

Capital Control, Monetary Policy, and Financial Accelerator in a Small Open Economy

Shigeto Kitano* Kenya Takaku†

Abstract

We develop a small open economy, New Keynesian model with and without a financial accelerator. Applying a Ramsey-type analysis, we compare the welfare implications of optimal monetary policy under flexible exchange rates and optimal capital control policy under fixed exchange rates. In an economy without a financial accelerator, the optimal monetary policy under flexible exchange rates is superior to the optimal capital control under fixed exchange rates. In contrast, in an economy with a financial accelerator, the optimal capital control under fixed exchange rates brings about a higher welfare level compared to the optimal monetary policy under flexible exchange rates.

Keywords: capital control; monetary policy; Ramsey policy; exchange rate regimes; small open economy; nominal rigidities; New Keynesian; DSGE; welfare comparison; incomplete markets; financial accelerator; financial frictions.

JEL Classification: E52, F38, F41.

*RIEB, Kobe University

†Faculty of Business, Aichi Shukutoku University