Article | Review of International Economics | September 2004

Capital Controls: A Political Economy Approach

by Laura Alfaro

Abstract

This paper examines the economic consequences of political conflicts that arise when countries implement capital controls. In an overlapping-generations model, agents vote on whether to open or close an economy to capital flows. The young (workers) receive income from wages only while the old (capitalists) receive income from savings only. We characterize the set of stationary equilibria for an infinite horizon game. Assuming dynamic-efficiency, when the median representative is a worker (capitalist), capital-importing countries will open (close) while capital-exporting countries will close (open). These predicted patterns are consistent with data on liberalization policies over time and across various countries.

Keywords: Economy; Voting; Conflict of Interests; Capital; Government and Politics; Wages; Saving; Forecasting and Prediction;

Citation:

Alfaro, Laura. "Capital Controls: A Political Economy Approach." *Review of International Economics* 12, no. 4 (September 2004): 571–590.

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