Funding the Future

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A commentator called Martin Clews posted this morning on this blog, saying:

It is a real worry for me that any independent attempt by the UK to democratise our economy, backed by MMT, will experience attempts to sabotage it, e.g., capital flight. I realise it is not easy to move factories, etc, but there might be attempts to destabilise sterling. Do you feel the anti socialist establishment would attempt destabilisation, and what would be the countermeasures?

The answer would have to be capital controls. I posted this glossary entry on that subject yesterday, but it seems appropriate to share it as a result.

Podcast guest Larry Elliott recently mentioned his support for capital controls, and I have supported them for an extended period of time. Maybe I should mention them more often.

Capital Controls

Capital controls are the rules and tools that a government might use to regulate the flow of money into and out of its economy. They exist to protect a country from the destabilising effects of speculative financial flows, and most especially the hot money flows that can inflate bubbles on the way in and trigger crises on the way out of an economy.

There are several aspects of capital controls that require explanation.

First, capital controls are not exotic or radical. They are simply the financial equivalent of border checks. Every nation already regulates goods, people, and data crossing its borders in some way. Regulating capital is no different: it ensures that the financial system serves the public purpose rather than being captured by footloose cross-border speculation.

Second, capital controls come in many forms. They can include taxes on short-term inflows, minimum holding periods for financial investments, limits on foreign borrowing and lending by banks, restrictions on offshore lending, and reporting requirements on large cross-border transactions. Some controls are prudential. These are designed to strengthen the banking system. Others are macroeconomic and are designed to support exchange-rate stability or prevent asset bubbles.

Third, they work. Countries that have used capital controls judiciously, from Malaysia during the Asian financial crisis to Iceland after the 2008 banking collapse, have often recovered faster and with less social damage than those that did not. These controls gave policymakers room to cut interest rates, stabilise currencies, and support domestic recovery without being punished by speculators.

Fourth, capital controls are a defence of democracy. Without them, governments are constantly held hostage by the threat that markets might withdraw funds if they disapprove of policy choices. With them, economic policy can be oriented toward public well-being rather than placating global finance. Controls weaken the power of hot money to veto democratic priorities.

Fifth, capital controls are entirely compatible with a modern, open economy. They do not prevent productive investment, whether inward or outward, real trade, or long-term international cooperation. They ensure that capital entering a country does something useful, whether that be by building capacity, creating jobs, or supporting innovation, rather than fuelling a casino.

Finally, capital controls express the fundamental principle that money is a public good, and its movement should support the stability and prosperity of the whole economy. In an age of globalised speculation, they are one of the few tools that can restore balance between democratic states and the financial systems that can too often otherwise seek to overwhelm them.

Capital controls are not about shutting the world out. They are about keeping destabilising forces in check so that society, and not speculative finance, sets the terms of economic life.