IEO

Independent Evaluation Office
of the International Monetary Fund

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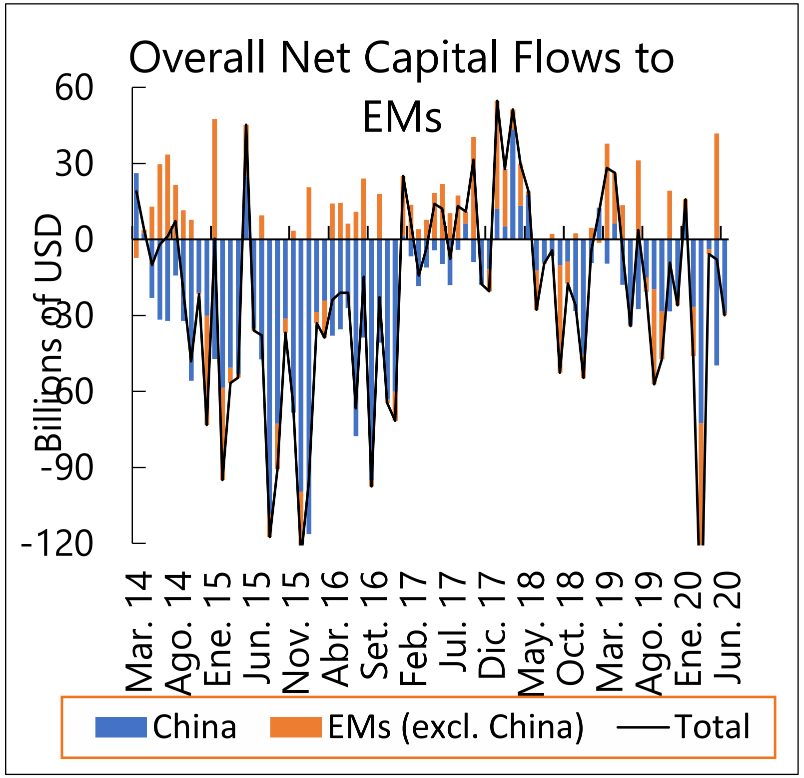
Introduction



- Surges and sudden stops remain a policy challenge
- In 2012, IMF adopted an "Institutional View" to guide advice on how to deal with volatility and on capital account liberalization

Plus

- Macroprudential framework

And enhancements to:

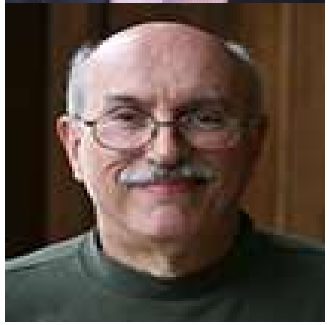
- External Balance Assessment
- Assessment of Reserve Adequacy

- Report evaluates IMF advice on capital flows since the adoption of the Institutional View

Background work supporting the report

Country Cases

- Review of experience of 27 countries
- Mix of advanced economies, emerging markets and frontier economies



Thematic

- Theoretical advances and empirical evidence on use of capital controls
- Evolution of capital flows; use of capital account measures
- Multilateral issues
- Update on COVID-19 crisis

Key findings: Bilateral advice on managing volatility

- IMF deserves credit for upgrading framework for advice
- Considerable effort to make advice consistent, tailored, evenhanded
- Advice on dealing with outflows in crisis cases effective in program cases
- Framework has served well so far during COVID-19 crisis
- But also several issues that are undermining influence and value added

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Issues with bilateral advice

1) Role for pre-emptive use of capital flow measures (CFMs) in certain circumstances

2) Labeling: macroprudential measures or capital controls?

3) Greater role of foreign exchange intervention (FXI) than acknowledged

4) Advice on dealing with disruptive outflows could be more nimble

5) Use of CFMs to advance social goals (e.g. housing affordability)

6) Technical challenges
   - Reliance on metrics: EBA and ARA
   - Quantification of thresholds: “surge”; “macro-relevance”; “near-crisis”

Issue 1: Preemptive use of CFMs

- Pushback from country experience and recent research on Fund advice against pre-emptive use in all circumstances
  - CFMs can be valuable part of financial stability framework
    - Korea, Peru; Iceland in 2016
    - ASEAN policy paper
  - CFMs can expand policy space for tools such as monetary policy
- Integrated Policy Framework: research suggests preemptive use can be effective in particular circumstance (shallow FX markets; currency mismatches)
- Private investors see role for CFMs on certain occasions to contain financial stability risks

