The Onset of the East Asian Financial Crisis

Steven Radelet & Jeffrey Sachs

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This paper provides an early diagnosis of the financial crisis in Asia, focusing on the empirical record in the lead-up to the crisis. The main goal is to emphasize the role of financial panic as an essential element of the Asian crisis. At the core of the crisis were large-scale foreign capital inflows into financial systems that became vulnerable to panic. The paper finds that while there were significant underlying problems and weak fundamentals besetting the Asian economies at both a macroeconomic and a microeconomic level, the imbalances were not severe enough to warrant a financial crisis of the magnitude that took place in the latter half of 1997. A combination of panic on the part of the international investment community, policy mistakes at the onset of the crisis by Asian governments, and poorly designed international rescue programs turned the withdrawal of foreign capital into a full-fledged financial panic, and deepened the crisis more than was either necessary or inevitable.

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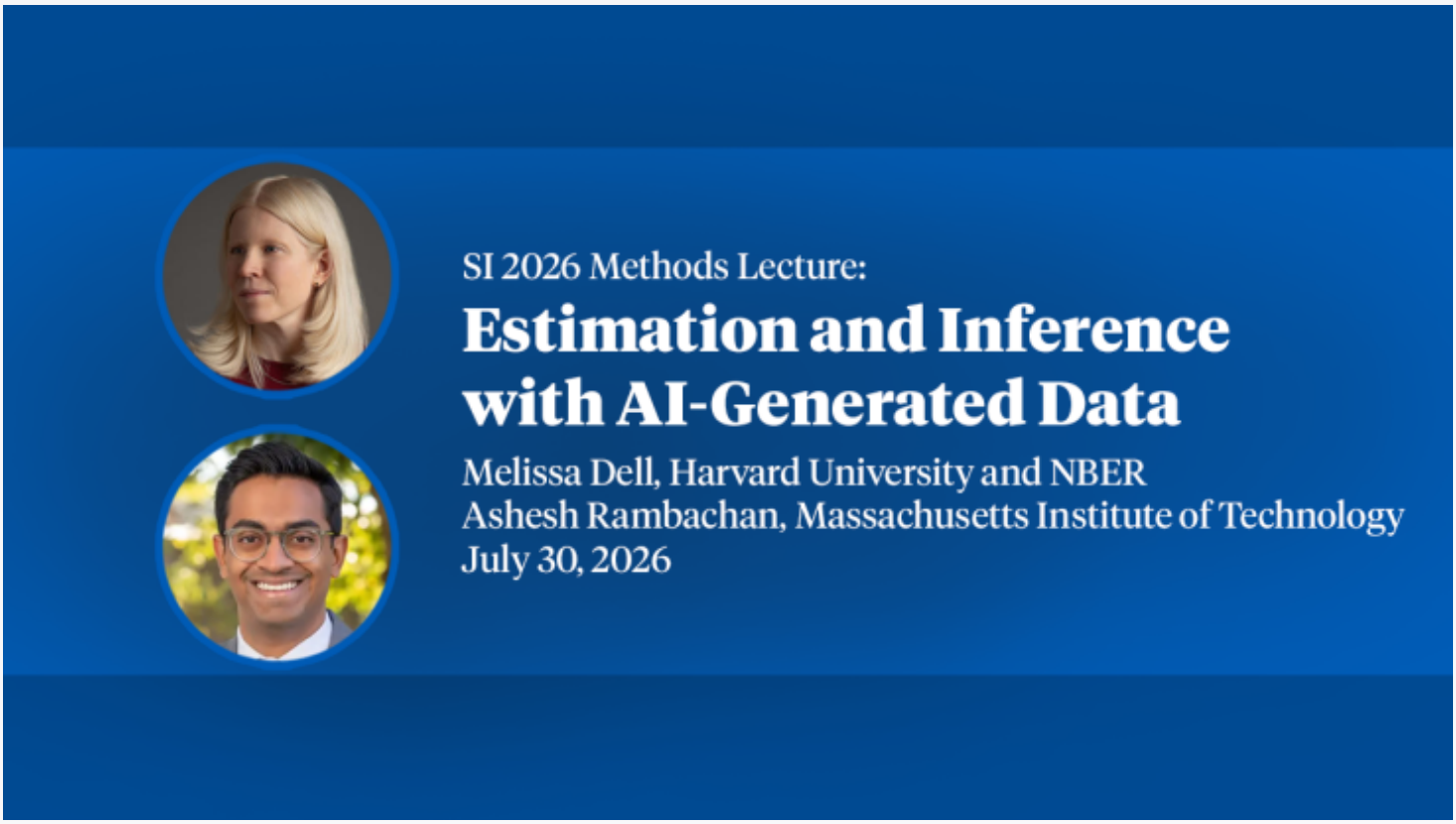


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Contact Us
1050 Massachusetts Avenue
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617-868-3900
info@nber.org
webaccessibility@nber.org

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