative shocks can lead to a financial crisis. The main idea of this model is that the negative effects of cyclical lending can be easily leveled out in a closed economy, while in a country where the use of external loans was a source of domestic investment, it can lead to the spread of crisis phenomena: bankruptcy of companies and banks.

P. Krugman offers his version of the third generation model of the financial crisis. A leading role in shaping the financial instability author devotes the balance of the Company, yayusch them the opportunity to invest, and the financial flows of capital coming into the country to determine the exchange rate of exchange. The model considers the possibility of companies and banks to external borrow from the collateral they have accumulated for this. In conditions of capital inflow, the need for loans is growing, and residents are actively borrowing abroad. This process can have two outcomes.

According to P. Krugman, in the first option, the profitability in the domestic and international markets will gradually become equal. In the event of a negative outcome, in the event of an increase in external corporate debt, creditors may doubt the ability of borrowers to fulfill their obligations, as a result, the lending process will stop, the withdrawal of assets will begin, and as a result, the devaluation of the national currency. Since the loans taken by companies and banks are denominated in foreign currency, due to the depreciation of the national currency, the probability of non-payment is high. Borrowers go bankrupt [19].

Thus, according to P. Krugman's model, the mechanism of the crisis is as follows: a decrease in the rate of capital inflow leads to a deterioration in the financial situation of companies, making it impossible to attract new loans, as a result of which a non-payment crisis sets in. Foreign investors, fearing loss of profits, are beginning to withdraw assets. In this situation, the central bank's support of the exchange rate at the previous level seems to be inappropriate, since in conditions when foreign borrowers do not want to lend to local banks and companies, this will lead to a decline in production [9].

Summarizing the above, we can state that the source of the crisis, according to the proposed model of P. Krugman, is the excessive external debt of the corporate sector. Another important finding is that the likelihood of a crisis depends on the degree of debt attracted in foreign currency. The larger the share of the debt, denominated in foreign currency, the higher the danger of a crisis. This fact is very important, since the weakening of the exchange rate leads to a deterioration in the financial situation of borrowers, and contributes to an even greater capital outflow. Currency imbalances are often common in emerging markets because the corporate sector can borrow enough foreign currency funds [5].

Thus, the above proposed models reflect different versions of the mechanism for the development of currency and financial crises. They reflect only a limited number of crisis episodes. Currently, there is a need to develop a unified classification of types of possible crises in emerging markets, which combine the ideas in the above models.

Based on the studied international experience in the development of crisis phenomena in emerging markets, from our point of view, currency and financial crises caused by massive capital inflows should be divided into four main types:

1. Crises associated with a trade deficit.

The mechanism of the formation of a crisis according to this classification can be described as follows: The presence of a free or floating exchange rate regime in the country leads to its revaluation, the growth rate of lending increases, imports grow - this leads to an increase in consumption and to a deficit in the balance of payments. At a certain point in time, investors begin to pay attention to the deteriorating macroeconomic statistics - an increase in the country's balance of payments deficit and slow or negative export growth rates. In the context of a deteriorating macroeconomic situation, a speculative attack on the national currency exchange rate begins, leading to its depreciation, which causes panic, and as a result, capital outflow from the country's domestic financial market.

2. The crisis of public finances.

The mechanism for the emergence and transmission of this crisis is admissible even if the country has a positive balance of payments, under the conditions of a controlled floating exchange rate regime. The algorithm for the deployment of this type of crisis can be described as follows: in conditions of a positive capital inflow, the state issues government debt to cover the budget deficit. The national currency may be under pressure from speculators if the amount of liabilities significantly exceeds the country's current gold and foreign exchange reserves. At a critical moment, investors, realizing that the situation has gotten out of control, put forward demands for the repayment of obligations from the state. As a consequence of an acute shortage of liquidity, the country's financial authorities are defaulting on public debt. This type of crisis was very common in emerging markets in the 90s and 2000s.

