



## **Executive Board Minutes 22/27-1**

March 21, 2022–10:00 a.m.

### **Review of the Institutional View on the Liberalization and Management of Capital Flows**

Documents: SM/22/42, and Sup. 1, and Sup. 1, Cor. 1, and Sup. 2. and Sup. 3, and Sup. 4, and Sup. 5

Staff: Adrian, Erceg, and Kokenyne Ivanics, MCM; Dell’Ariccia, Durdu, Basu, and Gourinchas, RES; Zettelmeyer, Morra, and Pazarbasioglu Dutz, SPR

Length: 2 hours

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APPROVAL: December 16, 2022

CEDA OGADA  
Secretary

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<sup>1</sup> Minutes are the official record of a formal Board meeting in which the Board may adopt decisions and reach understandings related to the business of the Fund. Staff background documents issued before the meeting are the principal basis for the meeting. Preliminary “gray” or “buff” statements by Executive Directors and staff’s responses to Directors’ technical questions are circulated prior to the meeting. Adopted decisions and/or summings up—the Chair’s “sense of the meeting” or policy conclusions/recommendations—are issued after the meeting. The minutes include all these elements, as well as the discussion record (a verbatim transcript of the discussion lightly edited for clarity). Minutes are made public consistent with the IMF’s Open Archives Policy.

## THE CHAIR'S SUMMING UP

Executive Directors welcomed the opportunity to discuss the review of the Institutional View (IV) on the Liberalization and Management of Capital Flows. They noted that, at the time of its adoption, it was envisaged that the IV would evolve in the light of research and lessons from its implementation. Directors highlighted the useful contributions from the work on the Integrated Policy Framework (IPF) and the Independent Evaluation Office's evaluation on IMF Advice on Capital Flows in informing the review.

Directors underlined that the core principles of the IV remain valid, namely the overall presumption that capital flows are desirable and can bring substantial benefits for countries. The IV should continue to aim to help countries reap those benefits while managing the risks to macroeconomic and financial stability of large and volatile capital flows. CFMs can be useful in certain circumstances, but should not substitute for warranted macroeconomic adjustments. It is also important to ensure that the Fund's policy framework on capital flows also guards against unintended effects or possible inappropriate use of CFMs. A number of Directors emphasized that strong macroeconomic frameworks and sound financial regulation and supervision, as well as structural reforms and market development to reduce underlying market imperfections, are the first line of defense to protect against excessive capital volatility. A number of Directors noted that policies in both source and recipient countries have a role in mitigating the multilateral risks associated with capital flows.

Directors supported the proposal on the use of measures that are both capital flow management measures and macroprudential policy measures (CFM/MPMs) on debt inflows in a preemptive manner (i.e., in the absence of a capital inflow surge) in some circumstances. They agreed that such measures may be warranted when systemic financial risks from stock vulnerabilities, notably currency mismatches, cannot be addressed effectively and efficiently with conventional policy instruments. Directors also generally concurred that, in narrow and exceptional circumstances, preemptive CFM/MPMs may also be warranted to address vulnerabilities from local currency-denominated external debt stocks. A few Directors emphasized that the appropriate conditions for use of preemptive CFM/MPMs should be sufficiently forward-looking to allow a timely and effective response to systemic risks.

Directors stressed that the appropriateness of preemptive CFM/MPMs should be subject to a comprehensive evaluation process and periodic reviews to ensure that they do not substitute for necessary macroeconomic adjustments, undermine market development, or maintain or exacerbate external imbalances. Their adoption may also complement needed macroeconomic policy adjustments. CFM/MPMs should be targeted, temporary, and transparent. A number of Directors highlighted the importance of the Fund's capacity development assistance to address capacity constraints and underlying vulnerabilities. A number of Directors also emphasized the importance of staff judgment and flexibility in

evaluating CFM/MPMs and to be mindful of the limitations of the Fund's external sector assessment frameworks. Directors noted that if preemptive CFM/MPMs produce adverse spillovers that may significantly influence the effective operation of the international monetary system, in line with the Integrated Surveillance Decision, staff should examine whether alternative policy actions could achieve the same domestic policy objectives while minimizing the negative outward spillovers. They encouraged staff to transparently assess when CFM/MPMs are no longer appropriate and to discuss alternative policies. Directors stressed the need for staff guidance to ensure evenhanded and careful implementation of the evaluation process, as well as giving appropriate weight to the views of the authorities.

Directors broadly agreed with the proposal to accord a special treatment to certain categories of CFMs, including those introduced solely for national or international security reasons, adopted pursuant to certain internationally-agreed prudential frameworks (including reciprocity agreements), implemented in line with FATF standards to combat money laundering and the financing of terrorism, and CFMs arising from certain international cooperation standards against the avoidance or evasion of taxes. They concurred that the IV is not the right framework to assess the appropriateness of such measures, while noting that they should still be categorized as CFMs if those measures qualify as such under the definition of CFMs in the IV, and discussed in surveillance if they are macro-critical or may generate significant spillovers, consistently with the Integrated Surveillance Decision. Many Directors cautioned that measures introduced for national or international security reasons should be used sparingly and avoid misuse.

Directors noted that the IV's advice for managing capital inflow surges, responding to disruptive outflows, and undertaking capital flow liberalization remains unchanged. They welcomed the additional guidance provided to conduct assessments of macro-criticality and identify capital flow surges, imminent crises, and premature liberalization, noting that such assessments play an important role in formulating policy advice under the IV. Some Directors sought further clarification of some aspects. Directors called for a careful balance of staff judgment and evenhandedness, as well as transparency, when implementing the IV and assessing CFMs. Directors also welcomed the clarifications provided on certain operational issues, such as the treatment of measures that are both CFMs and exchange restrictions or multiple currency practices.

Directors noted that certain topics, including the use of CFMs for social or political objectives, the distributional effects of capital flow liberalization, the use of outflow CFMs outside of (imminent) crisis circumstances, and in particular the effects of digitalization and climate change on capital flows, need further research and could not be addressed in this review. Directors encouraged staff to continue research on these topics and consider their policy implications in a timely manner in a future review of the IV.

Directors urged careful and balanced external communication to stakeholders on the changes to the IV while emphasizing that the fundamental principles of the framework are preserved.

**EXECUTIVE BOARD ATTENDANCE<sup>2</sup>**

K. Georgieva, Chair

**Executive Directors**

I. Mannathoko (AE)

C. Huh (AP)

A. Bevilaqua (BR)

Z. Jin (CC)

P. Jennings (CO)

D. Palotai (EC)

A. Buisse (FF)

J. Stephan (GR)

S. Bhalla (IN)

D. Fanizza (IT)

T. Tanaka (JA)

M. Pösö (NO)

A. Mozhin (RU)

A. BinZarah (SA)

R. Lim (ST)

P. Trabinski (SZ)

**Alternate Executive Directors**

R. N'Sonde (AF)

B. Lischinsky (AG), Temporary

A. Guerra (CE)

M. El Qorchi (MD)

F. Al-Kohlany (MI), Temporary

L. Dresse (NE)

D. Ronicle (UK)

A. Medearis (US), Temporary

C. Ogada, Acting Secretary

M. Guerra Bradford / J. Morco, Summing Up Officers

R. Smith Yee / D. Alcantara, Board Operations Officers

L. Nagy-Baker, Verbatim Reporting Officer

**Also Present**

African Department: D. Sandri. Asia and Pacific Department: R. Craig, A. Gulde, S. Panth, S. Peiris, C. Rhee, K. Srinivasan. Communications Department: N. Ismail, I. Yackovlev Perez-Vilches. European Central Bank: D. Rakitzis, R. Rueffer. European Department:

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<sup>2</sup> For countries in each constituency, please see the Constituency Codes in the annex.

J. Lee. Finance Department: Z. Murgasova. Independent Evaluation Office: C. Collyns, P. Loungani. Legal Department: K. Christopherson Puh, A. El Murr, N. Rendak, G. Rosenberg, N. Stetsenko, J. Swanepoel, R. Weeks-Brown. Middle East and Central Asia Department: N. Blancher, M. Mati. Monetary and Capital Markets Department: T. Adrian, P. Chantapacdepong, A. Csajbok, C. Erceg, R. Gelos, I. Gudbjartsdottir, Z. Jiang, H. Kang, A. Kokenyne Ivanics, P. Miettinen, E. Nier, T. Olafsson, G. Pasricha, S. Popova. Office of Risk Management: B. Boulwood. Research Department: S. Basu, M. Das, G. Dell'Ariccia, E. Durdu, G. Ganelli, P. Gourinchas, L. Juvenal, F. Roch, D. Unsal Portillo Ocando, C. Van Hombecck. Strategy, Policy, and Review Department: R. Green, Y. Hashimoto, V. Klyuev, R. Koepke, N. Meads, D. Milkov, P. Morra, C. Pazarbasioglu Dutz, H. Perez-Saiz, M. Rodriguez Waldo, M. Sommer, Y. Wu, J. Zettelmeyer, Y. Zhao. Western Hemisphere Department: P. Alonso-Gamo, I. Goldfajn. Executive Directors: A. Andrianarivelo (AF), M. Mahmoud (MI), P. Moreno (CE). Alternate Executive Directors: A. Alhosani (MI), M. Alrashed (SA), C. Amarasekara (IN), H. Azal (EC), F. Fuentes (BR), A. Grant (AP), L. Herrera (AG), C. Just (EC), M. Kashima (JA), A. Marcussen (NO), F. Mochtar (ST), W. Nakunyada (AE), F. O'Brolchain (CO), O. Parkyn (AP), C. Roman (FF), J. Romero (CE), B. Saraiva (BR), F. Sylla (AF). Senior Advisors to Executive Directors: H. Andrianometiana (AF), E. Cartagena (CE), M. Choueiri (MI), R. Cunningham (CO), J. Garang (AE), R. Goyal (IN), V. Grossmann-Wirth (FF), M. Ismail (AE), L. Johnson (AP), R. Mahabir (BR), S. Naka (JA), T. Nguema-Affane (AF), D. Ong (ST), J. Rojas (CE), C. Sassanpour (MD), L. Smith (CO), F. Spadafora (IT), N. Thiruvankadam (IN), S. Tsur (NE), R. Velloso (BR), S. Wongwaisiriwat (ST), B. Yoo (AP). Advisors to Executive Directors: Z. Abdelrahman (SA), T. Abdygulov (SZ), N. Abu Bakar (ST), P. Al-Riffai (MI), D. Andreicut (UK), A. Arevalo Arroyo (CE), P. Arubilake (AP), T. Azlan Ariff (ST), R. Bah (AF), Dennis Bautista (ST), C. Becker (AP), B. Boostani (MD), E. Boukpepsi (AF), I. Bustillo (AG), T. Cham (AE), D. Cools (NE), J. Corvalan (AG), K. Dacharux (ST), M. Damane (AE), C. Eijking (NE), D. Fadhel (MI), D. Hamzah (MI), F. Kurniawan (ST), V. Lankester Campos (CE), G. Meizer (EC), M. Merhi (MI), R. Moral Betere (CE), A. Nainda (AE), L. Nankunda (AF), G. Ogmundsdottir (NO), K. Osei-Yeboah (MD), D. Shestakov (RU), E. Shimada (JA), B. Singh (IN), B. Slettvag (NO), L. Sturm (US), A. Tola (SZ), J. Yoo (AP), J. Barroso (BR), M. Law (CC), F. Lopez (CE), A. Mairate (NO), C. Weissermel (GR).

**DISCUSSION RECORD<sup>3</sup>**

*The Chair:*

The purpose of our discussion is to concentrate on the review of the Fund's Institutional View (IV) on the Liberalization and Management of Capital Flows. The Board has received the paper and four background notes prepared by staff. This is a very important undertaking for us because it touches on issues and policies that are core to the Fund's mandate and especially when we are in an environment of heightened uncertainty, coming up with the review at this time is so very helpful to our members.

The review brings the IV up to date with advances in theoretical and empirical research and with the policy experiences we have accumulated over ten years. It is informed by the work on the Integrated Policy Framework (IPF). It is informed by the findings of the Independent Evaluation Office (IEO) Evaluation of IMF Advice on Capital Flows done in 2020. It is informed by feedback from authorities and by staff's own experience with implementing the IV.

I want to recognize first and foremost Directors and their authorities for a very substantive engagement and also the team that has work tirelessly, bringing many departments and in particular Legal, SPR, MCM, and Research, as well as our area departments. I want to thank the Directors of these department but also thank Ms. Gopinath, who in her position as Chief Economist, has done a tremendous service to the membership and the institution in advancing the review.

Let me make three points at the opening. The first, to look back in the history of how the IV helped the Fund to provide consistent assessments and advice on capital account liberalization and the management of capital flows since it was adopted in 2012. As you know very well, the overall objective of the IV has been to help countries reap the benefits from capital flows while managing the associated risks in a way that protects macroeconomic and financial stability. It has incorporated capital flow management (CFM) measures into the policy toolkit to help contain these risks when circumstances warrant it, and it also brought up the importance of international cooperation leading to the development of guidelines for safe capital account liberalization. In other words, my very first point is that the IV has served the membership well, and that has been confirmed by the IEO.

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<sup>3</sup> Edited for clarity.

They recorded broad overall satisfaction with the IMF's advice on capital flows. It has recognized that Fund advice to countries has been consistent with the IV and that the applications have generally been seen as evenhanded.

My second point is that we never thought we would make the IV, as initially formulated something set in stone. We know the world is changing, and experience is being accumulated. It was expected from the very beginning that there will be reviews, and the IV will evolve based on analyses, experience, and feedback from country authorities, and this is what the team has done. What is so very important is that we have really pulled together. Ms. Gopinath, in our pre-Board meeting, reminded us that when we started the review, there were so many differences in views of how we can go about it that there was a bit of fear—are we able to yet again bring consensus? And today we are in this room because we have been able to bring consensus as it is important to serve our membership.

My third point is to say what remains, what we sustain, and where we are adapting the IV. The review remains the core principles of the IV. It leaves unchanged the overall presumption that capital flows can bring substantial benefits for countries and that CFMs, while useful in certain circumstances, should not substitute for warranted macroeconomic adjustments and even less, they should be used to gain unfair competitive advantage. This foundation remains, and the proposals are consistent with this foundation.

Where is it that we are making progress with the review? We are developing an Integrated Policy Framework (IPF) to study in a systematic and analytical way the policy options and tradeoffs available to policymakers in response to shocks. The important point I want to stress is that the IPF provided key elements to inform the review, and I want to thank all of you who have engaged in the IPF discussions. Now what we recognize is that under certain circumstances, preemptive CFM/MPMs may be useful to mitigate financial stability risks and their associated macroeconomic implications.

We had a very good Board meeting last July. We listened very carefully to the Board. We recognized there was broad agreement on the conceptual proposal and that we needed to advance with further details on implementation, and this is what staff has done. What we have in front of us is a very careful balance in recognizing that preemptive CFM/MPMs may be appropriate in some circumstances, but robust assessments are needed to rule out unintended side effects and inappropriate use. We also agreed that some issues would be outside of the scope of this review: distributional matters,

social objectives, the use of outflow controls outside of crisis circumstances, digitalization, climate change. They are very important issues on their own, but they require further analysis before we bring them into the IV.

These are my opening remarks. We have been served well. We have done thoughtful work on what is a foundation not to touch and where we need to evolve, and we have carefully integrated the guidance the Board has given us so far.

*The Director of the Strategy, Policy, and Review Department (Ms. Pazarbasioglu):*

First and foremost, I would like to start with thanking the Board on behalf of the whole team, Legal, MCM, Research, and SPR, for the constructive exchange we have had on this review since July of last year. Their comments have helped us clarify certain important aspects and improve the review. We are grateful for the many thoughtful comments that Directors have provided in the gray statements. What I am going to do is offer a brief summary of the key elements of the review and react to some of the issues raised by the Executive Directors in their gray statements.

As mentioned, the review proposes two key changes to the IV. First it recognizes that the use of CFM/MPMs on debt inflows, in a preemptive manner—in the absence of a capital inflows surge—may be appropriate in certain circumstances, specifically when stock vulnerabilities make countries vulnerable to systemic financial risks. This is based on the insights from the IPF, as well as our work so far. To minimize the unintended effects of inappropriate use of CFM/MPMs, the review proposes a very comprehensive assessment process.

The second policy change proposed by the review is to establish a special treatment for certain categories of CFMs, such as those adopted for national or international security reasons, and those in line with internationally agreed prudential standards, AML/CFT standards, and international cooperation against tax evasion. These measures are not well suited to be assessed for their appropriateness under the IV. They, however, will be discussed in surveillance if they are macrocritical or produce significant spillovers, and labeled as CFMs if they are designed to limit capital flows.

The review does not propose changes to the current advice of the IV on how to manage capital inflow surges, respond to disruptive outflows, or undertake capital account liberalization. However, it does offer additional guidance on some concepts that are key for assessments of policy advice

under the 2012 IV, in particular how to evaluate the macrocriticality of CFMs, identify capital inflow surges and imminent crisis circumstances, and assess premature liberalization.