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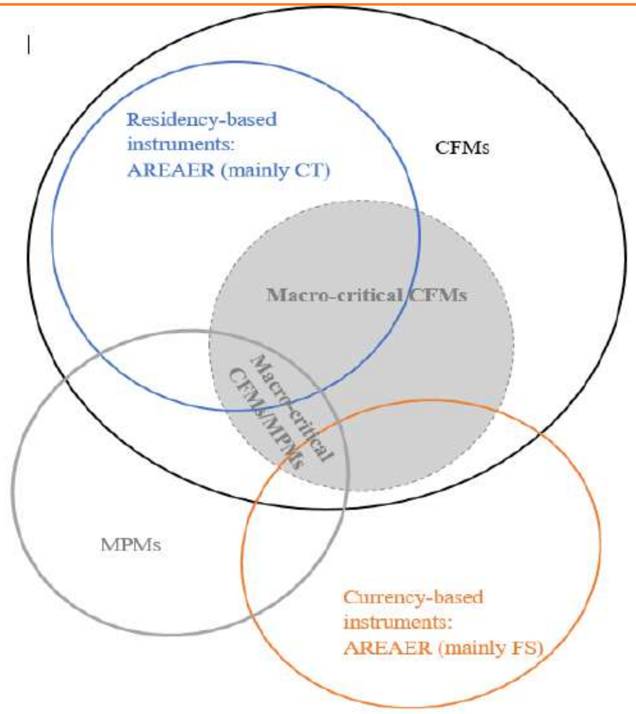
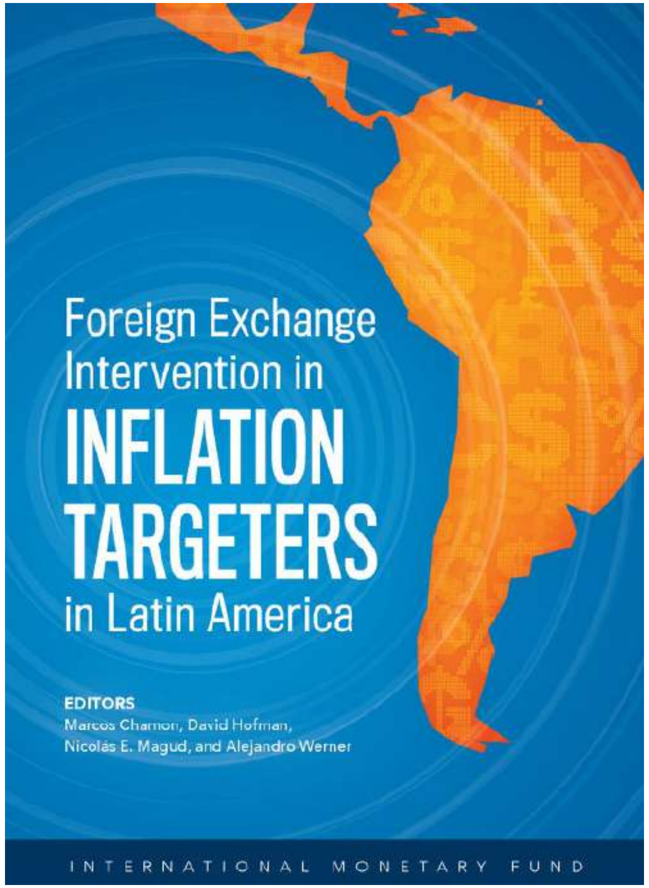
Issue 2: Labeling -- MPMs vs. CFM/MPMs



- Labels
  - CFMs = measure designed to limit capital flows
  - MPM = macroprudential measures to safeguard financial stability
  - CFM/MPM = measure designed to limit capital flows and safeguard financial stability
- Choice of label leads to a fork in the road in IMF advice
  - MPMs can be used pre-emptively and kept permanently, CFM/MPMs cannot
- Deciding between labels has involved extensive debate that has crowded out policy discussion

Issue 3: Role of FXI

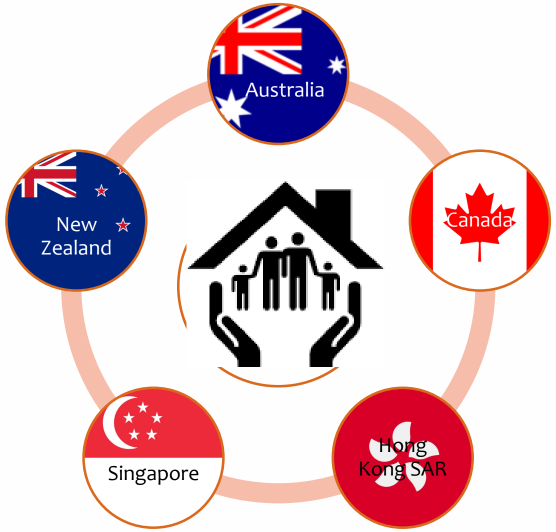


- Country experience and recent research suggests:
  - Greater role for FXI than acknowledged in Fund advice
  - "Dominant currency pricing" practices raise questions about stabilization benefits of exchange rate flexibility
  - Exchange rate movements can sometimes be a shock amplifier in the face of volatile flows

