Capital Controls and Welfare*

Shigeto Kitano

Research Institute for Economics and Business Administration

Kobe University†

January 14, 2010

Abstract

This paper computes welfare levels under different degree of capital controls and compares them with the welfare level under perfect capital mobility by using the methodology of Schmitt-Grohé and Uribe (2007). We show that perfect capital mobility is not always optimal and that capital controls may enhance an economy's welfare level. There exists an optimal degree of capital-account restriction that achieves a higher level of welfare than that under perfect capital mobility, if the economy has a distortion due to financial intermediaries such as inefficient banks. The results of our analysis imply that as the domestic financial intermediaries are less efficient, the government should impose stricter capital controls in the form of a tax on foreign borrowing.

---

*Earlier versions of the paper were presented at Kobe University, Hanyang University and Osaka University. The author thank the seminar participants for helpful comments. The author is also grateful to Shinsuke Ikeda, Yoshiyasu Ono and Young Jun Chun for valuable suggestions. Any remaining errors are mine.

†Research Institute for Economics & Business Administration (RIEB), Kobe University, 2-1, Rokkodai, Nada, Kobe, 657-8501 JAPAN, E-mail: kitano@rieb.kobe-u.ac.jp, Tel/Fax:+81-78-803-7009