

Capital Flight, North-South Lending, and Stages of Economic Development

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Abstract

We present a two-country OLG economy in which international capital mobility exists in the presence of moral hazard in financial contracts. The difference in the extent of asymmetric information is a source of capital movement and capital flows from the South to the North. Even though there exists a unique steady state under autarky, multiple locally stable steady states may emerge in a world economy with an integrated capital market. However, the integration may drive the South down to further impoverishment. The South's government therefore should take into account seriously the timing of capital market liberalization as a conduit of economic development.

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