3. The crisis of private finance.

The algorithm for the emergence and development of this crisis can be described using the third generation crisis model of P. Krugman. In the context of massive capital inflows to emerging markets, lending is growing. Since the domestic supply of loan capital is insufficient to meet the needs in the domestic market, companies and banks are beginning a policy of active external borrowing. They borrow money in large quantities at low interest rates. As a consequence of this policy, there is a significant increase in corporate external debt. Here we can talk about two basic scenarios for the further course of events, either internal and external rates will equalize, or investors, at the risk of losing their invested funds, will begin the process of withdrawing capital from the country.

4. The crisis of the effect of financial contamination.

This type of crisis arises from the strengthening of financial ties between countries as a result of the processes of globalization and integration. During a financial crisis in one market, investors withdraw their invested funds from other financial markets that are most closely related to each other. First of all, funds are withdrawn that were invested for a short period, the so-called. “hot money”. The key role in the deployment of this type of crisis is played by the fact that there is information asymmetry in the markets.

We believe, that monetary and financial crises that have occurred in some periods in the emerging markets are, as a rule, a combination of her different options. For example, a trade deficit and significant short-term aggregate corporate debt were indications of the countries hit hardest by the 1997 Asian financial crisis. The crisis of public finances, expressed in the excess of the state debt of the accumulated foreign exchange reserves of the country, and the subsequent speculative attack on the national currency due to the deterioration of the external conjuncture were characteristic during the period of the Russian financial crisis in 1998. A combination of a public finance crisis and a large trade deficit took place during the 1994 Mexican tequila crisis. Finally, the crisis of private finances, trade balance, the contagion effect was typical for the countries of Eastern Europe during the active phase of the global financial crisis in 2008–2009 [8].

Based on the generalization of the world experience of the occurrence and course of financial crises in countries with emerging markets, we can single out, in our opinion, the following determinants of financial volatility, caused by the excessive inflow of international financial capital into the domestic markets of these countries:

1. The predominance of short-term borrowings in the structure of total corporate external debt.

For example, during the 1997 Asian financial crisis, over 55% of loans were made on a short-term basis. In Thailand, 2/3 of the total corporate external debt consisted of short-term liabilities. In Korea, over 60% of total bank debt in 1998–2003 was based on a short-term basis [14].

Due to the fact that the debt is short-term, in the event of a financial crisis, and as a consequence - an increase in the risk of non-repayment of borrowed funds, creditor banks refuse to refinance the debt. Since bank loans are illiquid assets with a fixed income, they are more adaptable to changing economic conditions through changes in the volume of lending, rather than its cost. It should also be noted that cross-border lending is more volatile than cross-border investment in stocks and bonds. According to research by Barton, Nevell, Wilson, it is noted that the volatility of annual capital flows in emerging markets is 580% for bank loans and 300% for investments in debt securities, compared to developed markets, where the values of these indicators are 380% and 200% respectively [6, 12].

2. Active lending in foreign currency, financed by capital inflows, and as a result, an increase in the level of internal and external financial dollarization.

Capital inflows lead to an increase in foreign currency lending and, as a result, an increase in the level of financial dollarization of the economy. The problem of internal and external dollarization has become especially acute in Eastern Europe, where on the eve of the global financial crisis of 2008–2009, more than 60% of loans were issued in foreign currency (in the Baltic countries this figure exceeded the threshold of 90%). This fact, as mentioned above, is associated with the dominance of subsidiaries of large Western European banks in the banking system of these countries. After the sharp devaluation of currencies during the crisis, the problem of non-repayment of loans in foreign currency has become a key issue for many banks [21].

3. Overvalued exchange rates as a factor in stimulating an excessive inflow of speculative capital.

As the practice of the financial crisis shows, fixed overvalued exchange rates are one of the main sources of excess capital inflows, and as a result of the formation of macroeconomic imbalances. For example, in Ecuador, on the eve of the crisis, the overvalued rate was 37%, in Turkey - 35%, in Mexico - 32%. A fixed exchange rate causes an imbalance in the supply and demand of a currency, the stronger the subsequent adjustment can take place. Also, the absence of exchange rate volatility demotivates economic entities to hedge currency risks [12].

