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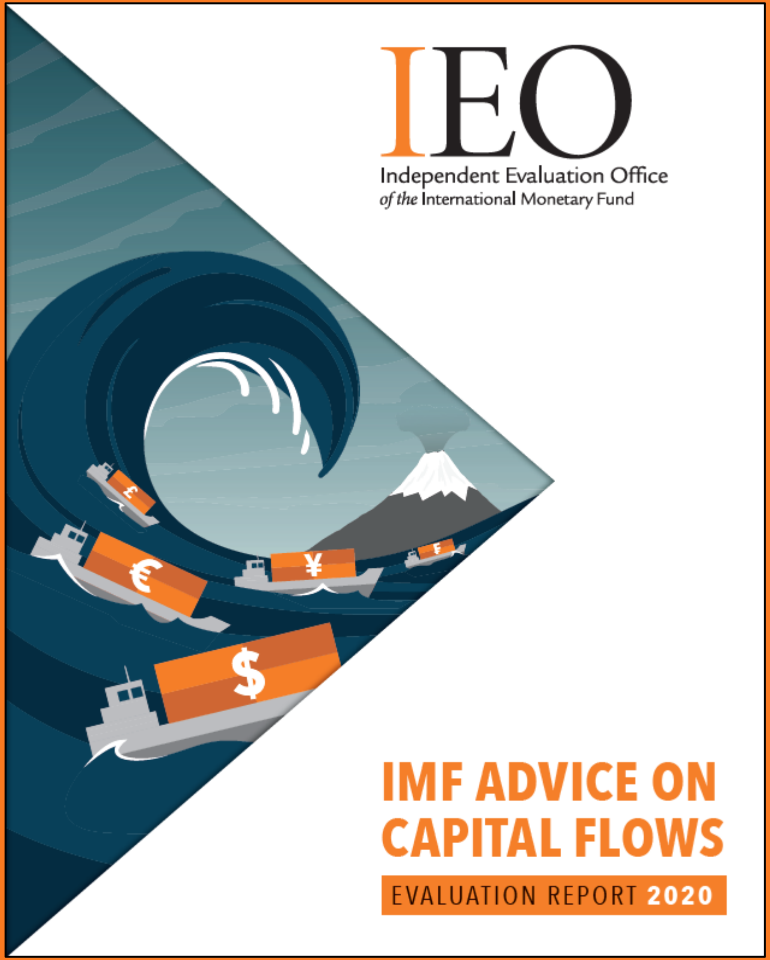

Prakash Loungani
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G-24 Technical Group Meeting | Session on Managing Capital Flow Volatility
February 23, 2021

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Introduction

- In 2012, IMF adopted an "Institutional View" to guide advice to countries on:
  - how to deal with capital flow volatility
  - how to proceed with capital account liberalization

- Over the past decade, IMF has also enhanced:
  - Macroprudential framework
  - External Balance Assessment (EBA)
  - Assessment of Reserve Adequacy (ARA)

- Report evaluates IMF advice on capital flows

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Background work supporting the report

Country Cases

- Review of experience of 27 countries
  - **Including 10 members and one observer of G-24 (Argentina, Brazil, China, Colombia, Ethiopia, India, Kenya, Mexico, Morocco, Peru; Indonesia)**

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

Anton Korinek

Peter Montiel

Key findings: IMF advice on liberalization

Karim El Aynaoui

Jose Antonio Ocampo

- Broad appreciation for Fund advice on careful pace and sequencing; IMF no longer perceived by most as making an "ideological push"
  - **Ethiopia**, **Kenya** and **Morocco** case studies
- A few difficult calls
  - advice to **China**, **India**: too cautious in making case for liberalization?
  - advice to **Argentina**: not cautious enough?
- Little attention to distributional effects of liberalization

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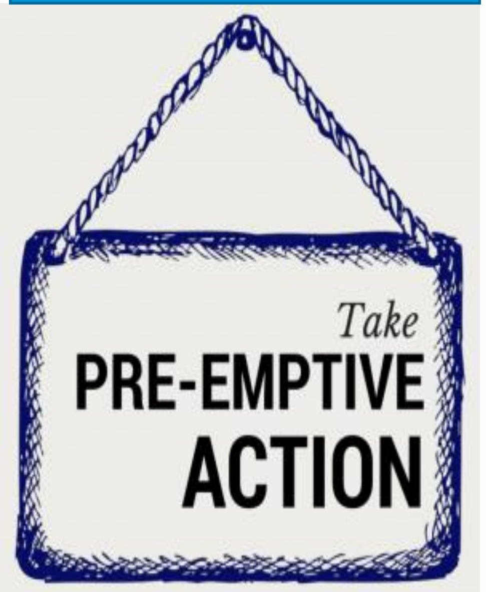
Key findings: dealing with volatility

