The return of capital controls to Asia?

Malaysian, Indonesian and Thai officials are raising the prospect of using pre-emptive capital controls to stave off financial crises. This is not necessarily unreasonable.

Capital markets are not the same as markets for goods and services

I would go as far as to say that every ***reputable economist*** would agree that free trade is better at creating wealth than restricted trade and that more trade is better than less trade. NB Emphasis on reputable and economist. Clearly, not everyone agrees.

The same does not hold true for capital markets though. There is, to the best of my knowledge, no similar uncontested and voluminous theoretical support for unfettered movement of capital, nor any suggestion that more capital flows are unambiguously better than less.

That is not to say that it is not so, and in the absence of a strong case against this premise, supra-national bodies like the IMF have simply tended to assume that capital works more or less the same as trade, and so more open markets are better. Usually. Because there is also a long history of countries seeking to liberalize capital markets ending up wrecking their banking systems. Sometimes twice. Even so, that tends to be viewed as an unfortunate consequence of moving to a better state, an omelette does require the breaking of a few eggs, after all.

Pre-emptive controls?

It is no surprise that the latest suggestion to do more with capital controls comes from Malaysia's central bank governor. After all, under PM Mahathir in the Asian financial crisis, Malaysia aggressively implemented capital controls to protect the Ringgit, and with the massive benefit of hindsight, history seems to have judged that decision reasonably kindly, though not at the time.

What is also interesting about the new suggestion, spearheaded by the Malaysian Central Bank Governor, Nor Shamsiah Mohd Yunus, is that the controls would be implemented "pre-emptively". In other words, they would be imposed before a crisis developed.

This raises all sorts of interesting questions like, when do you opt to implement them? Is the Fed tightening one of the factors that might lead ASEAN central banks to implement such controls? Why not just try to limit hot capital inflows if you are worried about subsequent outflows? And hasn't Malaysia's capital account, which is far from free and open, got enough controls already? None of which I intend to answer here.

All I will say in conclusion is that this initiative is not necessarily and intrinsically harmful to the economic prospects of the countries advocating it. Some version of this proposal might, under some circumstances, have some economic merit. Defining that version and those circumstances is unlikely to be easy, and a one-size-fits-all policy remedy for Malaysia, Indonesia and Thailand is not very likely.

Moreover, while the IMF has softened its dogmatic criticism of capital controls over the decades since the Asia crisis, it's gut instinct is still to support open markets, so I don't expect they will be rushing to support this proposal.

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