4. Credit boom, on the eve of the financial crisis.

Capital inflows in the form of corporate borrowing are causing a boom in the lending market, thus causing it to overheat. A sudden suspension of capital inflows and a change in the trend towards an outflow is accompanied by a sharp drop in the prices of assets that were subject to lending, and, as a consequence, a decline in the real sector. For example, in 2007, in connection with the onset of the US mortgage crisis, which escalated into the global financial crisis in 2008, which caused a contraction in international liquidity and, as a consequence, the suspension of capital expansion to emerging markets. At the same time, countries with financial markets that are less dependent on external financing, relying mainly on domestic resources, turned out to be the most resistant to a sudden capital outflow. The countries of Central and Eastern Europe suffered the most, where capital inflows in the form of bank loans and short-term portfolio investments led to overheating of the stock and credit markets and the subsequent formation of bubbles in these segments. According to the calculations of experts from the IMF organization, as well as specialists from the analytical department of Sberbank of Russia, Kazakhstan, the Baltic countries, Ukraine, and Hungary are recognized as the most affected countries from the inflow of speculative capital into the financial market in the pre-crisis period.

The financial market of the Republic of Kazakhstan was one of the first to feel an acute shortage of liquidity. In 2007, on the eve of the crisis, banks' external debt amounted to over 50% of bank liabilities. In the pre-crisis years, thanks to high oil prices and active borrowing, the banking market was actively developing. The growth of the credit market was accompanied by a credit boom financed by the inflow of loan capital into the banking system. A significant part of the loans issued were in the real estate sector, in particular in mortgage loans to individuals. As a result of this process, a speculative bubble was formed in the real estate market. In the face of rising prices, most borrowers purchased real estate in order to make an effective investment. An abrupt halt in the process of financial capital inflow into the banking system caused a halt in lending to the largest construction companies, as a result of the collapse of the resulting imbalances, freezing of construction, and a drop in real estate prices.

Similar symptoms of financial system vulnerability to capital outflows created by capital inflows and a credit boom fueled by increased external borrowing can be seen in other Eastern European countries. For example, in Ukraine, as well as in other countries of this region, against the background of expanding access to world capital markets, the entry of a large number of foreign banks into the Ukrainian market and soft monetary policy, the absence of restrictions on the inflow of speculative capital.

As a result of three years, in the pre-crisis period, the volume of bank lending grew on average by 70% per year, and more than half of the loans issued were denominated in foreign currency. This circumstance led to an increase in the level of dollarization, and as a consequence of the currency risk.

The rapid growth in bank lending, financed by readily available cheap loans, has led to a deterioration in the quality of the banking system's assets. According to the NBU, the share of negatively classified loans (loans are classified as uncollectible) in 2007 was 13.2%, which is one of the highest in Eastern Europe. The presence of a high share of overdue loans, as well as significant currency risks, made the Ukrainian banking system vulnerable to capital outflows during the 2008–2009 financial crisis.

5. A significant share of non-residents in the stock market.

The expansion of capital is also accompanied, first of all, by an increase in the share of non-residents in the stock market of the recipient country, thereby making it more vulnerable and volatile to the external negative background during financial crises. For example, during the Asian financial crisis in 1997, the share of non-residents in the Indonesian stock market was 76% of the total volume of participants, 50% were non-residents in Malaysia and the Philippines, 26% in Thailand. In 2008, during the active phase of the global financial crisis, the stock markets of those countries where non-residents held a significant market share were most affected. For example, on the Ukrainian stock market in the pre-crisis period, according to various calculations, the share of non-residents exceeded more than 50%, the PFTS index fell by 85% since the beginning of 2008 [15].

In order to increase the financial stability of emerging financial markets to international volatility during the financial crisis, it is necessary to use market instruments to control capital inflows during the period of economic recovery. The main goal of the measures is to prevent a massive inflow of short-term speculative capital into the domestic financial market. Based on the positive international experience in controlling the movement of short-term speculative capital, we can highlight the following main control tools that can theoretically be applied in emerging markets.