With respect to source country policies, the review maintains the principle of the current IV that source country policies have a role in mitigating the multilateral risks associated with capital flows. Spillovers from source country policies and the coordination of policies continue to be addressed in the context of Fund multilateral, and bilateral surveillance with member countries, consistent with the Integrated Surveillance Decision. The paper also provides guidance on other operational issues that have come up in recent years in the implementation of the IV, such as the assessment of measures that are both CFMs and exchange restrictions, or multiple currency practices.

Let me address some of the issues raised by Executive Directors in their gray statements. First, we agree that appropriate communication of the changes introduced in the review is very important, in particular to make clear that the Fund continues to emphasize the benefits of capital flows and is not advocating for suboptimal policies. As the Managing Director noted, the review maintains unchanged the core principles underlying the IV. We continue to subscribe to the view that capital flows are desirable, as they can bring significant benefits to countries. Our policy advice will remain focused on helping countries maintain healthy economies, address vulnerabilities, undertake the necessary structural reforms to reduce the underlying market imperfections, and develop markets to allow them to respond effectively to shocks.

If and when CFM or CFM/MPMs become necessary to achieve domestic or external stability, staff will work with the authorities to ensure that they are well-designed, targeted to address the relevant vulnerabilities, temporary, and that they do not substitute for warranted macroeconomic adjustments, discourage structural reforms, or hamper market development help maintain a stronger-than-warranted external position or gain any unfair competitive advantage. These will be the key issues that staff will assess in our surveillance work. We will make sure that we are clear about these principles in our communications.

With respect to the operationalization of the proposal of preemptive CFM/MPMs, some Directors asked who would be responsible for making the assessments; what would be the role of staff judgment and the involvement of the authorities, and how we would make sure that the assessments are

transparent and evenhanded. The assessment process proposed in this review aims to ensure that the preemptive CFM/MPMs are used appropriately. This process will build on the existing process, which according to the IEO evaluation, has resulted in consistent application of the IV and was perceived as generally being evenhanded. The assessment will be undertaken by an interdepartmental team comprising staff from Legal, MCM, Research and SPR in collaboration with the country teams and will include a strong internal review to ensure consistency and evenhandedness. As measures are assessed, staff will work very closely with the authorities to gather information and give emphasis to country-specific circumstances. When the measures are macrocritical, these assessments will be discussed transparently and comprehensively in staff reports, which will also reflect any divergence of views between the authorities and staff. We will incorporate the details of the Board paper on the implementation of policy changes, as well as some concepts necessary for implementation, in our detailed Guidance Note, and this will be shared with the Board in due course for information.

*Mr. Guerra:*

We agree with the Chair that this is a strategic topic. First, we want to acknowledge staff for the hard and diligent work. This has been an example of how high-quality collaborative work across departments should be, including the timely contributions of the IEO. It has been a long journey, but the IMF and international community have benefited from this discussion. Looking forward, we have to continue as we expand analytical underpinnings of the IPF to include the effects of digital money in the cross-border capital flows. We believe that this should be our next IPF analytical target. I will make two points and then two comments on communication.

My first point is that the IMF should aim to deliver advice on the best policy strategy in a comprehensive manner. In this respect, the use of preemptive CFMs should always be accompanied by a policy agenda that helps the country to address the imbalances and vulnerabilities in a decisive and sustainable way. This is a necessary condition in order for the membership to get the best advice in the rare occasions where CFMs are justified, so the Fund should support the structural policies and reforms to address the underlying frictions through a specific policy agenda that should be tailored to address the specific country circumstances and vulnerabilities and also reduce the need to rely on CFM/MPMs.

My second point is on spillovers. The imposition of CFM can have important immediate spillover effects to other countries, specifically to

low-income (LICs) and middle-income countries (MICs). There can be immediate market effects but also more protracted effects on member countries that would warrant policy action, so we reiterate that even under the cases where CFMs are not analyzed under the IV, like the case of imposition of CFMs for national security reasons, its economic consequences should be dealt with and assessed during the Article IV consultation process. It may not be macrocritical for the country that is implementing the CFMs, but it may be the case that the spillovers have a strategic effect on other countries.

Finally, on two aspects on communication and following what has just been stated by Ms. Pazarbasioglu, in outreach to explain the changes to the membership, the basic principles of the IV should be included. We should not only focus the message specifically on what is changing. The results of our discussion should be in the context of the overall framework and the objective of the IV.

For my second point regarding communication, let me start with anecdote. At the time of what was named the tequila crisis, the Mexican authorities complained that analysts were giving a bad name to a good drink. I believe that in our communication we should be careful not to give a bad reputation to a good capital flow. The paper presents detailed descriptions of benefits of capital flows in the background papers. Thus, we should use this to have a balanced communication strategy so that the potential benefits of capital flows and important policy objectives of liberalization of capital flows are fully understood.

*Mr. Buisse:*

I can fully support MD's introductory remarks. I can support Mr. Guerra too, especially on tequila. Let me thank staff for the comprehensive set of papers and the extensive underlying work. It has taken time, but as the Chair said, we managed to reach a consensus. We very much welcome this review, also informed by the IPF work, the 2020 IEO findings, and staff experience with the implementation of the IPF. I issued a common gray statement with Mr. Fanizza, Mr. Hilbers, Mr. Palotai, Mr. Pösö, and Mr. Stephan; I will focus on three points for emphasis.

First, we support the proposed way forward for the inclusion of the preemptive CFM/MPMs on inflows into the policy toolkit. As mentioned by staff, this policy should be implemented under very specific and limited circumstances; but they, indeed, can be in those circumstances useful to address financial stability risks stemming, for example, from currency

mismatches. We welcome the proposed two-step approach even if the framework for the assessment of the vulnerabilities may need to be further refined to clarify the monitoring.

Second, we agree to refrain from assessing the appropriateness of certain measures classified as CFMs when introduced for national or international security reason. This should be used very sparingly and AML/CFT purposes. In our view, special treatment should also be granted to measures consistent with the internationally agreed prudential standards, such as Basel III framework, or with international standards against tax avoidance and evasion.

Third, while we fully understand it was not possible to tackle these issues within this review, we encourage staff to conduct further research on the implications of financial innovation and climate change for capital flows and their management as well, of course, as a redistributive impact of capital flows.

*The Chair:*

As I said in the beginning, we recognize that this is not the last review. Work needs to continue.

*Mr. Tanaka:*

This is, indeed, a timely and important review considering the recent volatile markets and monetary policy changes of major central banks, as they could potentially cause spillover effects in global capital flows. As we issued a comprehensive gray statement broadly supporting the staff proposal, we offer the following comments for emphasis.

First, we strongly support maintaining the core principle of the IV. In principle, as the MD and Ms. Pazarbasioglu said, CFMs should not substitute for macroeconomic adjustment, even though they may be sometimes useful in certain circumstances. Only limited number of countries has deployed CFMs during the pandemic, while most authorities have effectively responded with other policy measures. Capital flows can bring substantial benefits for countries. This experience strengthens the rationale for the core principle.

Second, at the same time, we welcome the staff proposal to allow preemptive use of inflow CFM/MPMs, which flexibly updates the IV to be more pragmatic as an evolving framework. We acknowledge that the

preemptive CFM/MPMs would complement MPMs when MPMs alone are not sufficient to prevent aggravation of stock vulnerabilities such as forex mismatches and in some exceptional cases, local currency debt. We positively note that the proposed evaluation framework would facilitate consistent and country-tailored advice and assessment.

Third, having said that, the staff and the authorities should make sure the use of CFM/MPMs are targeted, temporary, and reversible. In order to achieve sound medium-term growth, the authorities should make necessary macroeconomic policy assessments and address underlying structural vulnerabilities even if they apply CFM/MPMs. In this regard, we reiterate that staff should carefully review and support the steady progress of key reforms for financial market developments through regular discussions in Article IV and other engagement by the country team and functional department teams. We also agree with staff that spillover effect of CFM/MPMs should be considered in the Fund's assessment.

Finally, like other chairs in their statements, Mr. BinZarah and Mr. Mohieldin, we strongly expect staff to deepen their analysis within IV and possibly IPF on digitalization, including digital money in the future, as it has broader implication for capital flows and CFM. Thank you very much for the review of IV at this time.

*The Chair:*

I do recognize what Mr. Tanaka said about digital money. If anything, this is going to speed up, and, therefore, we need to understand the implications.

*Mr. Bevilaqua:*

I would like to add a few points for emphasis. First, we fully support accounting in the IV for preemptive CFM/MPMs on capital inflows. Such measures should counter the buildup of external liabilities, which could amplify eventual sudden stops and therefore create systemic risks. We welcome the background note with guidelines for identifying systemic risks linked to currency mismatches in external liabilities and appreciate the flexibility afforded by the proposed two-step approach. That said, we highlight that judgment will always be an important ingredient of the process and that public data may need to be complemented by country-specific data and cooperation from authorities to produce them. We also take positive note of staff's acknowledgement of local currency external debt as a possible

source of vulnerability in the case of strong repatriation pressures while underscoring that the use of local currency remains an important mitigator of debt vulnerability.

Second, we agree that preemptive CFM/MPMs carry some relevant policy risks and should therefore be carefully balanced against other policies. That said, while we agree that preemptive CFM/MPMs should not unduly substitute for warranted macroeconomic adjustment or unduly amplify external imbalances, there are circumstances of elevated systemic risks in which authorities may elect to implement CFM/MPMs while the necessary macroeconomic and external balance adjustments run their course. The key point here is not to depict CFM/MPMs as necessarily an option of last resort. On the contrary, depending on the situation, they may well be key measures to address significant systemic risks and should remain handy in the policy toolkit.

Third, we take positive note of the detailed definitions proposed for key IV concepts, including capital flow surges and imminent crisis. That said, the report must make even clearer that judgment will always be a necessary ingredient for policy assessment. Policymakers will often prove to be more conservative than what might be suggested by any set of indicators, and this is usually well justified given the stakes at risk. Indeed, a risk-based approach is a key element of any conceptual framework and should be fully incorporated into the definitions for the overall guideline for their application.

Fourth and last, let me acknowledge that we agree with the categories of measures carved out from the IV assessment. That said, national security, prudential, and integrity policies will often be macrocritical for one or more affected jurisdictions. They should be fully reported to the Board and considered as appropriate in other surveillance contexts.

*The Chair:*

I want to emphasize two points. One, judgment; it is a prerequisite for a good outcome. Judgment based on data. Two, that when we look at the toolkit, we should not put these measures at the bottom. They are within the toolkit, and judgment should tell us when and how to use them.

*Mr. Stephan:*

We issued a joint gray statement, and we welcome the policy changes proposed in this review. In particular, we support the proposed change

concerning the use of preemptive CFM/MPMs on inflows, and we appreciate the greater clarity on when these instruments may be usefully employed. We also agree that they might be justified in situations where other policy instruments are insufficient, ineffective, or too costly.

We also agree that the Fund is not a suitable institution to discuss or evaluate certain CFMs, like those pertaining to national or international security, AML/CFT, or international tax practices. However, we would like to point out that this might create incentives to dedicate measures as national security measures, for instance, even though this classification might not fit the specific measure. Maybe staff can briefly comment on how they are planning to deal with this issue.

On the various concepts that play an important role in the implementation of the IV, we welcome the additional elaborations provided in the staff report. In particular, the assessment of whether a measure is macrocritical plays a decisive role in assessing whether it is discussed in the Fund's bilateral surveillance or not. The discussion in the review has shed some further light on staff thinking on this issue, but it seems, of course, it relies in some cases heavily on judgment. The discussions have not yet clarified and cannot clarify all questions ex-ante, so there is a large room for interpretation, and we reiterate our plea that in doubtful circumstances, the assessment from national authorities should be given a high weight when determining macrocriticality.

Going forward, the work on the IV will obviously continue. As noted by staff, several important topics have not been part of the current review, as the analytical basis has not yet been sufficiently developed. In this context, we support staff in their endeavor to extend its analytical work to such important issues like influence of digitalization and cryptocurrencies on capital flows, climate change, and the effects on capital flows over the coming years. And we think also it will be important to continue the analytical efforts on distributional effects of financial liberalization, as well as on CFMs with social objectives. We would also appreciate if staff could conduct further research on CFMs on outflows outside of imminent crisis circumstances.

*Ms. Medearis:*

We know that this exercise was not an easy undertaking.

We want to join others in commending staff for their breakthrough research on capital flows, which is at the core of the Fund's mandate. We

issued a comprehensive gray statement supporting the proposed policy change, the elaboration of key concepts, and the special treatment for certain measures. I just want to give two comments this morning, the first on board oversight and the next on implementation of the revised IV.

First, we think it is important to recognize that staff surveillance and policy advice on CFM/MPMs in general, and particularly preemptive use in the face of an imminent crisis, will be occurring in a dynamic context. If the Board is to provide effective oversight of both staff's CFM/MPM analysis and policy advice, as well as capacity development and policy advice on other reforms to reduce stock vulnerabilities, the Board will need to have a sense of the extent of the problem. In our view this should include whether the list of countries with these vulnerabilities is narrowing, hopefully due to effective Fund engagement, or widening, due to, for example, lack of CD resources or government ownership. We urge staff and management to consider ways to keep the Board informed to enable this oversight.

Secondly, we continue to see implementation, including communication, as the key challenge going forward. We welcome and appreciate the groundbreaking research under the IPF and staff efforts to clearly lay out their evaluation criteria and process outlined in Background Note 2 to practically apply that research, including in the IPF models. The insights from the IPF should be applied symmetrically with equal weight placed on identifying when nontraditional measures are not necessary or where other less distortive tools could take their place. We encourage staff to proactively use the new framework on these issues and identify strategies to ideally help country authorities avoid circumstances where, for example, the use of preemptive CFM/MPMs becomes necessary. Effective implementation will determine if the Fund achieves a desirable result of a more consistent and disciplined advice on CFMs and CFM/MPMs, along with other nontraditional measures. As Mr. Moreno and Mr. Guerra too stressed in their gray statements and comments, we believe that communication with individual members and with the Board and with external stakeholders will be of paramount importance.

*The Chair:*

Very clear points both on board involvement and on the significance we need to assign to implementation in a way that is consistent and allows us to identify, should there be a need, more emphasis on structural reforms, as Mr. Guerra said in the beginning—the more comprehensive view we take.

*Mr. Jennings:*

We support the two proposed changes to the IV, and we have issued a detailed gray statement.

First, we appreciate that staff have emphasized that open capital accounts with free and nondiscriminatory capital flows bring substantial benefits to both recipient and origin countries.

Second, we support the proposed change to consider preemptive CFM/MPMs to mitigate potential risks in certain clearly defined circumstances. We would stress that these measures should not substitute for necessary macroeconomic adjustment and structural reforms, and they should not serve to justify keeping exchange rates undervalued.

Third, we would have liked the hierarchy of policies to be more explicitly laid out in the main document, specifically that MPMs as standalone options should be considered first, followed by CFM/MPMs that discriminate by currency second, and CFM/MPMs that discriminate by residency only as a last resort. While these views are in the reports, we think they merit more emphasis in the main review document.

Fourth, we would also have liked to see more consideration to the risk that foreign exchange interventions bring. The data show that foreign exchange interventions are often used, but as the review highlights, the intended goals of these interventions are often not clear. They might be used to address vulnerabilities associated with capital inflow surges or disruptive outflows, particularly when currency mismatches exist. We recommend staff consider a more comprehensive review of foreign exchange interventions as a policy tool in the future.

Finally, we support the proposal in Section 3 to provide special treatment for certain measures whereby staff do not have to assess their appropriateness. As Mr. Stephan and others have emphasized, it is important to ensure that national and international security rationale for this special treatment is used sparingly and is well justified.

*The Chair:*

And just to recognize that this point of carefully applying security-justified measures and our role for assessing those is on the minds of many of our Board members for a good reason.

*Ms. Mannathoko:*

We appreciate the responses to questions that were posed in our gray statement. We just want to welcome the incorporation of some insights from the work on the IPF, and we hope that the ongoing IPF work will still further inform the IV in the future, especially once the global digital money use rises—as noted by Mr. Guerra, Mr. Tanaka, Mr. Stephan—given the risks from higher cross capital flows that we will see and the potential for digital dollarization, especially in developing countries.

Overall, we support the proposals, especially on the use of preemptive CFM/MPMs and thank staff for elaborating important policies and concepts. We note that preemptive CFM/MPMs will help address systemic financial risks that can arise from stock vulnerabilities, and therefore they will help preserve financial stability. They will also prove important for EMDEs, especially as the influence of nonbank financial institutions (NBFIs) grows in capital flows.

