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# Hot Money Blues

**By PAUL KRUGMAN**

Whatever the final outcome in the Cyprus crisis — we know it's going to be ugly; we just don't know exactly what form the ugliness will take — one thing seems certain: for the time being, and probably for years to come, the island nation will have to maintain fairly draconian controls on the movement of capital in and out of the country. In fact, controls may well be in place by the time you read this. And that's not all: Depending on exactly how this plays out, Cypriot capital controls may well have the blessing of the International Monetary Fund, which has already supported such controls in Iceland.

That's quite a remarkable development. It will mark the end of an era for Cyprus, which has in effect spent the past decade advertising itself as a place where wealthy individuals who want to avoid taxes and scrutiny can safely park their money, no questions asked. But it may also mark at least the beginning of the end for something much bigger: the era when unrestricted movement of capital was taken as a desirable norm around the world.

It wasn't always thus. In the first couple of decades after World War II, limits on cross-border money flows were widely considered good policy; they were more or less universal in poorer nations, and present in a majority of richer countries too. Britain, for example, limited overseas investments by its residents until 1979; other advanced countries maintained restrictions into the 1980s. Even the United States briefly limited capital outflows during the 1960s.

Over time, however, these restrictions fell out of fashion. To some extent this reflected the fact that capital controls have potential costs: they impose extra burdens of paperwork, they make business operations more difficult, and conventional economic analysis says that they should have a negative impact on growth (although this effect is hard to find in the numbers). But it also reflected the rise of free-market ideology, the assumption that if financial markets want to move money across borders, there must be a good reason, and bureaucrats shouldn't stand in their way.

As a result, countries that did step in to limit capital flows — like Malaysia, which imposed what amounted to a curfew on capital flight in 1998 — were treated almost as pariahs. Surely they would be punished for defying the gods of the market!

But the truth, hard as it may be for ideologues to accept, is that unrestricted movement of capital is looking more and more like a failed experiment.

It's hard to imagine now, but for more than three decades after World War II financial crises of the kind we've lately become so familiar with hardly ever happened. Since 1980, however, the roster has been impressive: Mexico, Brazil, Argentina and Chile in 1982. Sweden and Finland in 1991. Mexico again in 1995. Thailand, Malaysia, Indonesia and Korea in 1998. Argentina again in 2002.

And, of course, the more recent run of disasters: Iceland, Ireland, Greece, Portugal, Spain, Italy, Cyprus.

What's the common theme in these episodes? Conventional wisdom blames fiscal profligacy — but in this whole list, that story fits only one country, Greece. Runaway bankers are a better story; they played a role in a number of these crises, from Chile to Sweden to Cyprus. But the best predictor of crisis is large inflows of foreign money: in all but a couple of the cases I just mentioned, the foundation for crisis was laid by a rush of foreign investors into a country, followed by a sudden rush out.

I am, of course, not the first person to notice the correlation between the freeing up of global capital and the proliferation of financial crises; Harvard's Dani Rodrik began banging this drum back in the 1990s. Until recently, however, it was possible to argue that the crisis problem was restricted to poorer nations, that wealthy economies were somehow immune to being whipsawed by love-'em-and-leave-'em global investors. That was a comforting thought — but Europe's travails demonstrate that it was wishful thinking.

And it's not just Europe. In the last decade America, too, experienced a huge housing bubble fed by foreign money, followed by a nasty hangover after the bubble burst. The damage was mitigated by the fact that we borrowed in our own currency, but it's still our worst crisis since the 1930s.

Now what? I don't expect to see a wholesale, sudden rejection of the idea that money should be free to go wherever it wants, whenever it wants. There may well, however, be a process of erosion, as governments intervene to limit both the pace at which money comes in and the rate at which it goes out. Global capitalism is, arguably, on track to become substantially less global.

And that's O.K. Right now, the bad old days when it wasn't that easy to move lots of money across borders are looking pretty good.