When Capital Inflows Come to a Sudden Stop: Consequences and Policy Options

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Abstract
In this paper we present evidence that capital account reversals have become more severe for emerging markets. Because policy options are limited in the midst of a capital market crisis and because so many countries have already had crises recently, we focus on some of the policies that could reduce the incidence of crises in the first place, or at least make the sudden stop problem less severe. In this regard, we consider the relative merits of capital controls and dollarization. We conclude that, while the evidence suggests that capital controls appear to influence the composition of flows skewing flows away from short maturities, such policies are not likely to be a long-run solution to the recurring problem of sudden capital flow reversals. Yet, because fear of floating, many emerging markets are likely to turn to increased reliance on controls. Dollarization would appear to have the edge as a more market-oriented option to ameliorate, if not eliminate, the sudden stop problem.

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