

Gains from Policy Cooperation in Capital Controls and Financial Market Incompleteness

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We examine how the degree of financial market incompleteness affects welfare gains from policy cooperation in capital controls. We find that when financial markets are more incomplete, global welfare deteriorates under the Nash equilibrium, while the optimal global policy mitigates the welfare loss due to financial market inefficiency. When financial markets are more incomplete, the welfare gap between the optimal global policy and the Nash equilibrium increases, and the welfare gains from policy cooperation in capital controls then become larger.