We also welcome the incorporation of a broader set of measures, the high-frequency data in IV modeling and analytical tools, to better identify imminent crisis circumstances. We look forward to the Guidance Note in this regard, in addition to the instructions that we will have on preemptive CFMs. Flexibility with informed judgment and effective cooperation with authorities will be especially important during volatile times. In addition, we also welcome the intent to work closely with area departments on identifying relevant capacity development (CD) and technical assistance (TA) needs and incorporating them in CD plans as appropriate.

We appreciate the review's elaboration on premature liberalization and highlight the importance of IMF programs and policy advice, including in LICs and FCSs, in ensuring that developing countries' financial and institutional development has reached the relevant thresholds that are required for successful liberalization.

Like Mr. Guerra, we also urge careful attention to prevention or mitigation of negative spillovers to LICs and MICs from CFMs that are exempted from the IV for security or other reasons. I agree with others that careful attention to this is needed.

Lastly, we encourage further research on the potential use of CFM/MPMs to mitigate risks as digital money becomes entrenched. And as

noted by Mr. Stephan also, research on the use of outflow CFMs outside of imminent crisis circumstances. Research on policy implications in other areas such as climate change and social and political objectives are also welcome.

*Ms. Lim:*

We issued a comprehensive gray statement, and I will just raise three comments.

First, we welcome the review and agree with the premise of the IV on the benefits of capital flows, while we are concerned that the Fund has not adequately adapted its rulebook fast enough to help countries cope with the changing circumstances. It is apparent that we are operating in a rapidly evolving environment with structural changes taking place amid high global uncertainties. Emerging economies continue to face large and volatile capital flows, and in this context, we need a reboot to avail us of more, rather than less, policy options given the already discussed policy space. As Ms. Mannathoko, Mr. Huh, and Mr. Binzarah put it, it will be counterproductive and more costly for countries to have to wait for financial risks to materialize and potentially trigger a crisis before adopting CFM/MPMs. The Fund as a trusted policy advisor, should provide advice targeted at increasing the resilience of the financial system in advance, even if it means using CFMs. We reiterate the importance of policy measures to respond to impending spillovers from source countries and call for them to be discussed more holistically as part of the toolkit. We cannot afford to wait on another financial crisis to happen before using it to inform the next review.

Second, we cannot let the rigidity of the institution detract from the value of staff-informed assessments in application. Like Mr. Bevilaqua, Mr. Bhalla, and others, we reiterate the critical role of judgment for undertaking assessments. Recent discussions on the EBA and EBA-lite remind us that it is not always as straightforward to apply a cookie cutter methodology across countries. The same challenge should be acknowledged for the IV, especially when it relies on the EBA for policy assessments. Again, the policy discussion should veer towards policy effectiveness and complementarities in line with the IPF, rather than being solely fixated with preconditions and policy hierarchies. In this regard, we support several Directors' call for transparent and clear guidance notes to ensure consistent and evenhanded application of the IV. We positively note that the guidance notes would be shared with the Board when ready and call on staff to include concrete examples and illustrative scenarios from the Fund's experience and provide further elaboration on assessing key concepts like macrocriticality.

Finally, we take note of MD's opening remarks, that the IV is not set in stone and will be refined and informed by research and country experiences. It will be essential to fast track priority areas to further refine the scope of the IV's policy advice. In addition to new areas such as digital money and climate change, we would also like to see resources dedicated towards the use of outflow CFMs outside of imminent crisis, which is certainly pertinent in considering a more balanced set of policy considerations.

*The Chair:*

I want to confirm that we would like to share the Guidance Note with the Board. I take good note of Directors calling on us to bring examples, so it is easier to understand this guidance.

*Mr. Pösö:*

We support the Fund's work in helping countries to manage financial and economic stability risks related to capital flows. As the Chair said too, this review is important to ensure that the Fund's framework evolves with the global environment and with new policy and academic insights. Still, we welcome that the core premises and objectives of the IV remain unchanged, and we continue to stress the importance of strong economic fundamentals, policy frameworks, and institutions as the first line of defense against volatile capital flows. We have issued a joint gray statement with five other chairs; I will make only a few additional comments focusing on the main policy proposal on the use of preemptive CFM/MPMs.

First, we agree that temporary application of preemptive CFM/MPMs on inflows can under certain conditions be warranted for mitigating financial stability risks, in particular in the context of elevated FX mismatches. The case is less convincing for local debt inflows, but we can see merit under narrow and exceptional circumstances, especially for small open economies with shallow bond and foreign exchange markets.

Second, we see some risks that the proposed policy change could open the door for more persistent application of CFMs, and we see it as essential to ensure that these measures are effective for their intended purpose and eliminated when conditions allow. CFM/MPMs should not substitute for market development or necessary structural policies, and the Fund should

work actively with authorities to address underlying vulnerabilities, including through capacity development.

Third, we emphasize the need for considering and being transparent about the different costs of using CFM/MPMs, including potential implications, such as economic distortions and changes to investor behavior and market development. Country-specific gains of preemptive CFM/MPMs should be carefully evaluated in financial stability terms and weighted against both short- and long-term negative side effects.

Finally, it is especially important to ensure that the preemptive CFM/MPMs are not used to maintain or increase a stronger-than-warranted external positions, and we would expect staff to always present a thorough assessment of their appropriateness when used. Going forward, we would also welcome stocktaking Board discussions with country cases on whether the framework works as intended with the possibility to develop or adjust operational guidelines if deemed necessary.

Before ending, let me say a word on communication. We can see that this discussion has concentrated on the changes, which is natural. However, I agree with Mr. Guerra that in our external communication, we should focus on the basic principles of the IV, rather than the changes.

*The Chair:*

I am very keen to hear from Board members' views on communication. This is something we discussed before we came into this room; I appreciate Mr. Pösö's last point, as well as the point on being transparent about both costs and benefits, rather about benefits and costs.

*Mr. Palotai:*

We issued a comprehensive gray statement with five other Directors; I will limit myself to a few key issues, also making some reflections on staff responses, which we appreciated.

While we agree on the use of preemptive inflow of CFM/MPMs under certain circumstances with the explicit aim of preventing elevated stock vulnerabilities from aggravating, we also point to the risks these practices can carry. The respective CFMs should be targeted, temporary, and reversible and not a substitute for the warranted macroeconomic adjustments. We appreciate staff's efforts to clearly outline the criteria to assess the appropriateness of

these measures, but the assessment will inevitably require some judgment, considering among others, the limitations of the External Sector Assessment (ESA). The interdepartmental teams of the Fund will need to carefully evaluate country-specific circumstances in close cooperation with the authorities. We are pleased to read that staff puts a premium on avoiding that these measures become permanent by continually seeking ways of how the Fund can best support its members in the efforts to address the underlying frictions.

We particularly appreciate staff's elaboration on the key concepts that could also support the IV's implementation going forward. Like many Directors, we also believe that the improved clarity on the concept of macrocriticality is of key importance. At this point, however, we also echo Mr. Huh's call for gaining a better understanding of country-specific conditions since macrocriticality can only be determined on a case-by-case basis. Since the IV must continue to evolve to remain relevant, like several Directors, we also call for further research, in particular, attention being paid to the implications of financial innovation and climate change on capital flows and their management.

Finally, I support the comments made just by Mr. Pösö on communication, and we would also welcome additional information from staff on the timeline for preparing the Guidance Note to help members with the appropriate models and tools.

*Mr. Bhalla:*

We broadly agree with the suggestions and particularly welcome incorporating new elements drawn from the IPF workstream. We have issued a detailed gray statement; I would like to make just three points for emphasis.

First, we welcome incorporation of the preemptive use of CFM/MPMs, which has been one of the key messages from the analytically rich IPF workstream, and this has also been recommended by the IEO. Though we agree that preemptive CFM/MPMs should not substitute for market development or structural policies, their use in the interim may be appropriate, as it takes time to reduce the underlying frictions.

Second, even though CFM/MPM provides interim relief to the economies witnessing surge and sudden capital outflows, use of these measures is not without cost. There may be side effects such as misallocation of resources and rent seeking. Given that a surge and reversal of capital flows

may also reflect spillover of macro policy stance of source economies, policy actions need to be coordinated among the recipients and source economies. Not only will this reduce the overall need of adjustment and the economic cost, it would also meet the requirement of fair burden-sharing.

The final point relates to the procedure to determine appropriateness of the CFM/MPMs. In particular, we need to ensure that this use does not exacerbate divergence from the warranted external position. Despite detailed procedures to assess over- or undervaluation of currencies and the proposed use of heatmap analysis of capital flows, subjective assessment will likely still play a critical role; and subjective assessments are invariably a source of disagreement between the staff and the authorities. Efforts need to be continued therefore to bring in more objectivity and to ensure evenhandedness.

*Mr. Dresse:*

I welcome this review and commend staff for the excellent work on the topics of this review, informed by the work on the IPF. Special thanks also to the IEO for the insightful findings of the 2020 evaluation, which facilitated the current review in a highly relevant and timely manner. We issued a joint gray statement with five other Directors; I can be brief with three points for emphasis.

First, the war in Ukraine is likely to increase the fragmentation of the global economy. While geopolitical factors, which are expected to hinder capital flows and liberalization are beyond the Fund's mandate, there is no better moment for the membership to minimize other disruption and spillovers at the national, regional, and global levels.

Second, it is warranted that the permanent change in the IV occur only under periodic reviews. However, the Fund should adapt its policy advice to structural changes in the global economy within the boundaries of the current guidelines. More in general, like Mr. Buisse and others, we encourage staff to make sure that the IMF is ahead of the curve in the identification of crypto assets and digital money on capital flows. It is also very important to consider how climate change and mitigation policies may affect capital flows and their management.

Third, we agree that the IV's guidance on capital flow liberalization remains appropriate and that liberalization is more beneficial if countries have reached certain threshold of financial and institutional development.

Nevertheless, we echo the message from the IV that full liberalization is not always an appropriate goal for all countries, as noted by Ms. Mannathoko. As an example, which is relevant for some countries in our constituency, a premature liberalization of capital flows in dollarized economies may significantly increase financial sector instability, and preemptive CFM/MPMs are often needed in those countries.

*The Acting Chair (Ms. Sayeh):*

Quite a number of Directors stressed this point of capacity development, and I want to recognize it is critical. If we have strong institutions, then, of course, this is the best defense against risk of crisis.

*Mr. Huh:*

We welcome the timely review of IV on capital flows, which are in the scope of the Fund mandate. As we issued a comprehensive gray statement; I would like to highlight a few points for emphasis.

First, we strongly support the proposed policy change to allow preemptive use of inflow CFM/MPMs in some circumstances. Like many other Directors, we see a critical role of staff judgment and flexibility in the application of the criteria. The assessment should be conducted in a broad macroeconomic context, tailored to country-specific circumstances in a forward-looking way. In addition, when authorities are advised to remove the CFM/MPMs, the Fund should advise on alternative policies that could better achieve the same objectives. Considering increasing uncertainties in the global economy, negative spillovers of a preemptive use of CFM/MPMs would be rather limited. These measures can help enhance the resilience of a country's financial system and prevent more effectively the buildup of FX vulnerabilities in advance, which will contribute to global finance stabilization, as well as sound liberalization, as Mr. Dresse already mentioned on this issue.

Second, we reiterate the importance of the macrocriticality assessment and call on staff to reevaluate all preexisting CFMs to take account of their size and potential impact at both the sectoral and aggregate level. The application of the macrocriticality test requires a deeper understanding of the diverse country conditions to provide tailored country-specific policy advice.

Third, we encourage staff to conduct further research on the topics that are emerging as important in the use of CFMs for social and political

objectives, such as housing affordability, remains a priority. We should also consider the effects from digitalization and climate change on capital flows in connection with the other workstream of the Fund. Attention should continue to be given to the use of outflow CFMs outside imminent crisis circumstances.

Finally, staff should be cautious to the narrative on the preemptive use of CFM/MPMs only because of data gaps. Less developed countries could have bigger data gaps but might have more needs of preemptive use of CFM/MPMs because of their higher asymmetric information in the financial market. In that case, appropriate staff judgment should play a critical role considering inevitable data insufficiency.

*Mr. Ronicle:*

My reading of the gray statements and Directors' oral statements so far today is there is broad consensus, not an easy feat on an important topic where views can be strongly held. Let me also commend them for the process with this review, building on both the analytical work of the IPF and the experience of the membership captured in the IEO's review. We issued a detailed gray statement welcoming and supporting the review for all the reasons MD gave at the outset. I do not want to repeat any of those points this morning, but I did want to come in to offer my support to three specific points made by others, including Ms. Shortino in her gray statement and many others today.

First, we agree with her that staff will need to make sure that potential spillovers to third countries with stock vulnerabilities are an important part of the assessment of any preemptive inflow measures. Otherwise, we risk a bad equilibrium in the spirit of the prisoner's dilemma with pervasive capital flow measures as each country reacts.

Second, I agree that country surveillance will need to capture the vulnerabilities that might warrant preemptive inflow measures, and our surveillance needs to provide a consistent track record of advice on how to reduce those vulnerabilities, a point Mr. Guerra also emphasized.

Third, I share Ms. Shortino's hope that the clarification of macrocriticality can help us avoid time-consuming and fruitless discussions of housing measures that are self-evidently not macrocritical.

Finally, I want to fully endorse the staff's response to Mr. Jin's question as to how the Fund is stepping up in response to the IEO's finding that the Fund had been slow to consider the role of source countries. As

advanced economies have moved to tighten monetary policy over recent months, the Fund has diligent in flagging the risks to emerging markets and the importance of source countries getting their communication right. This issue came across clearly in the October WEO and GFSR and in the updates at the beginning of this year, and I expect to see this theme developed further in the April WEO and GFSR. To these examples, I would also add the heavy emphasis the Fund placed on the role advanced economy central banks played in stabilizing financial markets in March 2020, which also served to arrest and even reverse the severe capital outflows we had started to observe in many countries at that time.

*The Chair:*

Mr. Ronicle's point on the role of central banks of advanced economies in March 2020 and how important it is today, is really well noted.

*Mr. N'Sonde:*

We broadly agree with the staff proposals, as indicated in our gray statement, while making specific comments and raising issues. We strongly encourage staff to continue to ensure evenhanded treatment in the application of the revised IV and welcome that the interdepartmental group on capital flows will continue to work with country teams in this regard. That said, we would like to emphasize the following points.

First, we stress the importance of better coordination of capital flow policy actions between source and recipient economies to reduce the need for and cost of adjustment in reference to surges and reversals of capital flows. The Fund should enhance transversal surveillance and advice in intertwined economies to reduce negative spillovers of macroeconomic policies in source economies and fairly share the burden in regulating capital flows and addressing their volatility.

Second, regarding the special treatment for certain measures, like other Directors, we emphasize that relying on the members' representation that CFM is adopted solely for reasons of national or international security poses a serious risk of misuse. In the current context of rising geopolitical tensions, more vigilance is required to prevent abusive measures or at least identify them.

Third, we highly value the strengthening of international cooperation against tax avoidance and evasion, which is an acute issue for LICs in

particular. We note from the proposal the necessary transition that tax measures constituting CFM must be based on or implemented in accordance with certain agreed international cooperation standards in order to be excluded from the assessment of appropriateness under the IV. In this regard, we believe that the ongoing international cooperation effort could be more inclusive for all members' concerns to be addressed and the related standards to be universally accepted.

Finally, for such strategic issue, we underscore the importance of a clear and granular staff guidance note to minimize unwarranted interpretation. Equally important is capacity development and appropriate outreach to low-capacity members to ensure good understanding of the revised IV. In this regard, we welcome the expected work with area departments to identify members' needs and incorporate them in CD plans.

*Mr. Fanizza:*

We issued a gray statement with other five European colleagues. I am not going to reopen issues that have been discussed at length, but I would like to focus a bit on the implementation of the IV, what we are going to do next. I fully agree with Mr. Bevilaqua and Ms. Lim that in the implementation of the IV, judgment is bound to play a critical role. It is the sheer complexity of the proposal and the way we go is difficult to imagine since we can do only based in data. Data are very important to inform judgment, and I am not that sure that actually—we had a Board discussion on data recently, and I am not sure everybody here agrees to provide data up to the requirement of this review. I hope we will end up doing that. That is important, and we should try to do our best to avoid falling into labeling discussions that in the past have been hard to define seriously our capacity to interact. To authorities and some part of the constituency, we pay that price. It is very important to be concrete.

The conceptual approach is very interesting, very well done, and very well developed. I would have liked to see a bit more of concrete examples. In particular, the idea of the two-step approach in deciding whether the inflows produce systemic risks, I would like to see applied in concrete, maybe in a couple of past historical experiences.

Finally, it is very strange that we discussed this review in a moment in which maybe the most contentious issues on capital flows is the issues of CFMs on non-resident purchases of real estate properties. I fully understand that staff could not do that, but maybe it is an issue on which soon we need to say something.

