Removal of exchange controls

Finance

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Also, investors can get higher risk-adjusted rates of return by diversification

With higher rates of return, people are encouraged to save more and hence invest more which eventually leads to the growth of the country (Eichengreen & Mussa, 1998)

Increases the output of the nation

It generates greater efficiency by exposing the financial sector to global competition.

Increases direct foreign exchange contribute to an economy's growth rate by increasing the rate of capital accumulation (Wang, 2002)

A country also gains on technological innovation when Foreign Direct Investment is done

Intertemporal optimization (in times of temporary recession, a country can borrow from the rest of the world and smooth its consumption demands) (Wang, 2002)

Costs

As mentioned before, some recent incidents especially in Asia, Russia, and Latin America have highlighted the dangers that removal of exchange controls have created for nations. (Henry, 2003)

Invites speculative hot money

An open capital account leads to the investment of local savings into a foreign investment which would reduce domestic investment (Jadhav, 2003)

" It would weaken the ability of the authorities to tax domestic financial activities, income and wealth" (Jadhav, 2003)

Convertibility of capital inflows would divert resources from tradable to non-tradable sectors (Cobham, 2001)

" Surge in capital inflows and a sudden reversal of capital flows can induce crises, often due to contagion & external shocks" (Kawai, 2007)

Excessive expansion of aggregate demand (Jalan, 1999)

Can cause excessive investment in risky projects if there is asymmetric information in the domestic economy (Wang, 2002)

Conclusion

As seen from the explanation of the benefits and the costs, removal of exchange controls has been very popular for countries however some nations have suffered due to the implementation of Capital Account Liberalization. To reap the benefits, a country must adopt the correct policies to support the liberalization and constantly monitor the economic situation of a country in case something goes wrong.