1. Direct restrictions on external loans of the corporate sector.

This method was successfully used during the Asian financial crisis in Malaysia. In our opinion, it is an extreme measure, since direct restrictions lead to a decrease in investment attractiveness on the part of international investors, and also has a negative impact on the convertibility of the national currency. We believe that priority should be given to the use of measures of a purely market nature, which will be discussed below.

2. The mechanism for conducting foreign exchange interventions to limit excess short-term capital inflows and the growth of external borrowing.

During the period of expansion of short-term speculative capital to the domestic financial market in the country, the exchange rate of the national currency is strengthening. This fact stimulates banks and companies to increase foreign borrowing at low interest rates. This situation creates the preconditions for the emergence of financial vulnerability of the market in the event of a trend change at the onset of the financial crisis. Therefore, the policy of containing the excessive revaluation of the national currency by conducting active foreign exchange interventions will reduce the incentives to build up excess short-term debt denominated in foreign currency. However, it must be understood that the negative consequences of such a policy in the long run in the event of a trend reversal and a speculative attack on the exchange rate will be the depletion of the gold and foreign exchange reserves of the country's Central Bank.

3. Differentiation of the reserve requirements.

This tool is the most popular in emerging markets. He has been active successfully used in the Republics e Chil and in 1983–1986 years. The essence of this measure lies in the fact that the Central Bank of the country sets different standards of required reserves depending on the currency and the term of borrowing. High reserve rates lead to a decrease in the growth of short-term borrowings denominated in foreign currency. The effectiveness of this measure is expressed in the higher financial stability of the banking sector during the period of massive outflow of short-term capital during the financial crisis. In our opinion, this tool is the most effective at the moment and should be used in emerging markets.

4. Using the standard of the debt resident s commercial bank to the size of its own funds.

The purpose of this measure is to limit the growth of liabilities to non-residents of a commercial bank by linking them to the size of their own funds. A positive consequence of this measure, in our opinion, will be an increase in the capitalization of the banking system during the period of massive capital inflows to the domestic financial market. Since in the period of capital inflow and the availability of short-term foreign borrowing at a low interest rate, banks will increase their own funds to gain access to cheap funding to maintain the current lending growth rate.

5. Increase in rates on deposits of the Central Bank.

By its nature and nature of action, this measure has a lot in common with open market operations. It should be noted that the application of this measure will be effective and justified as long as the rates on deposits are not equal to the rates on government bonds on the market.

6. Application of foreign exchange swaps for external borrowings.

If this instrument is used, the Central Bank conducts operations with foreign currencies at the current spot rate and at the same time undertakes to carry out a counter - transaction after a certain time at a predetermined exchange rate (forward rate). This policy will allow the Central Bank to redistribute excessive liquidity for future periods.

7. Using e deposit requirement on foreign loans.

The main purpose of this measure is the obligation of the borrower to block, for a certain period of time, on a special account of the Central Bank, a part of external borrowings attracted in foreign currency. At its core, it is a tax on foreign borrowings of the banking sector. This measure has proved its effectiveness in Latin America, such as

Chile and Colombia. However, it should be noted that its application can have negative consequences for medium and small banks in the country, which are very limited in their ability to attract resources from international financial markets. Moreover, it can also be stated that the use of this measure will have a negative effect on the convertibility of the national currency.

We believe that this measure can be applied in countries where foreign exchange legislation is not fully liberalized. It can only be used in the short term. For a country that has liberalized financial markets, the use of this measure may lead to a decrease in investment attractiveness.

8. Taxation of short-term borrowings.

Over a long period, the introduction of a tax on short-term borrowings has been the most radical and controversial measure to reduce the inflow of short-term speculative capital. The use of this tax should lead to a decrease in the share of short-term loans from banks and companies. The tax rate should be linked to the borrowing period. However, as practice shows, in the long term, the effectiveness of this measure will decline.

9. Use of countercyclical measures to regulate the country's banking system.

Capital flows in emerging markets are cyclical. Based on this, the main meaning of these activities is to take into account the stages of the cycle, and the development of prudential indicators. Here you can use indicators such as the minimum amount of equity, which depends on the stage of the economic cycle.