*Mr. Mozhin:*

As I am probably the only one in this room, certainly among Board members, who participated in the original discussions and drafting of the IV a decade ago, I am very glad about the main conclusion of the current review, which is that the IV has served the membership well and that there is no need for a major redrafting or reconsidering of the key elements of the IV. I am very glad to see this conclusion.

I do not need to make a long intervention since most of the points I would want to make have already been made by Mr. Guerra, Mr. Bevilaqua, Ms. Mannathoko, Ms. Lim, Mr. Bhalla, Mr. Huh, and most recently, Mr. N'Sonde. I see the few changes introduced to the IV. The prominence given to the introduction of CFMs on the basis of national or international security is something which can be easily abused. Of course, we now live in the world of proliferating financial sanctions which are becoming more and more severe, more and more draconian; and in this respect obviously I would want to underline that such CFMs or sanctions introduced on the one side should be expected to be responded to by the introduction of CFMs on the other side. There should be an evenhanded treatment of those CFMs sanctions and counter sanctions.

Now, the question I have to staff is about how this IV was applied in the recent crisis in Argentina, to what extent the IV was relevant to the developments in the country both in the period of high inflows and also in the period of massive outflows and abrupt sudden stop. This is something I would be interested to hear from staff.

*Mr. Jin:*

Fund's advice on capital flows has been evolving over the years, and we welcome staff's efforts to modernize the IV framework taking into account the IPF—the IEO report also. We have issued a comprehensive gray statement; I would like to limit myself to a few points today.

First, while we agree that the principles underpinning the IV remain valid, when evaluating the appropriateness of CFM measures, it is necessary for the Fund to take into account the specific national conditions, institutional arrangements, and the policy space of each country, and make a comprehensive judgment. We noticed staff's recognition that the introduction of IV does not imply the Fund has extended its jurisdiction to capital account.

Second, we reiterate the importance that capital flows should be regulated at both ends. That means both the source and the recipient countries, and monetary policies in advanced economies played one of the more important roles in global capital flows. Staff needs to step up their analytical work in the upcoming flagships in the future surveillance work. There needs to be more details on how imminent crisis circumstances are identified in practice given that crises are in nature difficult to predict, and there needs to be significant staff judgment the Fund would need to eliminate stigma impact and ensure consistency and evenhandedness.

Lastly, as I mentioned in the informal Board meeting last year, the proposals related to national security should have a mechanism to avoid abuses. We also stress that staff should provide analysis on the related spillover effects.

*Mr. Trabinski:*

I would like to briefly highlight the four key points.

First, like many others, we strongly agree that the core principles underpinning the IV remain valid and should therefore remain unchanged. The associated risks, like large and volatile capital flows, should be addressed by implementing sound macroeconomic policies, as well as financial supervision and regulation. As stressed by Ms. Shortino in her gray statement, the IV should constitute the basis for consistent advice also on significant benefits of capital flows. In this regard and looking a little bit more broadly, we support Mr. Guerra's and Mr. Pösö's points that it would be important in our communication from this meeting to focus on basic principles and in this context carefully present changes to the IV.

Second, we welcome that only a select few changes to the IV are proposed now. Theoretical and empirical advances in research on capital flows since the IV was adopted ten years, the insight from staff's work on IPF, and recommendations from the IEO evaluation all need to preserve the delicate balance of use.

Third, we underscore the need for strong safeguards to ensure that preemptive CFM/MPMs are not used inappropriately. These measures should be temporary, targeted, and should be unwound as soon as the factors that justified their use no longer exist. In this context, we are of the view that local currency debt vulnerabilities do not generally justify preemptive CFM/MPMs

given the availability of better suited ex-post policy instruments, as also highlighted by Mr. Tanaka.

Fourth and finally, we should ensure that important elements that serve as the basis for staff judgment on the appropriate use of preemptive CFM/MPMs are assessed properly. In this regard, we call for continued work to enhance the External Sector Assessment methodology, a point also made by Ms. Lim and Mr. Tanaka. In our view, this would be important, as the exchange rate assessments under the ESA will play a key role in evaluating the appropriateness of preemptive inflow CFM/MPMs.

*Financial Counsellor and Director of the Monetary and Capital Markets Department  
(Mr. Adrian):*

I would like to react to some of the issues that Directors have raised, and then other staff are going to address additional issues subsequently.

The overall objective of the IV is to help countries reap the benefits of capital flows while managing the associated risks. Our member countries continue to gradually move toward greater liberalization, which reflects the recognition of its benefits while bearing in mind that the appropriate degree of liberalization is not the same for all countries. Legacies from the pandemic, the ongoing geopolitical tensions, and normalization of monetary policy in advanced economies are posing significant challenges to our membership in terms of managing capital flows. The reviewed IV will make sure that our advice on these matters is up to date and of value to our members.

As noted by a number of Directors, the use of preemptive CFM/MPMs should not substitute for market development or structural policies that can address the underlying frictions and thereby reduce the need for relying on CFMs. We agree that the Fund has an important role to support the membership's efforts in this regard and promote conditions that allow for safe liberalization of capital flows. Let me emphasize that staff will continue to work closely with member countries, including through CD, to facilitate market development and implement structural policies. We will continue to provide technical assistance on issues such as developing local currency bond markets, boosting the credibility of market economic policy frameworks, advising on safe capital flow liberalization, and developing sound financial supervision and regulation, including adequate stress-testing tools.

In addition, we are also providing technical assistance on the development of IPF models to facilitate countries' use of the policy rate,

exchange rate flexibility, FXI, MPMs, CFMs, and CFM/MPMs in a consistent way.

Directors also discussed the growing role of non-bank financial institutions in intermediating capital flows and the importance of mitigating the related risks of greater capital flow volatility and adverse macrofinancial developments. The pandemic-driven outflows in March 2020 were a very strong reminder of such risks. MCM is working closely with other international organizations and standard-setters, including the

FSB and the BIS, to develop policies and regulations to mitigate risks in the NBFIs sector, including those resulting from the cross-border activity. As in the past, we will keep the Board updated on this work as it progresses.

Our efforts to improve and broaden international cooperation will continue. As a follow-up to the IEO report on the Fund's advice on capital flows, we are working to deepen our cooperation with the OECD on a range of issues related to capital flows. As the Managing Director and Ms. Pazarbasioglu have stressed, we will ensure that communication is balanced and emphasizes the benefits of capital flows. Of course, strong communication is helpful for enhancing policy effectiveness and for strengthening accountability. We fully concur with Directors that the Guidance Note is critical. We will work on the Guidance Note immediately after this meeting and plan to complete it in coming months.

Finally, let me note that staff are already working on issues left out of the scope of this review, which Directors emphasized would be important going forward and which the Managing Director mentioned in her opening remarks. Let me touch briefly on one topic, namely capital flow issues related to digitalization.

Fintech notes are coming out that examine the implications for the design of CFMs, of rapid growth in crypto assets, stablecoins, and central bank digital currencies (CBDCs). We have committed to an ambitious research agenda on this issue, and we look forward to discussing them with the Board at a later stage.

*The Economic Counsellor and Director of Research (Mr. Gourinchas):*

Let me say a few words on how the review of the IV is related to the work on the IPF and the research agenda.

We launched the IPF research agenda in 2019 to expand the frontier of current knowledge and provide a systematic analytical framework for the optimal use of multiple tools, recognizing that the world is far from the frictionless one in the simple Mundell-Fleming model and that several market imperfections may be important at the same time for many countries in our membership. Our key finding has been that the optimal policy combination depends on the specific shocks and country characteristics.

Now, how have the IPF findings been incorporated into Fund policy? The IPF's finding on the use of FX intervention was not restrained by the IV, and the staff Guidance Note has already been issued on it in December 2020. The IPF's findings on the use of CFMs and CFM/MPMs during inflow surges were consistent with the IV with the value added that the IPF helps inform in more detail the staff judgment in implementing the existing elements of the IV. However, the IPF's finding on the use of preemptive CFM/MPMs to contain stock vulnerabilities outside inflow surges was not deemed appropriate in the IV, and we have proposed to modify the IV to enhance consistency between policy and the latest research.

The IPF work agenda will continue as the questions it tackles are at the core of the Fund's advice to its membership. Staff will provide advice as appropriate on how to combine preemptive CFM/MPMs with other policy tools. Therefore, the change in the IV would enable staff to provide the appropriate policy advice to members in line with the most recent developments in the literature.

*The staff representative from the Legal Department (Ms. Rendak):*

I would like to talk about this issue of security-based CFMs. We heard broad support from the Directors for staff's proposal to exclude certain measures, including those adopted for national and international security reasons from the general assessments of appropriateness under the IV. At the same time, we also heard Directors emphasize that these measures should be used judiciously and that they may have significant effect, economic impact, that the Fund should cover. There was a question also whether security representations can be misused. These are all very valid concerns, and I believe we addressed some of those concerns in our written responses to Directors' questions, but let me just reiterate a few points here.

As explained in the paper, our proposal builds on the approach that has served the Fund well for several decades, and that is the streamlined procedure for approval of exchange restrictions introduced solely for reasons

of national and international security under Decision 144. Under the staff's proposals for CFMs introduced for similar reasons, staff would not challenge the authorities' representation and could simply convey this in the staff report, while also assessing the economic implications of such measures where they are macrocritical or if they generate economically significant outward spillovers. Adopting such approach would be consistent with the longstanding principle recognized by this Board in the past that the Fund does not provide a suitable forum for discussing political or military considerations that may lead to the imposition of certain policies for reasons of national or international security.

Now that said, we do acknowledge that relying on the member's representation raises concern that the meaning of national security could be stretched and maybe misused. In such cases, because the measures would fall outside of the scope of the ideal assessment of appropriateness, this may, indeed, be an issue. However, because the discussion of the impact of macrocritical measures will still be included in the staff report, we hope that this will provide the safeguard against the abuse or misuse of such representation because the member may not want to be seen as using the security justification in an unjustifiable manner. As explained in the paper, the Executive Board can always express views with regard to the authorities' representation if it disagrees with it and express concerns about it.

We feel that this is a pragmatic approach, and in staff and management's view it strikes a good balance between allowing the Fund to cover the economic impact of security-based CFMs where it is appropriate under the general Fund surveillance framework while also using transparency to discourage misuse of such labeling.

*The staff representative from the Strategy, Policy, and Review Department  
(Mr. Zettelmeyer):*

I will answer Mr. Mozhin's question on the application of the IV to Argentina in 2018-2019. The answer is that the imposition of outflow controls in the setting of Argentina back then would have been consistent with the current IV before the change that we are considering today, as these were imminent crisis circumstances. As to the staff's advice and the authorities' reactions, this was covered in some detail in the Ex-Post Evaluation (EPE); there were discussions on the imposition of outflows controls, at least in the context of contingency measures, and the authorities were not open to these types of measures until the fourth review, and by that time, it was too late.

With hindsight, it was a mistake not to have imposed outflow controls in this program.

Maybe just to add one point. The articles give us the flexibility to require CFMs in program conditionality. This has never been used, and the reason that it has never been used, as far as I understand it, is that in general—and the case of Argentina might be a rare exception—it is usually the authorities that are more proactive at imposing such controls in a crisis situation, and then the Fund would accept them in the context of a program, but no conditionality would be attached. It is not necessarily the case that this will always be like that; therefore, in principle, from a legal and a policy standpoint, outflow controls in the context of Fund programs are conceivable, and just because they have not been used in the past and were not used in the case of Argentina 2018-2019 does not mean that they will not be used in the future.

*The Chair adjourned the discussion.*

## ANNEX

- Gray Statements
- Staff's Responses to Executive Directors' Technical Questions
- Constituency Codes

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GRAY/22/786

March 15, 2022

**Joint Statement by Mr. Buissé, Mr. Fanizza, Mr. Hilbers, Mr. Palotai, Mr. Pösö, and Mr. Stephan on Review of the Institutional View on the Liberalization and Management of Capital Flows (Preliminary) Executive Board Meeting March 21, 2022**

We welcome the Review of the Institutional View (IV) on the Liberalization and Management of Capital Flows, informed by the advances in research, notably the work on an Integrated Policy Framework (IPF), the findings of the 2020 Independent Evaluation Office (IEO) on IMF Advice on capital flows and staff experience with the implementation of the IV. While the main elements of the IV remain valid, we welcome the policy changes proposed in the Review of the IV. This contributes to fine-tuning the IMF's advice on the use of capital flow management measures (CFMs). We also welcome Staff's clarification that the IV does not modify IMF members' obligations or Fund policies under Article VIII, Sections 2 (a) and (3).

We agree with Staff that sound domestic macroeconomic frameworks as well as appropriate exchange rate regimes and sound financial regulation and supervision constitute the first line of defense to protect against excessive capital volatility. CFMs, while useful in certain specific circumstances, should not substitute for necessary macroeconomic adjustment and should not serve to keep exchange rates undervalued.

In general, measures addressing capital flow volatility should be targeted, temporary and reversible. In situations where capital flows pose financial stability risks, CFMs may be warranted as part of a broader approach to protect the stability of the financial system. Any use of these tools should be considered in the context of their broader implications.

We welcome the guidance provided in the Review of the IV on the assessment of macro-criticality with the aim to determine in which circumstances staff should assess the appropriateness of a CFM in accordance with the criteria established in the IV. We note however that these determinations continue to involve a substantial amount of judgement.

Going forward, further analysis remains necessary to understand the effectiveness of various instruments as well as the implications of their joint use with other policy instruments. Moreover, we invite Staff to assess the implications of financial innovation, including in the

area of crypto assets and digitalization, and of climate change for capital flows and their management. Further analysis is also necessary to assess the implications of financial globalization on inequality and how to take this into account when assessing the potential need for CFMs.

We welcome the proposed policy change provided by Staff in the Review of the IV, on the appropriateness of the use of CFM/macprudential measures (MPMs) on inflows in a pre-emptive manner, i.e., in the absence of an inflow surge, to prevent a further accumulation of already-elevated foreign exchange mismatches and the associated systemic financial risks. We also agree that pre-emptive CFMs on inflows may play a role in the presence of financial vulnerabilities in the private sector from accumulated external debt stocks in local currency, when MPMs are insufficient and ex-post policy instruments may be impeded in preventing a sharp tightening of financial conditions during a capital flow reversal.

We agree with the proposed change introduced in the Review of the IV that the Fund should refrain from assessing the appropriateness of certain measures classified as CFMs, under the IV when introduced for national or international security reasons (a motivation that should be used sparingly), for Anti Money Laundering (AML) and Combatting the Financing of Terrorism (CFT) purposes. Further, special treatment should also be granted to measures, classified as CFMs, which are consistent with internationally agreed prudential standards, such as the Basel III framework, or with international standards against tax avoidance and evasion. These measures could be discussed in bilateral surveillance, when considered "macro-critical", or as part of multilateral surveillance if they generate significant outward spillovers.

In managing capital inflows, countries should aim to minimize distortions and spillovers at the national and global levels, which creates a strong rationale for international co-operation. To that end, measures should be transparent so that other countries can assess their effects and potential consequences. Clear communication of the policy objectives and the specific measures being used can help avoid disrupting market and public expectations. We welcome the guidance proposed in the Review of the IV on how to identify capital inflows surges, based on quantitative indicators, high-frequency capital flows data as well as on macro and financial conditions. We invite Staff to make further progress in this area, and to share it with member countries on a regular basis. We also welcome that measures that do not discriminate by residency are preferred.

We agree with Staff that crises are by nature difficult to predict, and, in this regard, we welcome the proposed clarifications on how high frequency data and qualitative information can contribute to the identification of the development of crisis circumstances, in order to better understand under which conditions the use of CFMs could be justified. We invite the Staff to make further progress in this area as well, and to share it with member countries in the forthcoming years.

We agree that the sequencing of liberalization measures deserves careful attention to avoid premature liberalization. In this regard, we welcome the clarifications presented in the

Review of the IV on how to identify instances of premature liberalization, through the assessment of whether the removal of CFMs has outpaced the capacity of the economy or the financial system to safely handle the resulting flows based on a wide range of macro-financial indicators. In terms of sequencing, owing to the benefits and risks occurring at different stages of the process, there are arguments in favor of pursuing first liberalization of "genuine" foreign direct investment (FDI) inflows linked to real economic activity in the recipient country, followed by other long-term flows, and subsequently short-term flows.

As with other policies, CFMs, and pre-emptive CFMs on inflows, should be subject to periodic reviews (and/or explicitly linked to macro-financial target variables), to ensure that the CFM/MPM continue to be the appropriate policy tools, and that are removed once financial vulnerabilities have dissipated. The longer CFMs or CFM/MPMs are being kept in place, the more likely it is that the distortive effects on the economy will materialize.

