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RIPE mini-symposium

"Capital controls and the global financial crisis: An Introduction"

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The global financial crisis of 2008 opened a new chapter in the debate over the consequences and management of international private capital flows. During the neo-liberal era, one had to look to the work of the Keynesian minority within the academic wing of the economics profession (e.g., Crotty 1983, 1990, Crotty and Epstein 1996, 1999, Epstein, Grabel, and KS 2004, Grabel 2003a, b, 2004, 2003c, Chang and Grabel 2004, 2014, Epstein 2005) and to the world's dirigiste governments and central banks to find assertive, consistent support for the management of international capital flows.

Enter the global financial crisis. Many extraordinary things happened during the crisis, one of which is that Keynesian-inflected ideas about the legitimacy and necessity of managing international capital flows began to infuse the work of a broader set of economists in academia and in the policy community. Views on capital controls at the International Monetary Fund (IMF) also evolved rather importantly during the crisis, though it must be said that this was a grudging evolution that reveals continuing discomfort (Chwieroth 2013, Gallagher 2011, Grabel 2011, Moschella 2010, 2012). The changes at the IMF are reflected in the

positions taken by staff when working in the field with member countries, in research by the organization's economists, and in the public positions taken by its top-ranking officials (as discussed by Grabel, this issue). The re-discovered Keynesian view sees capital controls as a "legitimate part of the policy toolkit" (to borrow a now oft-cited phrase from recent IMF research on the subject, e.g., Ostry et al. 2010, 2011) and is broadly consistent with the institution's tolerance for controls in the post-WWII era (see Helleiner 1996, 2014). Greater tolerance for controls is also reflected in the pronouncements of analysts at the credit rating agencies and in reports in the financial press during the crisis. As the papers collected here collectively demonstrate, perhaps most important of all is the fact that during the crisis a large set of developing and emerging economies and one wealthy country, namely, Iceland, deployed far-reaching and heterogeneous controls on capital inflows and outflows. In Iceland's case, controls were adopted as the economy imploded; in others they were a response to identified financial fragilities and involved either new controls or the strengthening of existing controls; and in the majority of cases, they were a response to the downside risks of relative economic success during the crisis (see Chwieroth, Gallagher, Grabel, this issue, and Siggurgeirsdottir and Wade on Iceland, this issue). Capital controls targeted a panoply of risks including the risks of large-scale investor exit and currency conversions by domestic and foreign asset holders, asset bubbles, currency and/or inflationary pressures, overleveraging, locational and currency mismatch, and the risks associated with the cross-border derivatives (on the latter, see Gallagher 2014, Ocampo, Spiegel, and Stiglitz 2008). They were driven by a range of economic and

political objectives, not least of which included enhancing the autonomy of domestic economic policy, insulating the domestic economy from crises elsewhere and/or the ramifications of quantitative easing on the part of wealthy nations (especially the USA), and countering US monetary power (on the matter of capital controls and US monetary power, see Gallagher, this issue, and Gallagher 2014).

It should come as no surprise to scholars of international and comparative political economy that the capital controls deployed during the crisis were heterogeneous in design and were also not deployed uniformly, even in countries facing the same challenge of inflow surges. Indeed, in some national contexts policymakers took pains to reject publicly the rising tide of what they saw as mistaken capital controls, others denied that the measures they used were in fact capital controls when they clearly were, and others creatively reframed their controls as "prudential regulations" (see papers by Chwieroth and Grabel, this issue) or even as "temporary" when, as for example in Iceland's case, they have been in place (as of this writing) for almost seven years (see Siggurgeirsdottir and Wade, this issue). And in still other countries, aggressive currency market interventions were utilized in lieu of capital controls in response to the macroeconomic pressures induced by large inflows (as the case of the Swiss Central Bank exemplifies; see Moschella, this issue). From a pre-crisis vantage point, the boldness, range, and creativity of the policy interventions deployed in capital and currency markets across a large number of economies were, in a word, unexpected.

But indeed, we should not be surprised by this outbreak of interventionism. A longer run perspective on what appears to be the "new normal" (Grabel 2011) situates the new initiatives in the context of a longer-run process of legitimation that began--albeit slowly, unevenly, and absent much momentum--after the Asian financial crisis of 1997-8 (e.g., see Abdelal 2007, Chwieroth 2009, Moschella 2009). Hence, the current crisis has intensified a process of legitimation that predated it. Crises often have effects of this sort: they can provide the space and the impetus for policy and ideational change (see discussion of the literature in Grabel, this issue). But this process can be and generally is fraught. Several of the papers in this collection examine the continued contestation over controls (e.g., within particular governments, within and between the IMF and the Group of 20) and the efforts by some economists and national policymakers to counteract the rising tide of capital controls. In view of this continued contestation, we argue that it is best to understand the complex processes of change around this policy instrument as "messy," uneven, and uncertain.

The papers in this symposium collectively address several matters that to date have not been sufficiently explored. What were the macroeconomic challenges induced by large capital inflows and outflows that called forth such diverse responses by national policymakers across a range of countries? Why was there so much variation in the observed policy responses? How, and to what extent, did policymakers, the IMF, the financial press, and the credit rating agencies frame these diverse policy responses so as to make sense of them (and, in some cases, make

them more palatable)? To what extent does the use of and the reaction to the panoply of capital controls reflect underlying changes in thinking on the part of economists, actors within the Bretton Woods institutions, shifts in global economic power, and/or experiences during the Asian financial crisis of 1997-98? Or was the rise of capital controls simply an ad hoc reaction to an unexpected and contagious global crisis? Finally, what forms and in what forums do we observe continued contestation over capital controls?

Whether or not the present changes around capital liberalization will prove "sticky" as the crisis subsides remains to be seen. On balance, though, the contributors to the symposium exhibit cautious optimism. None expects anytime soon a return to the single-minded, hubristic celebration of capital liberalization that marked the neo-liberal era. A skeptical reader may reasonably ask why?

The global crisis posed a sharp challenge to true believers in the universal desirability of unrestrained international capital flows. The implosion of the US' highly liberalized, internationally open, and liquid financial system severely weakened the case that the US government had made for several decades that its own brand of financial liberalization was the ideal to which all other countries should aspire. The crisis also shone a bright light on the diverse ways in which unrestrained capital flows and excessive liquidity undermined macroeconomic performance and fueled spectacular and unsustainable bubbles (as the cases of Iceland and the collapses in US financial markets and institutions exemplify). The

crisis also highlighted the ways in which unrestrained capital flows aggravated geopolitical tensions and financial and economic fragility in well-performing economies that were, for a time, recipients of massive inflows associated with global carry trade activity, only later to be confronted with the sudden reversal of these capital flows.

The global crisis is fertile ground for scholarship in the international and comparative political economy of finance (see discussion of this issue in Katzenstein and Nelson 2013). It is our hope that the papers collected here stimulate further debate about the extent to which the crisis is catalyzing changes in thinking, practice, and rhetoric around the management of international capital flows. Ultimately, the effort intends to contribute to a deeper understanding not just of the restoration of capital controls, important as that topic is, but also of the dynamics of transition from one vital international economic policy regime to another.

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