Abstract (summary):

The surge of private capital flows to emerging market economies has been one of the major characteristics of the international financial world for the last 15 years. While these capital flows were initially welcomed, the significant capital reversals or 'sudden stops' during a series of currency crises have generated a major rethinking of appropriate policies toward such flows. There has been a vast amount of academic work done on the causes of currency crises; however, much less systematic research has been devoted to analysis of the roles of capital flows. This dissertation aims to fill this gap.

In the second and the third chapter, I investigate whether some types of capital flows are more likely to reverse than others during currency crises. Foreign direct investment is usually considered stable while portfolio investment is frequently depicted as the least reliable type of flow. Recent statistical testing has yielded conflicting results on this issue. A major problem with recent studies is that the degree of variability of capital flows during normal or inflow periods may give little clue to their behavior during crises and it is the latter that is most important for policy. Using data for 35 emerging economies for 1990 through 2003, I confirm that direct investment is the most stable category but find that bank loans on average are as reversible as portfolio flows.

In the fourth and the fifth chapter, I investigate the effects of surges in capital inflows on the probability of sudden stops. The empirical investigation based on 38 emerging market economies between 1990 and 2003 reveals that a surge in capital inflows significantly increases the probability of a sudden stop. In addition, a surge accompanied by weak macroeconomic fundamentals such as a large current account deficit or an appreciated real exchange rate has a higher probability to turn into a sudden stop. Finally, I find that a surge that is dominated by private loans and portfolio flows is more likely to end in a sudden stop. Foreign direct investment is stable and it does not cause other flows to suddenly stop during crises.