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GRAY/22/787

March 16, 2022

**Statement by Mr. Andrianarivelo, Mr. N'Sonde, and Mrs. Bah on Review of the  
Institutional View on the Liberalization and Management of Capital Flows  
(Preliminary)  
Executive Board Meeting  
March 21, 2022**

We thank staff for the comprehensive, insightful papers and notes and for their hard work to adapt the Fund's policies to the evolving global environment, drawing on recent research, analyses and experience. It is important to recognize that, while capital flows liberalization is generally beneficial to both source and recipient countries, notably by improving investment financing and resource allocation, the costs may also be damaging in some conditions, due to the instability caused by capital flow volatility and possible sudden reversals that may trigger disruptive financial crises. We appreciate the analyses in Background Note 1 which make evidence of those benefits and costs. We, therefore, generally support the proposed policy changes to allow for more flexibility in the management of capital flows under certain specified circumstances while preserving the premises and objectives of the Institutional View (IV). In particular, use of CFMs even when justified should not substitute for sound macroeconomic policies.

**We endorse the proposed change to the IV to consider preemptive CFM/MPMs subject to the considerations discussed in Section II of the report.** We recognize that, even in the absence of a capital inflow surge, excessive foreign exchange mismatches, domestic credit booms or asset price bubbles may bring about vulnerabilities that can be a source of systemic financial risks. The use of preemptive CFM/MPMs on inflows is likely to help mitigate the risks associated to those vulnerabilities by reducing FX mismatches and the cost of capital flow reversals. Managing these risks requires strong capacity and policies as well as close cooperation between source and recipient countries. As highlighted by the literature on CFM/MPMs, adequate controls on capital inflows can be successful in discouraging riskier short-term debt flows and encouraging longer-term more stable direct investment, which

result in safer external liability structures and stronger economic resilience during financial crises. Besides, consistent with the IV objectives, we agree that preemptive CFM/MPMs on inflows should only be a supplement to warranted macroeconomic policy adjustments and macroprudential measures when conventional stabilization policies are ineffective. Likewise, the structural reforms needed to strengthen the financial markets should not be left out for easier choices that may cause adverse effects on the allocation of resources. It is equally important to emphasize that liberalization is less beneficial and riskier when implemented prematurely in economies with low levels of financial and institutional development. Therefore, continuing to implement planned and well sequenced liberalization processes is critical to ensure resilience and sound financial markets, particularly in EMDEs. *Staff's elaboration on how countries should proceed in imposing preemptive CFM/MPMs without compromising their liberalization plans would be highly appreciated.* As regards the assessment method of the appropriateness of a preemptive CFM/MPM, we concur that using the level of systemic financial risks, the relevance of the control measures to address the identified risks, and the external position, is pertinent and should help target and tailor specific measures that can address risks effectively while minimizing costs and side effects including contagion in international financial markets. *That said, adroitness is still required in determining whether the CFM/MPM is used to gain an unfair competitiveness advantage. Staff's view is welcome.*

**We can go along with the proposal on the special treatment of measures introduced solely for national or international security reasons while calling for vigilance to prevent the abuse of such special treatment.** In the context of increasing geopolitical and trade tensions, as well as concerns on national security, the current Institutional View seems to be outdated and should be adjusted to accommodate these heightened challenges. However, we should remain vigilant on the compelling need to maintain evenhandedness and prevent misuse, as it is sometimes quite difficult to draw a clear line between cases involving national security risks and those involving economic motivations. In fact, capital inflow screenings introduced or expanded in some countries have had significant adverse spillovers on other economies, while leaving little room to assess their appropriateness and judiciousness. *Staff's comments on this issue would be welcome.*

**We concur with the proposal on measures based on internationally agreed prudential standards, in line with the Fund's regular calls for international cooperation in this area.** We agree that, given the Fund's engagement for further international and regional cooperation to expand reciprocity of MPMs, staff would not assess, under the Institutional View, the appropriateness of measures implemented in accordance with the Basel prudential

standards, and CFM/MPMs implemented in line with internationally agreed prudential standards, including mutually agreed reciprocity arrangements.

**We also agree that the appropriateness of AML/CFT measures that are considered CFMs and are implemented in accordance with FATF standards should not be assessed under the IV.** The development of cross-border capital flows and the associated risks of money laundering and terrorist financing has warranted increased AML/CFT measures that may constitute CFMs under the IV. We appreciate that the Fund recognizes the valuable contribution of the AML/CFT framework in combatting ML/TF risks and related offences including corruption, drug trafficking and tax crimes, across member countries and financial institutions, including in LICs.

**We attach a high value to the recognition that measures that levy discriminatory taxes consistent with certain international cooperation standards against the avoidance or evasion of taxes should not be assessed for their appropriateness under the IV.** These measures are coherent with the Fund's deep-rooted engagement on international efforts to combat tax evasion or avoidance and strengthen tax transparency standards and compliance. This is critical for LICs as the main victims of tax dodging, with billions in tax revenue being lost notably from natural resource sectors because of large multinational enterprises (MNEs) exploiting gaps and mismatches in tax systems. This foregone revenue, which often outweighs the amount of development aid given to the LIC in the same period could have been invested in much needed infrastructure, schools, or hospitals, especially during this challenging health crisis. However, considering institutional and administrative capacity gaps and the lack of financial resources, levying discriminatory taxes on powerful multinational enterprises may be challenging for poorer members. *Staff's comments on how LICs are implementing measures through international cooperation to enhance tax compliance by MNEs, and better combat tax avoidance or evasion are welcome.*

**Going forward, we encourage staff to pursue reflection on other important topics, including the use of CFMs for social objectives and the effects of digitalization and climate change on capital flows.** Such goals require timely adaptation of Fund policies to contemporary challenges facing the membership.

**We appreciate the additional guidance on the concepts of macro-criticality, capital flow surges, imminent crises and premature liberalization along the lines suggested in the report.** This will help underpin policy advice under the IV. On macro-criticality, we emphasize the need to be more holistic in the scope of sectors that could meet this criterion and mindful of country specificities. Regarding premature liberalization, the Fund should strengthen its advice to members on conditions to be met prior to capital liberalization, with a

view to avoid the reputational and other risks associated with “stop-and-go” policies such as the reintroduction of CFMs albeit temporary.

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GRAY/22/789

March 16, 2022

**Statement by Mr. Jennings, Mr. O'Brolchain, and Ms. Cunningham on Review of the  
Institutional View on the Liberalization and Management of Capital Flows  
(Preliminary)  
Executive Board Meeting  
March 21, 2022**

We thank staff for their in-depth analysis and constructive engagement with the Board and outreach to our office on this important topic.

**We strongly agree with the finding that the core principles of the Institutional View remain valid, and few changes are needed.** Open capital accounts featuring free and non-discriminatory capital flows bring substantial benefits to both recipient and origin countries. We welcome that this principle is evident throughout the Review, and we appreciate the evidence on the benefits and costs of capital flows provided in Background Document 1. We also welcome staff's clarification that the IV does not modify IMF members' obligations or Fund policies under Article VIII, Sections 2 (a) and (3).

**We support the proposed change to consider pre-emptive CFM/MPMs, subject to the considerations discussed in Section II.** We agree with staff that sound domestic macroeconomic frameworks, as well as appropriate exchange rate regimes and sound financial regulation and supervision, are the first line of defence to protect against excessive capital volatility. While pre-emptive CFM/MPMs may be appropriate to mitigate potential risks in certain clearly defined circumstances, we would stress that they should not substitute for necessary warranted macroeconomic adjustment and structural reforms, and they should not serve to justify keeping exchange rates undervalued. It is important to allow adjustments to occur so that relative prices align with fundamentals, and to ensure that short-term interventions do not lead to a build-up of longer-term imbalances. In managing capital inflows, countries should aim to minimise distortions and spill-overs. Measures addressing capital flow volatility should be targeted, temporary, and reversible. Where capital flows pose financial stability risks, CFMs may be warranted as part of a broader approach to protect the stability of the financial system.

**In placing the IV in the broader context of macro-financial stabilization policy, we would encourage the Fund to be more explicit about the preferred hierarchy of policies,** where MPMs are used first, CFM/MPMs that discriminate by currency are used second, and CFM/MPMs that discriminate by residency are third, with countries only resorting to the last category if the first two policy options have been exhausted. Background Note 3 mentions that “Where measures that do not discriminate by residency are available and effective, they should be preferred”, but we think this point would warrant mentioning in the main document.

**We note that staff spell out in paragraph 65 treatment of cases where CFMs/MPMs are applied to FX purchases between residents.** We agree that such policies should be treated as CFMs/MPMs and assessed under the IV. CFMs/MPM policies that target currency rather than residency could be preferable if the underlying vulnerability is FX mismatch or other sources that would be best addressed by targeting currency specifically. These potential strengths would need to be balanced with other considerations, such as that targeting currency would likely have more limited impact on balance of payments, and that targeting currency would ensure an equal treatment between residents and non-residents. This view is similar to some of the material in Background Note 3, but we think they also merit inclusion in the main Review document.

**Capital flow measures should also be transparent so that other countries can assess their effects and potential consequences.** Clear communication of the policy objectives and the specific measures being used can help avoid disrupting market and public expectations. We welcome the guidance proposed in the Review of the IV on how to identify capital inflows surges, based on quantitative indicators, high-frequency capital flows data, as well as on macro and financial conditions. We invite the Fund to make further progress in this area and to share it with member countries in the forthcoming years.

**We welcome the guidance provided in the Review of the IV on the assessment of macro-criticality,** but we find that these determinations continue to involve a substantial amount of judgement.

**We also agree that the sequencing of liberalisation measures deserves careful attention to avoid potential premature liberalisation.** In this regard, we welcome the clarifications presented in the Review of the IV on how to identify instances of premature liberalisation.

**We also agree with the proposals in Section III on the special treatment of cases described therein,** including for national or international security reasons, for AML/CFT purposes, and for international standards and agreements such as Basel III. As countries have already agreed to these arrangements, a negative assessment of any of their policies through the IMF could undermine the global support for these agreements. Nonetheless, we would emphasize that the exclusion based on national or international security reasons should be used sparingly. *Do Staff intend to add any further detail on what constitutes an emergency use of CFMs, especially given the current geopolitical sanctions?*

**As with other policies, CFMs and pre-emptive CFMs on inflows should be subject to periodic reviews** (and/or explicitly linked to macro-financial target variables). This is to ensure that the CFM/MPM continues to be the appropriate policy tool, and is removed once those financial vulnerabilities have dissipated.

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GRAY/22/790

March 16, 2022

**Statement by Mr. Huh, Ms. Johnson, and Mr. Yoo on Review of the Institutional View on the Liberalization and Management of Capital Flows  
(Preliminary)  
Executive Board Meeting  
March 21, 2022**

We thank staff for the comprehensive review paper which provides rigorous analysis and careful proposals on Fund policies regarding capital flows management measures. The Institutional View on Liberalization and Management of Capital Flows (IV) is central to the Fund mandate. We remain of the view that the IV should not be a doctrine nor a view set in stone but should evolve. In this vein, we take positive note that this review builds on the IEO report on IMF Advice on Capital Flows, research under the Integrated Policy Framework (IPF) and staff's experiences. **We broadly support staff's proposals and provide a few comments for emphasis.**

**We strongly support the proposed policy change to allow for the use of preemptive inflow CFM/MPMs in some circumstances.** Building on the work of the IPF, staff provides a strong case for the preemptive use of CFM/MPMs even in the absence of a capital inflow surge, where accumulated stock vulnerabilities arising from FX mismatches may increase the likelihood of sudden capital outflows and generate significant economic and financial instability which conventional policy instruments may not effectively address. We also acknowledge that, in narrower cases, the accumulation of external debt denominated in local currency may increase systemic financial risks. The proposed policy change will help staff provide more unified and high-quality advice to the membership while effectively leveraging the IPF. *In this respect, we would like to hear how the policy change under IV will feed into the existing interim staff guidance for the IPF. Staff's comments are welcome.*

- **While we appreciate efforts by staff to clearly outline the criteria to assess the appropriateness of preemptive use of CFM/MPMs, we are concerned about the**

**possibility of the criteria being applied overly prescriptively.** Staff should acknowledge that it is inherently difficult to make an objective and uncontroversial assessment on the three criteria outlined in the paper. We see a critical role for staff judgement and flexibility in the application of the criteria. In addition, given the limited availability of data such as hedging, staff needs to be informed by members' experiences with, and lessons learned from, the use of existing CFM/MPMs. The assessment must be designed in a way that can facilitate constructive discussions between staff and authorities and ensure proper judgement in the broader context of country-specific circumstances. We also stress that when staff advises authorities to remove CFM/MPMs, alternative policies that could better achieve the same objective should be discussed substantively.

- **FX vulnerabilities should be carefully assessed in a holistic manner with consideration given to the historical context and country specific circumstances.** We welcome the proposed two-step approach to assess systemic risks from FX mismatches. As rightly noted by staff, other frictions and vulnerabilities such as high leverage can amplify FX vulnerabilities. Given heterogeneity in economic conditions and financial market development across countries, staff should carefully consider a broader set of relevant indicators and the FX-related context of individual countries to assess the case for preemptive CFM/MPMs.
- **We encourage staff to set conditions for preemptive CFM/MPMs in a forward-looking manner.** The use of preemptive CFM/MPMs can be appropriate when the FX mismatch is not assessed as high now but could reasonably be expected to be high without relevant measures. Preemptive CFM/MPMs can be more effective if used before FX vulnerabilities intensify. It is desirable to increase the resilience of the financial system in advance and prevent the build-up of systemic vulnerabilities in the first place. In this regard, we welcome staff's intention to use a stress test under a reasonable adverse scenario as a preferred approach to the assessment of FX vulnerabilities.
- **We also acknowledge the importance of ongoing work on structural reforms.** Reforms to build the resilience of financial markets and the associated infrastructure could, over the longer term, help to mitigate some of the vulnerabilities addressed by CFM/MPMs. However, reforms will take time to implement and should be accompanied by guidance from the Fund.

**We broadly support the staff proposal to allow a special treatment for certain categories of measures.** We note that staff will not assess the appropriateness under the IV of measures introduced solely for national or international security reasons, measures adopted pursuant to internationally agreed prudential frameworks, AML/CFT measures

consistent with international standards and measures for international tax cooperation standards, although they are classified as CFMs when the criteria are met and discussed in surveillance when macro-critical. This special treatment is understood as a prudent decision to avoid an assessment in an area (national security) outside the Fund's jurisdiction and prevent inconsistencies in assessments of internationally agreed standards in those areas such as macroprudential policy, AML/CFT and taxes.

**We welcome greater clarification on the guidance on some concepts, such as macro-criticality, capital inflow surges, imminent crises, and premature liberalization, and operational issues.** This will facilitate the implementation of the IV and help staff provide appropriate policy advice under the IV in accordance with country specific circumstances. In particular, we reiterate the importance of the macro-criticality assessment and call on staff to re-evaluate all pre-existing CFMs noting staff's previous mechanical application of the macro-criticality test. The application of the macro-criticality test requires a deeper understanding of country conditions, to provide tailored country-specific advice, which is critical for securing traction with authorities. Mechanical categorization of measures work against staff as it places disproportionate focus on measures under the IV, crowding out advice on other more important issues and undermining advice on viable alternative measures. Staff should seek to understand the purpose of a measure, and assess its effectiveness, including the expected or actual impact on capital flows targets, in the broad macroeconomic context. Here we note that some measures may be critical at a sectoral level but may have a limited impact on aggregate capital flows and therefore fall short of being macro-critical.

**We encourage staff to continue analytical work on topics that are not tackled in this review to strengthen the evidence base for policy advice in these areas.** Further research needs to be coordinated with other workstreams to ensure efficiency, coherence, and attention to resource constraints. Of those listed, we consider the use of CFMs for social or political objectives as the most important priority and we continue to support the IEO view that, in some cases, capital account measures have a valid role to play in addressing social issues such as housing affordability. We also support further research into the distributional impacts of capital flow liberalization, the potential cross-border spillovers (both the source and destination of financial spillovers) from capital account measures and macroprudential tools, and a role of source countries to mitigate global financial distress. Attention should continue to be given to the use of outflow CFMs outside (imminent) crisis circumstances.

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GRAY/22/791

March 16, 2022

**Statement by Ms. Mannathoko, Mr. Ismail, Mr. Cham, Mr. Damane, and Ms. Nainda on  
Review of the Institutional View on the Liberalization and Management of Capital Flows  
(Preliminary)  
Executive Board Meeting  
March 21, 2022**

We thank staff for the extensive consultations during this Review of the Institutional View on Liberalization and Management of Capital Flows (IV), and for the informative set of reports and well-founded proposals. We are broadly aligned with the thrust of the recommendations and share the view that these refinements will help to maintain the IV's policy relevance, effectiveness and traction with members.

**Policy on preemptive CFM/MPMs on inflows**

We support the proposed policy change with the introduction of IV guidance to advance the use of pre-emptive capital flow measures as part of the macroprudential toolkit (i.e. CFM/MPMs), helping to curb the impact of excessive flows in emerging market and developing economies. It would be counterproductive and more costly, for countries to have to wait for financial risks to materialize and potentially generate a crisis, before adopting CFM/MPMs.

