

Can Capital Mobility be Destabilizing?*

Qinglai Meng
NYU

Andrés Velasco
NYU and NBER

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Abstract

In a standard two-sector neoclassical model with distortions, capital mobility can render the steady state indeterminate, in the sense that there exist infinitely many convergent paths. In the closed economy with no international capital mobility, the utility function must be linear or close to it for indeterminacy to occur, while in the open economy the shape of the utility function makes no difference. The reason is that in the no mobility case changes in aggregate investment must be matched by changes in aggregate consumption, while in the case of full capital mobility they can simply be financed by borrowing abroad. The paper provides some solid theoretical underpinnings to the concerns that de-regulating the capital account may be destabilizing.

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