# Who Needs to Open the Capital Account?

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# Purpose

- To reassess the case for capital account opening in the light of new developments
  - New theoretical developments
  - New discussions and thinking in official circles
  - New crises.
- To propose policy attitudes that we believe the international community should adopt.

# History

- White/Keynes tolerance of capital controls basic to Bretton Woods
- Increasing capital mobility led to downfall of Bretton Woods
- Latin American debt crisis and Asian crisis both caused by **sudden stop** to capital inflows
- Happened again with E. Europe in 2008-09
- This was also the cause of the Eurozone crisis.

# IMF Policies

- IMF has never had consistent policy toward capital movements
- Tolerated them in early days, became increasingly hostile culminating in aborted 1997 reform
- G-20 at Cannes displayed a willingness to envisage a regime, but failed to formulate one
- We formulate a proposal, to be presented in due course by Jeanne/Subramanian.

# Status Quo

- Emerging market finance characterized by wide variety of approaches to **capital account policies**
  - open capital accounts (Chile)
  - prudential controls (Brazil)
  - “closed” capital account (China).

- Unlike for trade in goods, there is no international regime to guide/discipline capital account policies.

- Is this a problem?

# Status Quo

- One view is that national discretion is not a problem because trade in assets is much less beneficial than trade in widgets (Bhagwati, 1998)
  - we confirm the underlying empirical evidence in Chapters 3 and 4 of the book
- However, we argue that the international community should agree on a set of rules for capital account policies
  - encourage "good" policies, discourage "bad" ones
  - spillovers

# The Case for International Rules

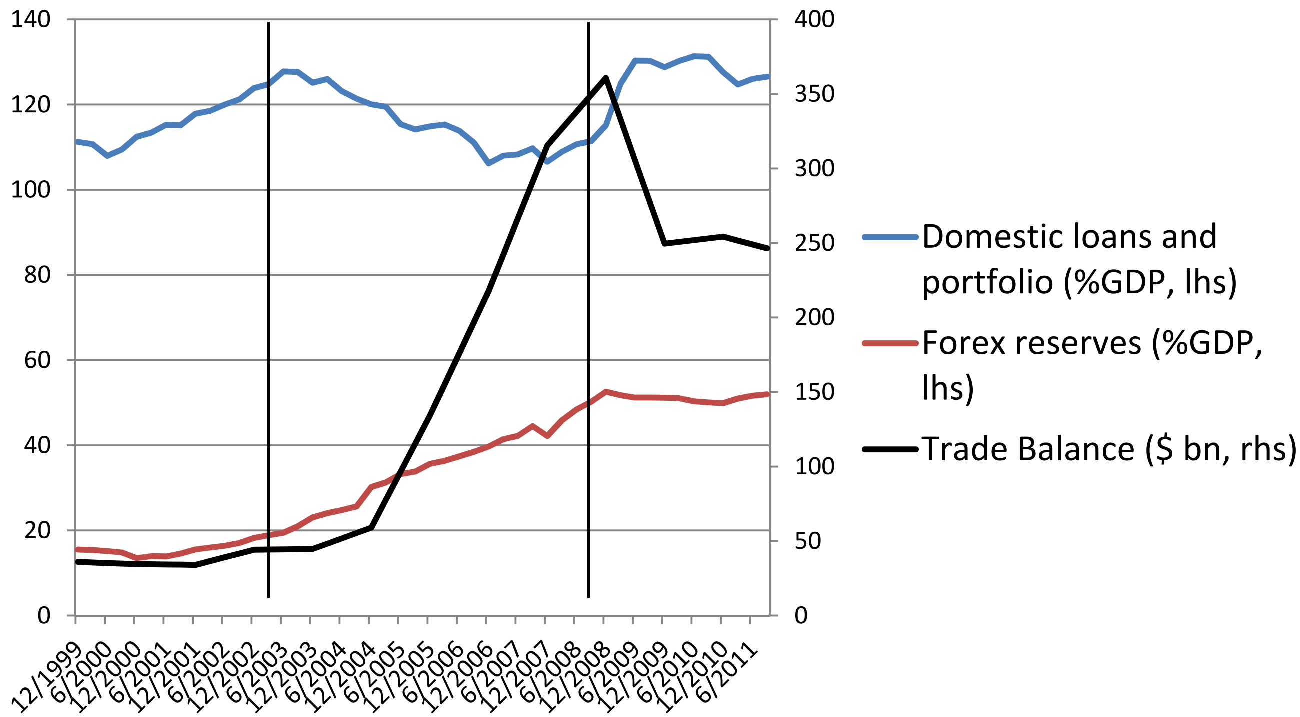
- We understand much better the case for **prudential** capital controls
  - curbing the boom-bust cycle in capital flows
  - "new welfare economics" of prudential controls reviewed in chapter 2

    → countercyclical tax on capital inflows

- A code of good practices could reduce the **stigma** associated with prudential controls
  - the IMF more tolerant, but still not enough

# The Case for International Rules

- Capital account policies can be used to distort exchange rates and trade
  - balance sheet of Chinese banking sector



# The Case for International Rules

## Correlation between undervaluation and capital controls

# The Case for International Rules

- **Theoretical result:** one can achieve the same outcome with capital account policies as with tariffs (subsidies) on imports (exports).

- **Practical implication**: a level-playing field in international trade requires limits on the use of capital account policies.

# Proposal

- The international community should adopt international norms for capital account policies
  - under the auspices of the IMF
- The goal should be to encourage good controls and discourage bad ones
  - not promote free capital mobility
- We would favor transparent, price-based measures (e.g., a tax)
  - with a 15% ceiling
  - caveats and exemptions

# Obstacles to Cooperation

- Principle and contents
- Principle of international regulation: Brazil, emerging markets?
- Counter-cyclical taxes on inflows: Financial sector
- Opening up capital account: China

# Sticks and Carrots

- Sticks: Countervailing capital controls by US to restrict Chinese purchases of US government assets (Bergsten, Gagnon and Hufbauer)

- Carrots:
  - Granting market economy status
  - Re-visiting investment rules as they apply to Chinese FDI to US

# Conclusion

- Regulation of capital flows overdue to correct foreign finance fetish
  - Eurozone crisis
  - US FTAs of early 2000s with Singapore and Chile

- Asymmetric international regulation of trade and capital flows increasingly untenable

- Need to regulate problem of too much inflows (Brazil) and too little inflows (China)