Since macroeconomic and structural reforms related to capital market infrastructure and instruments can take much longer to implement compared to introducing capital flow management measures, the use of pre-emptive measures will be of benefit to emerging market and developing economies (EMDEs) as their domestic systems develop or adjust. There is also a strong case for pre-emptive CFM/MPMs to deal with capital flow vulnerabilities stemming from the increasing role played by non-bank financial intermediaries (NBFIs) in capital flows. During the pandemic, liquidity mismatches in some NBFIs holding illiquid assets on one hand, while promising short-term redemptions to investors, contributed to selloffs in government bonds and withdrawals from repo markets. We also appreciate the attention given to general sources of vulnerability in the analysis, including stocks of external assets and liabilities and currency mismatches that can arise.

On spillovers from advanced economies (AEs), while we note staff's indication that the Integrated Surveillance Decision requires staff to explore and suggest alternative policies to address systemic financial risks with smaller negative spillovers, *we seek staff's assurance*

*that the assessment of appropriateness of pre-emptive CFMs/MPMs accommodates the fact that drivers of spillovers from AEs to EMDEs and the related capital flow deflections, are critical for retaining pre-emptive CFMs for some countries.*

### **Elaboration of important policies and concepts**

We appreciate staff's elaboration of IV policy relating to the **identification of imminent crisis circumstances**, we note that the treatment of worrying situations characterized by eroding reserves, sharp exchange rate depreciation, or declining economic activity amidst tightening financial conditions; that point to a likely sharp reversal of capital inflows and development of a crisis, has at times seemed subjective (dependent of the eyes of the beholder) and led to much debate. We agree that incorporating broader measures and high frequency data into modeling and analytical tools should help countries make a better case for additional policy interventions, including outflow CFMs, in the face of constrained policy space. *Could staff comment on plans to deploy CD/TA and to develop guidance notes to help members with appropriate models and analytical tools (including high-frequency indicators) to help identify imminent crisis circumstances and define preemptive CFM/MPMs?*

The guidance on **avoiding premature liberalization** is also important and should help countries to avoid situations where reform efforts intended to stabilize the economy and remove distortions, instead result in a crisis. It will be important for country teams encouraging liberalization, especially in the LIC and FCS context, to first ensure that all the relevant thresholds of financial and institutional development have been met. We note that the policy allows for CFMs to be re-imposed if liberalization is assessed to have been premature. In contexts where the premature liberalization arose from program policy advice, it will also be important that the relevant Staff Guidance Note ensures that the program review for the country in question does not directly or indirectly penalize the authorities for the failed liberalization reform.

We note that the Fund has an **interdepartmental group** that works with country teams to ensure consistent and evenhanded classification of measures. *Could staff confirm whether this group will also be working on evenhanded treatment in the application of IV to imminent crisis situations, and in advising against premature liberalization?*

On the **assessment of CFM macro-criticality**, we agree with the proposed definition and that country specific circumstances need to be considered. *As macro-criticality of CFMs will be determined on a case-by-case basis with much of the evaluation relying on staff judgement, could staff elaborate on safeguards to ensure evenhanded treatment?*

### **Special treatment of certain types of measures**

We note the special treatment status applied to measures introduced for security reasons, internationally agreed prudential standards, AML/CFT, and international cooperation standards against tax evasion or avoidance, and welcome that while not assessed under the IV, they will be classified as CFMs when they meet the criteria and will be discussed in surveillance when macro-critical. *Could staff comment on the possibility of misclassification of these measures, and whether this could give rise to unintended effects and inappropriate assessment under the IV?*

### **Exchange restrictions, MCPs and other operational issues**

We note that measures that are both CFMs and exchange restrictions and/or Multiple Currency Practices (MCPs), and considered current under the Articles, will be assessed under Article VIII; and that MCPs that apply solely to capital transactions and are CFMs, will be assessed under the IV. This will eliminate possible inconsistencies in Fund policy advice and potential overlaps between the application of the Article VIII framework and the IV.

We also agree with the proposal to only assess safeguard/contingency measures whose quantitative parameters are set at zero, under the IV, once they are activated (if macro-critical). Likewise, we agree on the treatment of other measures that could be CFMs whose parameters are set at zero, or are unenforced CFMs; where they are assessed under the IV once they are activated (parameters tightened). *Could staff comment on how the degree of tightening or the duration of activation of the measure might affect macro-criticality?*

**In closing**, we thank staff for the substantive work covered in this review and encourage future work programs to consider the distributional effects of capital flow liberalization as well as the effects of climate change and digitalization on capital flows.

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GRAY/22/796

March 16, 2022

**Statement by Mr. Chodos, Mr. Herrera, Mr. Lischinsky, and Mr. Corvalan Mendoza on  
Review of the Institutional View on the Liberalization and Management of Capital Flows  
(Preliminary)  
Executive Board Meeting  
March 21, 2022**

We thank staff for the Review of the Institutional View (IV) on the Liberalization and Management of Capital Flows, the detailed background notes, and the outreach to our office.

**We agree that the IV's core premises and objectives remain unchanged and support the IV review proposals.** The review incorporates advanced research in this area, lessons and experience from different country cases, and recommendations in the recent IEO evaluation on IMF advice on capital flows (IEO, 2020). In our view, the two proposed policy changes, preemptive CFM/MPMs on inflows and special treatment for certain measures, aim in the right direction and enhance the IV's role to guide Fund's advice to the membership on the liberalization and management of capital flows. Salient aspects of these proposals are the even-handed treatment of its application, and the respect of members' rights and obligations under the Articles of Agreement (AoA) or other international agreements.

**We endorse the proposed change to the IV to consider preemptive inflow CFM/MPMs,** subject to the considerations described in the report. We agree that transparent and clear guidelines to implement preemptive CFM/MPMs are needed for managing capital inflows when specific financial vulnerabilities and policy constraints occur in the domestic financial system. The IV needs to strike the right balance for a consistent application of these measures across the membership, considering both domestic concerns and international spillover effects. As we see it, the proposed framework is comprehensive, but it can become overly prescriptive to assess the case for preemptive CFM/MPMs when there is no concern about a stronger-than-warranted external position or a weaker-than-warranted exchange rate. While there may be a natural conflict of interest between the authorities and the staff's assessment of external balance adequacy, there should not be a conflict in their assessment of financial vulnerabilities. For this reason, when there is a difference of opinion between the staff and the authorities on the relevance of financial vulnerabilities or the existence of financial policy restrictions, the position of the authorities should be taken with special deference. *We would like to hear more details from staff on the implementation of the proposed change to the IV, especially when considering their*

*dialogue with authorities. We are also interested to know staff's opinion on the risk of the application of preemptive inflow CFM/MPMs turning into a permanent tool, which could substitute warranted macro-economic adjustment or postpone dealing with structural financial vulnerabilities.*

**We agree with the special treatment of measures proposals.** These treatments have four categories: i) national or international security reasons, ii) certain measures adopted pursuant to internationally agreed frameworks on financial stability, iii) AML/CFT measures, and iv) certain international cooperation agreements against the avoidance or evasion of taxes. Tackling these CFM's shortcomings will depend on a country-by-country basis and be discussed in the surveillance period when macro-critical. Having said that, the recognition of special treatment is warranted to facilitate dialogue with authorities on policy shortcomings. The latter would help prioritize surveillance and policy advice to help the membership in areas that might require improvement and are affecting other members. In this vein, we welcome this review presentation of clear cases and examples where the Fund would refrain from assessing certain CFMs or CFM/MPMs measures as appropriateness under the current IV. The recognition for special treatments on internationally agreed prudential standards, like the ones introduced into the Basel framework following the Global Financial Crisis (GFC), or FDI-screening mechanisms on grounds of national security during COVID-19 pandemic, and more recently, the financial measures introduced in response to the war in Europe, would certainly require judgment to assess them as CFM/MPMs under the current IV.

**The quality and depth of macroeconomic and financial policy advice are relevant to better discharge the Fund's surveillance duties responsibly.** This review of the IV is a positive step forward to close important gaps on surveillance and policy advice to member countries. We understand some important topics were not tackled at this stage, like the use of CFMs for social or political objectives, its distributional effects, digitalization, or climate change, because more analytical foundation and better data are still missing. We encourage staff to continue working on these issues and consider them in future reviews of the IV.

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GRAY/22/799

March 16, 2022

**Statement by Mr. Binzarah and Mr. Abdel-Rahman on Review of the Institutional View  
on the Liberalization and Management of Capital Flows  
(Preliminary)  
Executive Board Meeting  
March 21, 2022**

We thank staff for the informative report and the helpful background papers. We note that the envisaged proposals are informed by the work on the Integrated Policy Framework, the findings of the IEO evaluation of the Fund’s advice on capital flows, and staff’s experience with the implementation of the Institutional View (IV) on the Liberalization and Management of Capital Flows. We also positively note that the proposals have benefited from earlier engagements with the Board. Moreover, we welcome the additional clarity and guidance on some key IV concepts. Since we are in a broad agreement with staff’s proposals, in what follows, we focus our remarks on a few practical issues.

- **We encourage staff to maintain a proactive and collaborative assessment of “preemptive” and “imminent crisis” situations.** Timing is of essence when it comes to assessing the case for “preemptive” CFM/MPMs and for CFMs on outflows in “imminent crisis” situations. There is no point in imposing the CFMs on outflows after money has largely left the country and the associated damage has already occurred. Similarly, for the preemptive use of CFM/MPMs to be relevant, they should be allowed before the FX mismatches become more pervasive and harder to address. The need for a proactive assessment is also underscored by the ongoing uncertainties surrounding the outlook for inflation, global liquidity conditions, and investors’ risk tolerance. Moreover, in view of the key data gaps that are expected to arise in LICs and EMDCs between the data needed to conduct the assessment as prescribed by staff and that which is available, it is important that the assessment is built on a close collaboration with the authorities to benefit from their insights on the specific country circumstances. In cases where the CFM/MPMs are unwarranted, staff should provide concrete advice on the appropriate pace of phasing them

out and discuss alternatives that could be more effective in supporting macroeconomic and financial stability.

- **We underscore the importance of considering capacity and resource constraints in the assessment.** Here, we note that the condition of “sufficient actions” on reforms to address weaknesses or imbalances play a central role in the assessment of the appropriateness of using CFMs. While we concur that CFMs should not be used to substitute for warranted adjustments and reforms, we call upon staff to remain mindful of capacity and resource constraints in LICs and EMDCs which could make the required reforms daunting and time consuming. It should also be noted that some of the needed reforms may be of a medium-term nature and could take time to have effect. In cases where capacity and resource constraints are binding, staff should reflect those constraints in the assessment and engage in a constructive discussion with the authorities to identify capacity development needs and how the Fund can support these in a well-targeted and timely technical assistance.
- **The limitations of the External Sector Assessment (ESA) should be properly reflected.** We concur that CFM/MPMs should not be used to gain an unfair competitive advantage. Nonetheless, in view of the reliance of the IV on the ESA for the exchange rate valuation assessment, it should be noted that the ESA is not a panacea and has its own drawbacks. Indeed, as we emphasized in the recent Board discussions on the EBA and EBA-lite refinements, the fact that around one-third of 2020 assessments have changed following data and model updates is not a ringing endorsement of the process. Therefore, we call upon staff to remain mindful of the caveats associated with the ESA and to properly account for them in the CFM/MPM assessment. On a related note, it is important that the assessment properly reflects the fact that countries with fixed exchange rate regimes face more policy constraints that may strengthen the case for preemptive CFM/MPMs as rightly noted in the paper.
- **Finally, we encourage staff to step-up their work to incorporate the impacts of digitalization on capital flows in the IV.** The rapid rise in the relative importance of digital assets is expected to have significant implications on capital flows, and consequently on economic and financial stability across the membership. To remain relevant, the IV needs to evolve in a timely manner into this area. As the Fund prepares to ramp-up its work in the new priority areas supported by the augmented budget framework, the expansion of the IV to account for the impacts of digital assets should be an integral part of the Fund’s expanded work streams in the areas of macro-financial surveillance and digital money.

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GRAY/22/804

March 16, 2022

**Statement by Mr. Moreno, Mr. Guerra, Mr. Romero Tarazona, and Ms. Arevalo Arroyo  
on Review of the Institutional View on the Liberalization and Management of Capital  
Flows  
(Preliminary)  
Executive Board Meeting  
March 21, 2022**

We thank staff for the comprehensive set of papers and for their constructive engagement with our office during the development of the Review. The initial adoption of the IV was an important step towards providing consistent advice on the liberalization and management of capital flows and has allowed for a more orderly and efficient policy discussion and advice on capital flow measures. The current Review will contribute to updating the framework with IPF findings in hand with the recommendations from the IEO evaluation of IMF Advice on Capital Flows. We can go along with the proposed changes and will provide the following comments for emphasis.

**The Institutional View has served the IMF and its membership well. We welcome that the core premises and objectives of the IV remain unchanged.** Capital flows are desirable as they can bring substantial benefits for countries, and capital flow measures (CFMs) should not substitute for warranted macroeconomic adjustment. Reaping the benefits of capital flows can be possible while managing the associated risks, and in this regard, we believe that sound macroeconomic policies, financial regulation, and structural reforms are crucial to gaining resilience to shocks, including from capital flows. Also, the IV framework should acknowledge the prevalence and optimality of exchange-rate flexibility and monetary policy independence over nuanced policy advice. Thus, we should keep in mind that nothing substitutes for having one's economy's fundamentals in order. That said, while it is understandable that first-best policies are hard to achieve, these core premises are fundamental to avoid the unwanted signal that the advice regarding second and third-best policies is being institutionalized.

**Clear communication will be required to avoid sending a message that the proposed changes will now be a policy prescription rather than a policy recommendation.** Communicating the proposed changes to the IV to policymakers and the public will be challenging. The adjustments call for considering the use of CFMs under rather specific scenarios. However, the specificity of such scenarios is at odds with the announced general objectives of the IPF and the current IV discussion. On the one hand, this complicates the premise that the fundamental policy advice remains the same:

keep one's house in order. On the other hand, the message could be wrongly interpreted as meaning that the Fund is weakening its role as a trusted advisor. In this sense, the communication must be unambiguous to avoid the misconception that the Fund is endorsing broad and unjustified CFM use. Hence, the Fund should clearly spell out the longer-lasting first-best policies instead of highlighting the exceptional measures that could be implemented in very specific circumstances. Furthermore, we expect that the IMF will emphasize evidence of the broad benefits that capital flows have in growth and financial development in its outreach and communication of the changes to the IV (Background note 1).

**A precondition to recommend preemptive CFM/MPMs should be the implementation of policies to address the underlying frictions, structural vulnerabilities, or warranted policy adjustments.** As staff notes, the use of preemptive inflow CFM/MPMs can carry risks given they could delay warranted policy adjustments or structural policies to develop financial markets. Moreover, the empirical evidence provided (e.g., Background note 1) on factors that amplify capital flow risks strengthens the case for focusing IMF advice on mitigating such factors, for instance, by completing markets, adopting a more flexible exchange rate to limit imbalances, or bolstering the macro framework. Moreover, given that capital controls could be circumvented, using them when inappropriate could lead to policy uncertainty. There is then the risk of overstating the efficacy of capital controls.

**The preemptive use of capital flow measures can have important negative spillover effects on countries that do not impose those measures.** Although it is necessary to consider domestic circumstances in designing policies to deal with capital flows, it is also crucial to minimize significant global spillovers from these measures. For example, the broader use of preemptive CFMs can be problematic as it could potentially cause a diversion of flows to other countries, exacerbating capital flow volatility in those countries.

**Notwithstanding, we remain open to discussing cases when immediate adjustment may be unduly costly or may take time to have an effect, and preemptive CFM/MPMs may be temporarily appropriate as part of a broad and coherent policy package to undertake the warranted policy adjustments and initiate the structural agenda to lower vulnerabilities.** Also, if the macroeconomic policy framework requires adjustments with a small or partial effect on systemic risks, a temporary and targeted CFM/MPM may be an appropriate instrument to address the risks, alongside the correction of macroeconomic policies. In this context, we believe research must continue delving into the specific conditions in which this policy combination is feasible and favorable for the membership and is consistent with the recommendations under the Article IV consultations and FSSA evaluations. In line with this, we consider that any change in policy prescriptions should be accompanied by a research agenda aiming to identify unanticipated and undesirable consequences of CFMs, for instance, the buildup of external vulnerabilities in other countries that could receive the diverted capital flows.

**We agree that use of preemptive CFM/MPM should not help maintain or exacerbate a stronger-than-warranted external position.** In this regard, we remain skeptical of the efficiency of the assessment related to the actions a member should take to adjust its external sector when using

preemptive CFM/MPMs. Therefore, we see ample ground for extending research on those desirable policies to address the domestic policy gaps and the trade-offs between the benefits of reducing systemic financial stability risks and the costs of a stronger-than-warranted external position. Moreover, we believe that these policy actions could be subject to judgment issues regarding the evaluation of their duration and intensity.

