**Policy Rules for Capital Controls**

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**Abstract**

- Are capital controls macroprudential or mercantilist?
- The paper uses a policy reaction function approach to examine this question.
- Two novel datasets:
  - A novel, weekly dataset on capital controls policy actions in 21 EMEs from 1 January 2001 to 31 December 2015.
  - A new proxy for mercantilist motivations: the weighted appreciation of an emerging-market currency against its top five trade competitors.

**Introduction**

- A policy rule describes the systematic response of policy to competing objectives.
- Two main objectives of capital controls policy:
  - Macropudential: Mitigate systemic risk from excessive foreign borrowing.
  - Mercantilist: Exchange rate management to maintain export competitiveness.
- The different objectives of capital controls policy can involve trade-offs.

**Dataset on capital control policy actions**

- ~1300 policy actions for 21 EMEs, 1 January 2001 - 31 December 2015.
- A policy action: Easing or tightening of capital controls.

**New Mercantilism Proxy**

- Measures nominal/real appreciation against trade competitors (not USD).
- Identify top 5 trade competitors for each EME: Merchandise Trade Correlation Index (UNCTAD).
- Appreciation against competitors makes you uncompetitive but doesn’t increase systemic risk.

**Methodology: Panel Ordered Logit**

- Dependent variable: Number of net inflow tightening actions in the week.
- Main explanatory variables:
  - Mercantilism proxy.
  - Macropudential concerns, proxied by Domestic Bank Credit-GDP gap.
- Other key controls: VIX, Other domestic policies (fiscal, monetary).

**Results**

1. **Capital controls are both macroprudential and mercantilist**
   - Mercantilism stronger with higher exchange rate pass-through to export prices.
   - Stronger governance arrangements for macroprudential policy lead to more responsiveness to macroprudential motivations.

2. **Choice of instruments is also systematic**:
   - Policymakers respond to mercantilist concerns by using both instruments: inflow tightenings and outflow easings.
   - Only inflow tightenings in response to macroprudential concerns.

3. **However, policy is not well-targeted to foreign debt**:
   - No systematic response to foreign currency debt or external credit.

For inflow controls, macroprudential and mercantilist variables both important.

**Conclusions**

- Capital Controls are both macroprudential and mercantilist.
- First paper to provide direct evidence of the existence either motivation in the use of capital controls policy.
- More transparency of objectives can improve effectiveness and accountability.

**References**


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