

Abstract (summary):

Severe economic recessions accompanying recent currency and financial crises have brought economists and policy-makers to analyze what went wrong in policy responses as the effect of crises on the real economy seems to be exacerbated in those crisis-hit countries. By focusing on the output effects of crises, this dissertation investigates the roles of crisis-management policies and political institutions in times of financial crises. This dissertation begins by studying the channels in which the real economy is affected by crises as well as methodologies to quantify these effects. Since there is no consensus over techniques used to estimate output losses associated with crises, different estimations are used to calculate output losses and the real GDP both in level and growth rate in order to capture the magnitude of absolute output losses and growth contractions. These estimated output losses are used to examine the relationship between economic and political factors and the output costs of crises.

By using cross-section time-series of 57 countries over the period of 1975-to-2002, the presence of an explicit deposit insurance system is empirically found to reduce the output costs of financial crises since it prevents extensive financial runs. However, this benefit of adopting an explicit deposit insurance system needs to be traded off with the costs of increasing moral hazard incentives induced by deposit guarantee, which may make crises more likely. In addition, to study the effectiveness of any economic policies in minimizing crisis severity, the roles of domestic political institutions need to be examined since the cross-national differentiation in political structures, particularly the political decision making processes and the number of political decision makers, directly influences a government's ability to implement those policies efficiently. By applying the political theory of veto players to study the impact of domestic political institutions on severity of crises in emerging market economies, the empirical finding illustrates that countries with the absence of veto powers in their political system or with excessive veto players will severely suffer from a larger magnitude of output losses once financial crises occur according to the lack of credibility or flexibility of policy responses, respectively.