**Careful consideration will be required for the operationalization of the policy changes and the elaboration of concepts and policies to avoid placing the burden of proof on staff's judgement.**

The preemptive use of CFM/MPMs and the determination of macro-criticality, capital inflow surges, imminent crisis situations, and premature liberalization depend on a complex set of preconditions and policy assessments. We appreciate the detailed elucidation regarding the three key considerations to assess the appropriateness of preemptive inflow CFM/MPMs and the elaboration of important concepts and policies. However, we consider there are still practical and analytical gaps in determining the appropriate guidance to overburden judgement and ensure evenhandedness in the implementation. For instance, judgement will be required to confirm that CFMs are the best solution given country-specific circumstances, and not just a temporary solution with more unintended consequences and adverse spillovers. Therefore, while the proposed assessment process and guidance are necessary safeguards for consistent implementation of the policy and to avoid inappropriate use, we consider this will impose a heavy burden on staff to evaluate the adequacy of such policies. For example, the assessment of whether the exchange rate could significantly depreciate because of the imposition of CFM/MPMs would place the burden of proof on staff judgement. Also, the removal of preemptive capital flow restrictions can have unintended consequences, and this should be taken into consideration during the assessment process. *Do the policy changes imply that a country that meets the assessment criteria will be subject to this policy prescription?*

**On the special treatment for certain categories of measures, while the Review does not aim to assess their appropriateness under the IV, we consider that their implications should be analyzed and reported during the Art. IV process.** In particular, on the imposition of measures for national security reasons, we support that the Fund is not an appropriate forum to discuss the political or military considerations underlying the introduction of these measures. However, in our view, the measures should be discussed in bilateral surveillance, taking into consideration that imposing the measures may not be macro-critical for the country that introduced them, but they may have spillovers that are macro-critical for the countries directly affected by them. Therefore, care should be taken to ensure that the macro-criticality criteria take into consideration spillovers to other countries.

**We welcome the consistency between the IV, Basel III, and other measures based on internationally agreed prudential standards.** However, we stress the need for continued close collaboration between the IMF and the OECD regarding their frameworks' application and promotion of global financial integration and free capital mobility.

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GRAY/22/807

March 16, 2022

**Statement by Mr. Ronicle and Mr. Chrimes on Review of the Institutional View on the  
Liberalization and Management of Capital Flows  
(Preliminary)  
Executive Board Meeting  
March 21, 2022**

**We are grateful to staff for the extensive analytical work which has informed this Review, and their considered proposals, which we support.** We strongly agree that the core principles which underpin the Institutional View remain valid. Capital flows can bring significant benefits to countries and are desirable; if anything, we would welcome further work from the Fund to articulate the benefits of capital flows. At the same time, the associated risks must be managed in a way that preserves macroeconomic and financial stability and does not generate significant negative outward spillovers. Reflecting the evolution of the global financial system, we welcome the well-evidenced refinements and helpful clarifications staff are proposing for the IV (drawing on both the Integrated Policy Framework and the IEO's evaluation on capital flows), while underscoring that capital flow management measures should not substitute for warranted macroeconomic adjustments and structural reforms.

**The paper helpfully sets out the interconnectedness of the international system – and as such clearly indicates that capital flows and their management are important to the Fund's mandate.** We welcome Box 1's recognition that surges in cross-border flows may indicate a need for adjustment in both recipient and source countries; that countries should consider measures to address the macroeconomic and financial stability risks associated with cross-border activities of markets and institutions in their jurisdictions; and that cross-border policy coordination between source and recipient countries could help mitigate undesirable spillover effects from policies. Relatedly, we encourage the Fund to actively contribute to FSB work on non-bank financial intermediation and on crypto assts to help manage these risks, and to coordinate with other multilateral partners.

**We support the proposed change to consider pre-emptive CFM/MPMs in certain circumstances, though additional guidance may be needed to deliver a consistent and even-handed approach in practice.** We welcome that the Review establishes a degree of

hierarchy between measures – noting that, for example, “pre-emptive CFM/MPMs should not be used if MPMs alone would be sufficient to address the risks”, and that CFM/MPM measures that do not discriminate by residency, where available and effective, are preferable to those that do. However, like Mr. Jennings and Ms. Cunningham, we believe the main document could have given this hierarchy more explicit emphasis. The stepped assessment process for when pre-emptive CFM/MPM measures would be appropriate sounds sensible in principle, but *we would welcome greater clarity from staff on who would be responsible for providing this assessment in practice, when, and whether there is sufficient and timely data available to facilitate such an assessment.*

**We support the proposal for special treatment of certain measures, meaning that staff would not have to form a judgment on their appropriateness.** These measures include those introduced “solely for reasons of national or international security”. We underscore that we expect such measures would be invoked sparingly and must be clearly justified, but we agree that staff are generally not well-placed to judge their appropriateness. We also agree with the proposal for other defined “special” categories relating to international cooperation.

**We appreciate staff’s efforts to clarify other concepts relating to application of the IV. In particular, how macro-criticality is assessed in practice in relation to the IV remains an area of concern, and the clarifications here seem a useful step towards ensuring a pragmatic and consistent approach.** We agree that determining whether a measure is macro-critical involves assessing whether the effects on capital flows significantly influences a member’s present or prospective domestic or balance of payments stability. We acknowledge the need to consider country-specific circumstances and a role for staff judgment in assessing macro-criticality, but the process for how staff have assessed such measures in the past has at times not felt transparent, proportionate, or consistently rooted in the principles of the Integrated Surveillance Decision. In line with efforts to streamline surveillance and improve the traction of Fund advice – as per the Comprehensive Surveillance Review – we hope that the clarifications will ensure that only genuinely macro-critical measures, or those which have significant cross-border spillover effects, will be covered in surveillance. Staff’s emphasis on the sequencing of liberalization measures and their clarifications on how to identify premature liberalization also seem helpful.

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GRAY/22/811

March 16, 2022

**Statement by Mr. Bevilaqua, Mr. Saraiva, Mr. Velloso, and Mr. Barroso on Review of  
the Institutional View on the Liberalization and Management of Capital Flows  
(Preliminary)  
Executive Board Meeting  
March 21, 2022**

We welcome the Review of the Institutional View on the Liberalization and Management of Capital Flows (IV) and commend staff for building the work around the extensive Board discussions on the IEO report on IMF Advice on Capital Flows and the Integrated Policy Framework (IPF). The Review aligns the IV further with the theoretical advances and good practices that have been developed by member countries in coping with capital flow management and liberalization. We welcome the refinements being proposed, which are in the right direction, and believe they will make the IV more useful to guide the policy dialogue with the membership.

**The scope of the Review seems broadly appropriate.** We take positive note of the emphasis on preemptive capital flow management measures with a macroprudential motivation (CFM/MPMs). We also take note of the recommendation of special treatment for some measures that require specialized frameworks outside the scope of the IV. Despite the earlier informal discussions on several other topics, such as social and inequality considerations related to the adoption of CFMs, we agree with staff that their conceptual and empirical underpinnings are not sufficiently mature at this juncture. Finally, we welcome the added precision to the definition of some concepts used throughout the IV, including the concepts of capital inflow surges and imminent crisis circumstances.

**We support the proposed treatment of preemptive CFM/MPMs on inflows to counter systemic risk.** As underscored by the IEO and IPF discussions, sudden reversals of capital flows can be self-reinforcing when external debt levels are high, possibly triggering significant systemic risks. As highlighted by staff, such risks are higher in the presence of excessive leverage, asset price misalignments, unhedged exposure, and other features that could amplify the initial shock. In view of this conceptual framework, the IV would expect CFM/MPMs to partially offset the build-up of external liabilities, particularly when facing currency mismatches or repatriation risks in local currency markets.

**We broadly agree with the proposed circumstances for adopting preemptive CFM/MPMs.** The use of preemptive CFM/MPMs should not *unduly* substitute for needed macroeconomic policy adjustments or *unduly* exacerbate external imbalances. Indeed, for significant systemic risks, policymakers may find it useful to focus on measures to mitigate such risks, while macroeconomic adjustment and current account imbalances run their course. In other words, as also highlighted by the IEO and IPF discussions, there must be a tradeoff between policies. Staff has indeed shown this tradeoff in the report—including in the second bullet of paragraph 22, or condition 3.b in Figure 3. However, this does not come across as clearly as it could in the text, which emphasizes the negative conditions for withholding MPM/CFMs, rather than the positive ones. This distinction is relevant from a communications perspective, even if logically equivalent. We therefore suggest staff to consider an alternative drafting on this specific issue. In the same vein, we suggest reverting from Figure 3 to the more informative flow chart in Slide 16 of the staff presentation for the informal Board discussion last July.

**We support the special treatment for some categories of measures that follow rationales different than the ones covered in the IV.** While these measures should not be assessed in the context of the IV, they could be reported to the Board and analyzed in surveillance as appropriate. Accordingly, national and international security measures should be considered in surveillance if macro-critical. Similarly, internationally agreed prudential standards that impinge on capital flows, as well as AML/CFT measures consistent with international standards and measures arising from international cooperation frameworks against the avoidance or evasion of taxes should be carved out from the IV but covered by surveillance, as warranted.

**We welcome the improved definitions of some IV concepts, although stress the need to balance quantitative indicators with well-informed judgement.** We agree with a broad range of quantitative indicators for “capital inflow surges” with some caveats, as measurements could be biased towards the most recent data and not fully capture forward-looking events or unduly discount structural shifts. In these cases, judgement will be key in the assessment. While we see merit in trying to establish a conceptual basis for defining “absorption capacity,” we should retain the focus on actual macroeconomic pressures and policy limitations, avoiding overreliance on any single summary indicator or set of quantitative indicators. Regarding “imminent crisis,” we appreciate the extensive list of possibilities, but highlight that judgement will often have to play a major role. Therefore, guidance to staff should stress the need for close dialogue with policymakers to properly assess those risks. On “premature liberalization,” we agree that macro-financial imbalances and volatile financial markets are relevant criteria, but the assessment is often difficult due to the long lags for its effects to materialize. It is also important to assess whether the integrated approach to liberalization has been followed, or whether lack of capacity in some areas are leading to constraints in the overall approach.

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GRAY/22/812

March 16, 2022

**Statement by Ms. Lim, Mr. Mochtar, Ms. Wongwaisiriwat, Mr. Azlan Ariff, and Mr. Kurniawan on Review of the Institutional View on the Liberalization and Management of Capital Flows (Preliminary) Executive Board Meeting March 21, 2022**

We thank staff for the comprehensive report, background notes and outreach to our office. We welcome the review of the Institutional View (IV) on CFMs which is informed by IPF's work, IEO's evaluation, as well as the experience with IV implementation.

We agree that the principles underpinning the IV remain valid – capital flows can bring substantial benefits and CFMs should not substitute for warranted macroeconomic adjustment. That said, the reality of the environment we operate in is that risks arising from large and volatile capital flows have intensified amid higher global uncertainties and fragile investor sentiments. The role of CFMs in the policy toolkit is now more pertinent than ever, to equip policymakers with sufficient tools to manage risks from destabilizing exchange rate movements and potential amplification of domestic shocks. **We thus see this review as an opportunity to take such structural shifts into account and are disappointed that it is not forward-looking enough to help countries cope with more pressing circumstances.**

**Incorporating sufficiently forward-looking and pre-emptive elements into the IV**

**We remain unconvinced that the proposed use case for inflow CFM/MPMs is sufficiently pre-emptive to allow policies to respond to systemic risks in a timely and effective manner.** The condition that pre-emptive CFM/MPMs on inflows are appropriate only if systemic risks are elevated may be leaving it too late, when such risks can be addressed more effectively while they are taking root in the financial system. Importantly, policy trade-offs 'after' stock vulnerabilities have become elevated are often higher compared to before. When stock vulnerabilities are already high, policy responses typically need to be more forceful to be effective, involving the type and degree of CFM/MPMs (e.g.,

higher taxes on inflows) which could have larger spillovers. Therefore, we would have preferred the ability to undertake broader considerations when assessing the appropriateness of inflow CFM/MPMs.

We appreciate that staff has considered the use of pre-emptive inflow CFM/MPMs on local currency debt inflows but caution against taking a narrow view on this issue. EMEs with high non-resident participation in relatively deeper local currency bond markets, for example, face the risk of fire sale and currency depreciation when investor sentiments turn sour, especially when perceived as vulnerable, leading to an elevation of macroeconomic risks. In this regard, there may be a case to use pre-emptive inflow CFM/MPMs to manage these risks, even when the four conditions proposed by staff are not jointly met.

**We note that the IV will continue to be refined, as it is informed by research and country experiences.** Beyond the perimeter of this review, it would be essential to fast-track priority topics that will contribute towards refining the scope of the IV’s policy advice. In particular, we encourage staff to prioritize the “use of outflow CFMs outside ‘imminent crisis’ situations”, as this is a matter of particular interest for EMEs and essential for the completeness of the IV. In this regard, we hope that resources can be dedicated towards this issue to build the necessary analytical base and ensure that the Fund’s surveillance and policy advice under the IV remain timely and relevant.

#### **Maintaining the flexibility of the IV**

**As these refinements are underway, we encourage a flexible application of the proposed framework to avoid inadvertent rigidities when formulating policy advice.** We appreciate that the proposal expands on the conditions under which the use of CFMs is appropriate. Nevertheless, we caution that the continued emphasis on pre-conditions could limit the scope of policy advice and lead to country authorities’ perception of ‘restrictiveness’ and ‘lack of evenhandedness’, and impede the traction of the Fund’s policy advice as documented in the IEO’s evaluation in 2020. Given the heterogeneity of shocks, country characteristics and initial conditions, some degree of flexibility would be warranted when assessing the conditions under which CFMs are appropriate. In line with the IPF, CFMs should be understood in the context of policy complementarities within the broader toolkit (e.g., CFMs may be used to increase the space of other policy tools or paired with other complementary policies to reduce trade-offs). Importantly, the policy discussion should lean heavier towards policy effectiveness rather than strictly meeting the pre-conditions for appropriateness.

**Reasonable judgment is especially important when the IV relies on assessment tools that present its own set of shortcomings and challenges (e.g., EBA, ARA).** For example,

relying on the EBA to assess the external position of a country remains subjected to large, unexplained model residuals which typically require close dialogue and inputs from country authorities to interpret and contextualize. We urge staff to recognize these limitations and exercise flexible judgment when assessing the appropriateness of CFMs, to avoid the perception of the IV being another rules-based assessment. In fact, while the rationale and validity of the EBA tool remains contentious, it would be best to avoid making the IV assessment conditional on it.

**Providing clear guidance for consistent application and even-handed treatment**

**We look forward to the issuance of comprehensive guidance notes which will be critical for the operationalization of the IV in a consistent and even-handed manner. More importantly, we underscore the need for close engagement with authorities to understand circumstances on the ground including interaction with other polices in the IPF context.** It would be beneficial to have concrete examples drawn from Article IV consultations and how country specific considerations can be factored in determining the appropriateness of pre-emptive inflow CFM/MPMs. We would also appreciate further elaboration and illustrative scenarios on key concepts that are subject to wide interpretations and prone to disagreements such as macro-criticality, due to the lack of a universal indicator or numerical thresholds. We would be happy to have the guidance note discussed at the Board prior to issuance.

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GRAY/22/813

March 16, 2022

**Statement by Mr. Tanaka, Ms. Kashima, Mr. Naka, and Ms. Fukuda on Review of the Institutional View on the Liberalization and Management of Capital Flows  
(Preliminary)  
Executive Board Meeting  
March 21, 2022**

We appreciate the comprehensive and detailed paper based on the discussion at the informal Board meeting in July last year.

**We strongly support maintaining the core principle of IV** (the Institutional View on the Liberalization and Management of Capital Flows), which remains valid, that is, (i) capital flows can bring substantial benefits for countries, and (ii) CFMs may be useful in certain circumstances to address risks stemming from capital flows but should not substitute for warranted macroeconomic adjustment. The experience that only limited number of countries has resorted to CFMs during the COVID-19 crisis while promptly and decisively responding with other policy measures would support this principle.

**Meanwhile, we welcome the staff proposal to update and clarify the IV framework to be more practical and useful.** As discussed at last year's informal Board meeting, the IV is not a permanent dogma, but rather an evolving framework that should incorporate the experience of each country and the deepening of analysis by the IPF and other organizations. While generally agreeing with the individual proposals, we would like to offer some comments for emphasis:

***Preemptive Use of Inflow CFM/MPMs***

**In terms of evolving framework, we support the staff proposal for preemptive use of CFM/MPMs on capital inflows.** We understand that CFM/MPMs are useful tools complementing MPMs, given MPMs alone are not sufficient to fully address stock vulnerabilities such as already piled up FX mismatches. We also note that the introducing CFM/MPMs as a preemptive measure could prevent stock vulnerabilities from aggravating and could allow market reactions and policy responses to be milder and smoother even if capital reversal should occur. As the suggested framework for CFM/MPM assessment incorporates the external position assessments as a key element, the improvements to the EBA model need to be made as well. We also acknowledge the proposal to justify CFM/MPMs on local currency debt inflows in some exceptional circumstances, such as

shallowness of domestic markets and constraints of other policy measures. Still, as for local currency flow, we consider reasonable and important to limit the room for preemptive control because feasibility of ex-post responses would be likely to be preserved unlike foreign currency capital flow, even if inflow should reverse.