In our opinion, the most effective countercyclical measure can be the creation of so-called dynamic reserves in commercial banks. In the period of economic growth and credit growth rates of contributions st in reserves will increase in times of economic downturn and reduce the rate of credit growth, ratios will be reduced. Thus, commercial banks at the onset of the crisis will have significant reserves, which will allow them to be more stable during the period of financial turbulence. The main difficulty in practical testing of this measure is that in practice it is very difficult to identify the stages of the cycle. D anna I measures and has proven its effectiveness in the global financial crisis of 2008–2009 in Spain. Spain's banking system, which used to dynamic allocation of the crisis, as the main measure, etc. in e e knitalong supervision, thus accumulating substantial reserves, the least affected in times of crisis.

In describing the " countercyclical " fiscal measures to prevent it should also mention the introduction of this tool, and in Russia. Since 2016 in Russia for commercial banks introduced the requirement to establish a counter-cyclical capital buffers P Assumption m Bank of Russia on December 3, 2015 N 510-P, And For instructions s Bank of Russia from 6.28.2018 number 180-I. The creation of a countercyclical capital buffer by commercial banks is analogous to dynamic reserves.

Since the massive inflow of capital leads to the formation of macroeconomic imbalances, which, in turn, play a key role in the mechanisms for the deployment of crisis phenomena and their subsequent transmission to emerging markets, it is currently extremely relevant to develop recommendations for regulating the expansion of international financial capital to emerging markets. Countries in order to increase the resilience of these countries to financial crises, to minimize the impact of negative effects associated with capital inflows. The importance of the study is also emphasized by the fact that in recent years, the dynamics of the process of mass expansion of foreign capital into the financial markets of developing countries has been increasing, thereby explaining a noticeable increase in the number of crises in recent years. Therefore, identifying the factors of financial vulnerability to massive capital flight during periods of external shocks will help the governing bodies to create effective systems for monitoring the situation in the financial market and pursue economic policies that allow ensuring sustainable positive dynamics of the most important macroeconomic variables.

Based on the analysis, it can be concluded that the expansion of foreign capital creates economic imbalances leading to greater vulnerability of the financial system to international volatility of financial flows during the crisis, but this circumstance should not mean a complete rejection of the course of liberalization of the financial sector. Stopping the process of economic reforms, closing markets for the inflow of international financial capital - it is precisely such a reorientation of economic policy that poses a danger for countries with emerging markets, since this can actually mean stopping the process of general globalization, and as a consequence, stopping the inflow of foreign direct investments that carry according to most economists, the greatest contribution to the economic development of the country.

Developing countries may not become full participants in the global economic system. Therefore, despite the negative consequences of capital inflows, from our point of view, developing countries need to continue the current course of financial liberalization. In this case, as has already been shown by successful practice during the active phase of the global financial crisis of 2008–2009, the Asian model of gradual liberalization, with the opening of the market after reorientation to domestic sources of financing, complemented by existing market mechanisms for regulating short-term flows, can serve as an example for many developing countries. At the same time, from our point of view, it seems necessary to revise the provisions of the Washington Agreement, which is currently the law-making document of international economic relations. This document declares the principles of freedom of trade, movement of capital, labor, limitation of state intervention in the economy, etc.

4 Conclusions

Unfortunately, as the experience of the Mexican financial crisis of 1994, the Asian financial crisis of 1997, and the global financial crisis of 2008–2009 showed, the greatest danger to financial markets is caused by the penetration of a significant amount of short-term speculative capital into their domestic markets. Therefore, the governments of the countries must take this circumstance into account, the financial systems must be prepared for a sudden suspension of capital inflows and their change to an outflow during financial crises. To this end, it is necessary to give preference to direct investments of TNCs, which have proven their stability and long-term investments of pension funds. They will act on the principle " more investment in the real sector, less debt. " With regard to short-term financial investments, from our point of view, market elements of control and regulation of the dynamics of their inflow to financial markets can be applied [18].