- The Institutional View was a major step forward and its key principles remain valid
- IMF deserves credit for upgrading framework for advice
- Considerable effort to make advice consistent, tailored, evenhanded
- Flexible Credit Line (FCL) and Precautionary and Liquidity Line (PLL) arrangements have helped
    - FCL: **Colombia**, **Mexico**, Poland; PLL: **Morocco**
- Advice on dealing with outflows in crisis cases more effective when countries are in Fund programs
- Framework has served well so far during COVID-19 crisis

Issue 1: Preemptive use of CFMs

Luc Eveneart
Hans Genberg

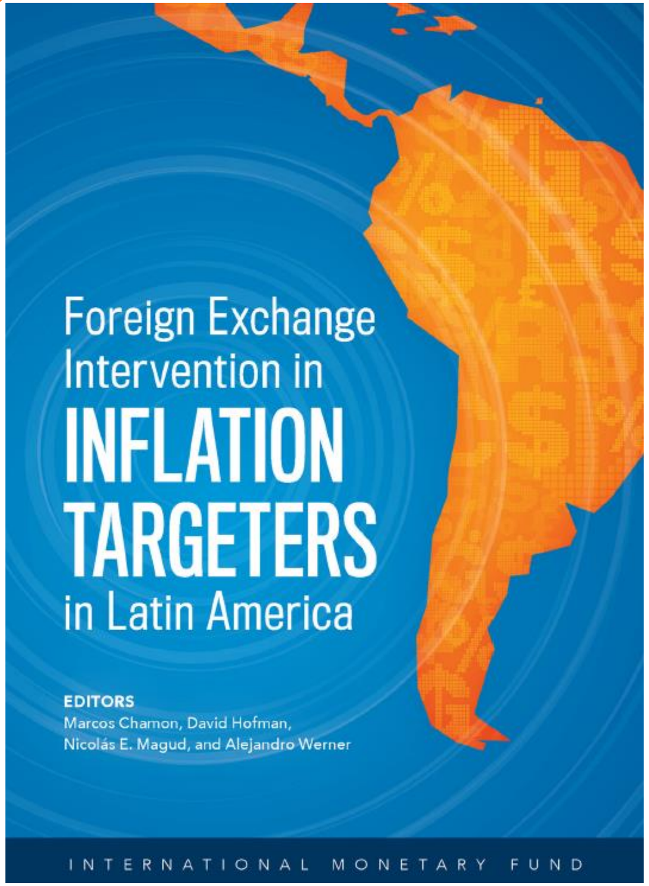


- Pushback from country experience and recent research on Fund advice against pre-emptive use in all circumstances
  - CFMs can be valuable part of financial stability framework
    - Korea, **Peru**; Iceland in 2016
    - ASEAN policy paper
  - CFMs can expand policy space for tools such as monetary 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

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
  - Korea, **Peru**.

Issue 3: Role of FXI



- Country experience and recent research suggests
  - Greater role for FXI than initially acknowledged in Fund advice (**Brazil**)
  - Exchange rate movements can sometimes be a shock amplifier in the face of volatile flows (IMF Asia and Pacific Department Policy Paper 2019)
- Advice on CFMs rests on metrics not fully convincing to countries
  - Disputes over exchange rate valuation or adequacy of reserves (**China**, Croatia, Israel, Korea, Malaysia, Poland).

Issue 4: Dealing with disruptive outflows

Eswar Prasad

Ila Patnaik

- 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 more nimble and validation more forthcoming
  - **China** in 2015
  - **India** in 2013

Main recommendation: revisit 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

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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

Reception to the report and follow-up

- "Directors broadly agreed on the need to revisit the IV in the light of recent research and experience" They underlined that the core principles underlying the IV remained valid … and emphasized the importance of [maintaining] safeguards against possible misuse of CFMs"

- "There were different views on the extent of revisions required"
  - "Many" directors supported pre-emptive and more long-lasting use of CFMs in specific circumstances
  - Views were "mixed" on:
    - allowing use of outflow CFMs outside of crisis or near-crisis
    - reconsidering difference in policy advice between CFMs, MPMs and CFM/MPMs
    - recognizing that CFMs may have a valid role to address social issues.

- "Many directors agreed that capital account liberalization strategies should consider distributional implications."

- Broad endorsement for supporting recommendations: medium-term agenda on capital flow issues & strengthening of multilateral cooperation on policy issues affecting capital flows

- Next steps: March-April 2021: Management Implementation Plan;
  During 2021: Review of the Institutional View

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THANK YOU!

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