Issue 4: Dealing with disruptive outflows

- May be need for out-of-the-box thinking well before the situation has reached "crisis" or "near-crisis" stage
- Some countries facing stresses felt IMF advice could have been nimbler and validation more forthcoming
  - China in 2015
  - India in 2013

Issue 5: CFMs used for housing affordability



- Some economies have limited non-resident inflows to limit house price inflation and keep housing affordable
  - Australia, Canada, Hong Kong SAR, New Zealand, Singapore
- Fund's labeling of these measures as CFMs or CFM/MPMs has proven contentious – because can only be supported in the prevalence of an inflow surge
- Institutional View not geared to social or distributional motives for capital controls

Issue 6: Technical challenges

- Advice on CFMs rests on metrics not fully convincing to countries
  - External balance assessment
  - Assessment of reserve adequacy
- Advice on CFMs requires difficult calls
  - Judgment on whether a measure is designed to limit capital inflows
  - Subjective definitions: surge; macro relevance; crisis or near-crisis

Key findings: Bilateral advice on liberalization

- Broad appreciation for Fund advice on careful pace and sequencing
  - Ethiopia, Kenya and Morocco case studies
- A few difficult calls
  - advice to China, India: too cautious?
  - advice to Argentina: not cautious enough?
- Little attention to distributional effects of liberalization

Key findings: Multilateral advice

- Fund has worked hard to adapt
  - 2012 Integrated Surveillance Decision
  - Attention to source country regulatory structures
  - Analysis of spillover effects of CFMs
- Concerns persist about traction on source country policy decisions
- Coherence between IMF's Institutional View and other multilateral frameworks, notably OECD's Code and Basel III

Key findings: Monitoring, research and analysis

- Fund has made important contributions
  - Analysis of changing market structures and regulations on capital flows
  - Filling of data gaps to improve tracking of capital flows
  - Annual report (AREAER) leads the way in data provision on capital account restrictions
- Lack of a sustained medium-term work agenda; resource constraints
- Recently, research on an Integrated Policy Framework is generating useful insights

Main recommendation: Refresh the Institutional View

- Consider allowing for pre-emptive and more long-lasting use of CFMs in some circumstances:
  - For measures designed for financial stability purposes, reduce hard distinction in policy advice between MPMs and CFM/MPMs
  - Acknowledge that CFMs have valid role to address social issues such as housing affordability
  - Recognize that CFMs can sometimes increase macro policy space, especially for dealing with disruptive outflows
- Consider distributional implications of capital account liberalization
- Consider defining CFMs based on form and function, not intent

Supporting recommendations

- Medium-term agenda for research on capital account issues, building on IPF:
  - More research on costs and benefits – short-term and long-term -- on CFMs and macroprudential measures
  - Ramp up resources for AREAER, including to build the Fund's own capital market openness indices
  - Deepen coverage of capital account issues in EBA and ARA
- Strengthen multilateral cooperation by:
  - Considering cooperation agreement with OECD to ensure coherence on capital account issues
  - Working with FSB and IOSCO on regulation of cross-border flows in securities markets
  - Addressing possible tensions between the Institutional View and the Basel III framework

Principal take-away from evaluation

- The Institutional View was a major step forward and its key principles remain valid – capital flows can bring sustained benefits and capital flow measures should not substitute for warranted macroeconomic adjustment
- After eight years, the Institutional View needs to be revisited to take account of country experience and recent research
- Refreshing the Institutional View will ensure a state-of-the-art framework to guide policy advice to ensure value added and influence

Reception to the report and follow-up

- IMF Executive Board discussion on September 18, 2020:
  - Executive Directors broadly supported the findings and the three recommendations …
  - …but expressed a range of views on the extent of revisions needed to the Institutional View
  - Managing Director welcomed report and indicated it would feed into review of Institutional View scheduled for next year
- Next steps:
  - March 2021: Management Implementation Plan
  - During 2021: Review of the Institutional View

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THANK YOU!

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