Thus, along with the strengthening of the liberalization of financial systems to access to international investments, control over financial institutions, primarily banks and companies through which investment flows pass, should be strengthened.

References

1. Bruno Coelho. Kevin P. Gallagher. Capital controls and 21 st Century Financial Crises: Evidence from Colombia and Thailand // Political Economy Research Institut Working paper No. 213–201 9
2. Jonathan D. Ostry , Atish R. Ghost, Karl Habermier , Marcos Chamon , Mahvash S. Qureshi, and Dennis BS Reinhardt . Capital Inflows: The Role of Controls // IMF SPN ? 10 / 04–201 8
3. Benedict Clements and Herman Kamil . Are Capital Controls Effective in the 21 st Century? The Recent Experience of Colombia // IMF Working paper ?09 / 30 - 2010
4. Capital flows and emerging market economies // BIS Working paper No. 33- January 20 1 9
5. Rakesh Mohan and Muneesh Kapur . Liberalization and Regulation of Capital Flows: Lessons for Emerging Market Economies // ADBI Working paper No. 186- January 201 8
6. Ramkishen S. Rajah. Sasidaran Gopalan . Sales to Foreign Banks in Emerging Asia // CESinfo DIDE Report No. 3–20 18
7. Rainer Kattel . Financial and Economic Crisis in Eastern Europe // Draft paper at International Conference in Muttukadu , India- January 201 8
8. Stephany Griffith-Jones, Jose Antonio Ocampo. The Financial Crisis and its Impact on Developing Countries // International Policy Center for Inclusive Growth. Working paper No. 53- A pril 20 1 9
9. Morris Goldstein and Daniel Xie . The Impact of the Financial Crisis on Emerging Asia // Federeal Reserve Bank of San Francisco . Asia Economic Policy Conference- October 18–19 20 1 9. Working paper materials.
10. Sanor Gardo and Reiner Martin . The Impact of the Global Economic and Financial Crisis on Central, Eastern and South- Eastern Europe . A Stock-Taking Expertise // European Central Bank. Occasional paper series No. 114- June 201 2
11. Dubravko Mihaljek . The financial stabilily implications of increased capital flows for emerging market economies // BIS Working paper ?44–20 1 8
12. Tony Cavoli . Exchange Rate Regimes in Asia : Intervention and the Influence of the G3 currencies on Asian Exchange Rates // School of Commerce and Center for Asia Business. University of South Australia- July 2018
13. Iia Patnaik, Ajay Shah, Amnol Sethy , Vimal Balasubramaniam . The exchange rate regimes in Asia : From Crisis to Crisis // National Institute of Public Finance and Policy. New Dehli . Working paper No. 69- May 2016
14. Richard Connoly . Financial Volnurabilities in Emerging Europe: An Overview // BOFIT Working paper ?3 - 2019
15. MS Mohantry and Philip Turner. Banks and financial intermediation in emerging Asia: reforms and new risks // BIS Working paper ?313- June 2015
16. Jeromin Zettlemeyer , Piroska M. Nagy, and Stephen Jeffrey. Addressing private sector currency mithmatches in emerging Europe // EBRD Working paper No. 115- June 2016
17. Ali Abbas SM, Espinoza R. Evaluating the Success of Malaysia Exchange Controls (1998–1999) // Oxford Development Studies - 2016 - Vol. 34, no. 2
18. Allen F. and D. Gale. Bubbles and Crises // Economic Journal-2018 .- No. 110, p. 236–255
19. Allen M. Rosenberg Ch., Keller Ch., Setser B., Roubini M., A Balance Sheet Approach to Financial Crises // IMF Working paper- December 2012

20. Altinkemer M. Recent experiences with capital controls: is there a lesson for Turkey // Bank of Turkey. - June 2013
21. Baily M., Farrell D., Lund S. Hot Money // The McKinsey Quarterly. -2001. -?2
22. Barajas A., Morales A. Dollarization of Liabilities: Beyond the usual Suspects // IMF Working Paper. - 2013. - No. 11