**Having said that, the preemptive use of CFM/MPMs can be easily prolonged because it is often difficult to judge when to lift them.** It should be always remembered that use of CFM/MPMs should be targeted, temporary and reversible. The sustained control in a way to discourage warranted macroeconomic policy adjustments could undermine sound medium-term growth. Country-specific circumstances that could justify CFM/MPMs in the short term—for instance, FX mismatches in balance sheets or underdeveloped hedging markets—should be primarily resolved through structural reforms in the long run, such as domestic market deepening. In this regard, we reiterate the point we made at the informal Board meeting that staff should carefully review and support the steady progress of key structural reforms for financial market developments through regular discussions in Article IV and other engagement. Further, we support the staff suggestion that the Fund policy advice would take into account spillover effect of CFM/MPMs. Staff should discourage a preemptive use of CFM/MPM, if the authorities are assessed to use it to exacerbate a stronger-than warranted external position affecting regional economic and financial stability.

**From an operational perspective, the proposed evaluation framework is undeniably complex, but we positively note it as enabling consistent and country-tailored policy advice and assessment.** We expect staff to ensure the consistent operationalization of the new IV under close coordination mainly through interdepartmental working group on capital flows, which comprises LEG, MCM, and SPR. Furthermore, we encourage staff to provide appropriate guidance by thorough discussions with the authorities more than ever. Specifically, the Fund should be fully accountable for its assessment based on the IV even though the ‘labeling’ issue between MPMs and CFM/MPMs is supposed to be less acute due to this framework refinement.

### *Special Treatment for Certain Categories of Measures*

**The special treatment that CFMs for national or international security reasons will remain out of scope of appropriateness assessment is favorable.** As staff acknowledges, the Fund is not an appropriate forum for discussion of political/military considerations. In the meantime, we note that this review envisages to incorporate such CFMs into the scope of surveillance if macro-critical. Although the definition of "macro-criticality" are clarified in this review, the scope should be carefully confirmed with the authorities on a case-by-case basis, as it leaves some room for judgment. We also welcome that potential conflicts between the IV and the international financial regulations such as the Basel III would be resolved in this review. We consider that internationally and regionally agreed regulations are unlikely to "substitute for necessary macroeconomic adjustments" in light of their regulatory purpose. Similarly, we welcome the clarification of the idea for policies against tax evasion and money laundering/terrorism financing.

### *Other Issues*

**We support the suggested elaboration of concepts such as "macro-criticality", "capital inflow surges", and "imminent crisis."** Discussions on CFMs and CFM/MPMs can

sometimes be sensitive, and thus we expect that practicality and viability of the IV as well as consistent and smooth surveillance would be secured through enhanced clarity of these key concepts. At the same time, the proposed balanced approach to present definitive guidance in a way that leaves some flexibility, which allows staff to consider country-specific circumstances, is thoughtful and appropriate.

Finally, we strongly expect the analysis within the IV on digitalization including digital money, which is set out of the scope of this review to be deepened in the future, as it should have broader implications for capital flows and CFMs.

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GRAY/22/814

March 16, 2022

**Statement by Ms. Shortino, Ms. Medearis, and Mr. Sturm on Review of the Institutional View on the Liberalization and Management of Capital Flows  
(Preliminary)  
Executive Board Meeting  
March 21, 2022**

We thank staff for the comprehensive papers and engagement with our office on an issue central to the Fund's mandate. We welcome the reaffirmation of the core premise of the Institutional View (IV): capital flows bring substantial benefits for countries, and capital flow management measures (CFMs) should be temporary and targeted while not substituting for warranted macroeconomic adjustment. We appreciate staff's work across departments to deepen the Fund's understanding of managing risks from capital flows and stress the need for continued strong interdepartmental collaboration during implementation of the proposed policy change allowing for preemptive use of CFM/MPMs in some circumstances. We recognize and commend IMF staff for their advances in research on capital flows, notably the extensive work on an Integrated Policy Framework (IPF). **We find staff's proposed change to the Institutional View on the liberalization and Management of Capital Flows (IV) to be firmly grounded in robust analytical findings. We support the proposed policy change and other refinements with the following comments.**

**Preemptive CFM/MPMs**

**We support staff's proposal to allow for preemptive CFM/MPMs in certain well defined and narrow circumstances, but we urge careful implementation by staff and management to deliver on the promise to avoid an "anything goes" atmosphere.** We continue to believe that a small set of members will meet the criteria of a high stock of FX mismatches with associated financial risks resulting in a recommendation for preemptive CFMs/MPMs. We welcome that Background Note 2 includes a two-step process to assess systemic risks from FX mismatches, but we continue to believe that transparently identifying those countries that meet Step 1 would be useful for country teams as well as the Board. Further, we urge staff to deepen ongoing efforts to support members' structural reforms and market development to reduce risks from FX mismatches as outlined in the first annex of the main paper. *To this end, it would be helpful if staff could regularly update the Board on which countries meet Step 1. Further, we also ask staff to provide a brief update on how*

*many countries may be affected by lack of data availability in conducting this two-step analysis.*

**We underscore the importance of mitigating the potential for negative outward spillovers from preemptive CFMs/MPMs.** Staff advice on CFMs/MPMs should include a careful assessment of potential spillovers, including to other members that have similar stock vulnerabilities. Such spillovers could be global or regional and could result in a ratcheting up effect that could increase global restrictions on the free flow of capital, albeit outside major economies. We appreciate Background Note 3 on the principles for designing measures to address FX mismatches, and we also fully concur with staff’s emphasis on domestic risks from preemptive inflow CFM/MPMs, including persistent use. We, therefore, urge staff to ensure that advice regarding preemptive CFM/MPMs incorporates proposals to minimize adverse side effects, including strategies to mitigate impacts on market development. We urge staff to proactively and transparently note when preemptive CFM/MPMs are no longer appropriate.

- **We support staff’s careful approach to recommending preemptive CFMs/MPMs on external debt in local currency.** We fully agree with staff’s finding that a wider set of policy tools is available to address these circumstances. Moreover, we attach great importance to the “jointly met” requirement for policy conditions to allow for preemptive CFM/MPMs on local currency debt to be introduced, and we urge staff to transparently address those criteria in staff reports.
- **We urge staff to carefully assess the use of CFM/MPMs in the context of fixed exchange rates;** staff should closely evaluate whether warranted economic adjustment might include greater exchange rate flexibility. We take note of staff’s view that fixed exchange rate regimes possess a stronger case for preemptive CFM/MPMs because they face tighter policy constraints. However, in many cases countries would benefit from reforms that support more flexible exchange rates and policy constraints, rather than pursuing preemptive CFM/MPMs in the context of constrained policy options.

### **Other Proposals**

**We welcome staff’s approach to types of measures related to international financial regulatory standards as well as issues in national security.** We agree that the Fund should refrain from assessing the appropriateness of certain measures classified as CFMs, under the IV when introduced for national or international security reasons. We also support special treatment for measures, classified as CFMs, which are consistent with internationally agreed prudential standards, such as the Basel III framework, or with international standards against tax avoidance and evasion.

**We welcome staff’s elaboration on key concepts, including macro-criticality and imminent crises, to support IV implementation going forward.** We continue to support staff’s focus on macro critical CFM/MPMs, and we appreciate Table 1 in the main paper which provides very useful illustrative examples of macro-criticality determinations. **We believe that improved clarity on the concept of macro-criticality will support more strategic focus by the Board, avoiding distractions on non-macro-critical housing measures, for example. While we support and welcome the elaboration on imminent crises, we underscore that this concept will also take on greater weight when**

**considering preemptive CFM/MPMs.** More broadly throughout the report we appreciate the emphasis on evenhandedness and clarity on the important role of judgement, and staff's elaboration on key concepts to support IV implementation going forward.

### **Implementation**

**Finally, we underscore the importance of transparent and clear communication to support Fund policy advice of CFM/MPMs.** The IV needs to continue to provide a basis for consistent advice, including on the benefits of capital flows and not just the risks. We urge staff to clearly and transparently explain staff's evaluation on the use of preemptive CFM/MPMs in bilateral surveillance. Put another way, staff reports should include the answers to the questions that staff list in their evaluation process, outlined both in the main paper and Background Note 2. This may be just as important in cases where staff find preemptive CFM/MPMs to be inappropriate as well as appropriate. In this context, we wish to continue to see staff analysis and policy advice firmly grounded in IPF model findings, and for staff to avoid IPF insights as generalized evidence to justify measures. We also encourage careful and balanced external communication to stakeholders on the changes to the IV including clear messaging on the need for CFMs/MPMs to not substitute for warranted macroeconomic adjustment. Communication should consistently reiterate that CFM/MPMs should be temporary and targeted.

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GRAY/22/815

March 16, 2022

**Statement by Mr. Trabinski, Mr. Peter, and Mr. Tola on Review of the Institutional View  
on the Liberalization and Management of Capital Flows  
(Preliminary)  
Executive Board Meeting  
March 21, 2022**

**We strongly support keeping the core principles underpinning the Institutional View (IV) unchanged.** In our view, the main tenets of the IV remain valid. Notably, open capital markets and capital flows entail significant benefits. Capital flow management measures (CFMs) should not be a substitute for warranted macroeconomic adjustment and necessary reforms. Macroeconomic policies, sound financial supervision and regulation, and strong institutions should play a key role in managing risks from large and volatile capital flows.

**Against this background, we welcome that only a select few changes to the IV are proposed.** The IV represents a delicate balance of views. It constitutes a strong framework to guide Fund policy advice, while providing the necessary flexibility to address risks. In our view, this balance should be preserved. At the same time, measures implemented under the IV should be evidence-based and informed by recent country experiences and research, including work on the Integrated Policy Framework.

**Adjustments to the IV should be accompanied with adequate safeguards to minimize risks of inappropriate use of CFMs.** We maintain the view that CFMs should not become standard policy and that they can only be used in narrow and exceptional circumstances. Excessively broad and/or long use of CFM/MPMs should be avoided, also in light of potential long-term adverse effects on domestic financial market development.

Against this backdrop, we emphasize the following points on preemptive inflow CFM/MPMs:

**We remain skeptical about the appropriateness of preemptive CFM/MPMs on local-currency debt inflows.** While the case for preemptive measures on FX inflows is presented in detail, the documents lack examples and comprehensive information on the

appropriateness of CFM/MPMs on local-currency debt inflows, except for a short section in Annex I in Supplement 2. Local-currency debt vulnerabilities do not generally justify preemptive CFM/MPMs, given the availability of better-suited ex-post policy instruments. *Could staff provide a more precise explanation of the specific narrow and exceptional circumstances under which preemptive CFM/MPMs are deemed appropriate? Concrete examples would be very appreciated.*

**We broadly agree with the proposed conditions and provisions to assess the appropriateness of preemptive CFM/MPMs on FX inflows.** We agree that preemptive CFM/MPMs should be deemed inappropriate if (i) they substitute for warranted adjustments in macroeconomic policies or (ii) they substitute for market development or structural policies. We also agree that preemptive inflow CFM/MPMs should be targeted, transparent, and temporary.

**While preemptive measures may make sense if stock vulnerabilities are high, the objective should be to prevent such vulnerabilities from arising in the first place.** Fund surveillance and policy advice play a key role in this respect. Furthermore, if such vulnerabilities already prevail, the Fund should provide policy guidance on how to address them in a durable way. A way forward from preemptive inflow CFMs/MPMs to capital flow liberalization will particularly be needed for countries with weak monetary policy credibility and/or FX mismatches and/or shallow FX markets.

**Periodic evaluations of the appropriateness of preemptive CFM/MPMs using concrete and stringent criteria and following a thorough assessment process will be critical.** It is important that staff always explains the appropriateness assessment transparently. Furthermore, it will be essential to require that measures be recalibrated and removed when the necessary conditions and provisions are no longer met and/or as soon as an effective alternative measure that does not restrict capital flows becomes available.

**We encourage continued research by staff on the correct assessment of shocks and capital controls following the Implementation Plan outlined in May 2021, also with a view to minimizing the risks of negative effects from preemptive CFM/MPMs.** Preemptive CFMs/MPMs, by definition, cannot distinguish between fundamental/persistent shocks and non-fundamental/transitory shocks. As such, they may hinder full macroeconomic adjustment to fundamental shocks. Therefore, it is important to identify fundamental shocks correctly to allow adjustment to policies and macroeconomic variables and to avoid further accumulation of stock vulnerabilities due to preemptive measures being implemented misguidedly. Meanwhile, the correct assessment and measurement of shocks is extremely challenging without real-time data. Staff work in this area is thus welcome.

On further aspects of the IV review, we make the following points:

**We call for continued work to enhance the External Sector Assessment (ESA) methodology.** This is important, as the exchange rate assessments under the ESA will play a key role in evaluating the appropriateness of preemptive inflow CFM/MPMs.

**We agree with the proposals on the special treatment** of (i) measures introduced solely for national or international security reasons; (ii) certain measures introduced pursuant to internationally agreed prudential standards; (iii) AML/CFT measures implemented consistently with international AML/CFT standards; and (iv) measures arising from certain international cooperation agreements against the avoidance or evasion of taxes. The approach proposed by staff appears broadly sensible. We note, however, that the special treatment of measures adopted for reasons of national or international security will raise the delicate issue of evenhandedness given the potential divergence in terminology and representation across countries.

**We support keeping the current IV policies for managing capital inflow surges and outflows unchanged.** We particularly welcome the elaboration and strengthening of the guidance on how to (i) assess macro-criticality, (ii) identify capital inflow surges, and (iii) diagnose imminent crises.

**We concur that the guidance in the IV on capital flow liberalization (i.e., the “integrated approach”) remains appropriate.** We caution that it will be challenging to assess whether liberalization occurred prematurely. When assessing the appropriateness of re-imposing CFMs, the analysis of policy actions to address the underlying weaknesses that led to the re-impositions would be essential.

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GRAY/22/817

March 17, 2022

**Statement by Mr. El Qorchi and Mr. Boostani on Review of the Institutional View on the Liberalization and Management of Capital Flows  
(Preliminary)  
Executive Board Meeting  
March 21, 2022**

We thank staff for the informative set of papers. We appreciate that staff has incorporated inputs from the Integrated Policy Framework (IPF), findings of the 2020 evaluation by the Independent Evaluation Office (IEO), and lessons from experience into the Institutional View (IV). Notwithstanding their considerable benefits, capital flows (CFs) may cause macroeconomic and financial stability risks in certain circumstances. The IV recognizes these risks and enhances the macro-financial stability by incorporating measures that mitigate them. Against this background, **we agree with the proposed policy changes** and welcome the elaborations on macro-criticality, capital inflow surges, imminent crises, and premature liberalization, which improve the effectiveness and evenhandedness of the IV in practice. That said, we offer the following points.

**We welcome the proposed change that allows the use of CFM/MPMs on inflows in a preemptive manner.** Even in the absence of inflow surges, capital inflows may increase vulnerabilities in the financial system. Vulnerabilities may result from foreign exchange mismatches, which could be amplified by other frictions in the financial system. Therefore, preemptive CFM/MPMs can help a country contain macro-financial risks and preserve stability by limiting capital inflows and reducing amplification of vulnerabilities. We agree with staff that CFM/MPMs on inflows should remain in place until vulnerabilities in the financial system abate.

**Preemptive CFM/MPMs on inflows should not substitute for warranted policies** or be used to gain an unfair comparative advantage by depreciating exchange rate. Under all circumstances, it is key to allow adjustments in exchange rate, fiscal, and monetary policies in response to CFs. If policy space is limited due to an overvalued exchange rate, overheating economy, and ample foreign reserves, CFMs may be used to restrict the inflows. Moreover, the use of CFM/MPMs should also be considered if inflows generate systemic financial risks.

**Full liberalization of capital account may not be suitable to all countries and under all circumstances.** Capital account liberalization is beneficial when a country has the capacity to handle volatile CFs without creating macro-financial risks. If the necessary conditions for safe liberalization are not met, removal of CFM measures gives rise to premature liberalization, and reintroduction of CFMs will help preserve macro-financial stability.

**We agree that certain measures should not be considered or reviewed by the Fund under the IV** because of their special nature. These measures are those (i) introduced solely for national or international security reasons, (ii) adopted pursuant to internationally agreed prudential frameworks (including reciprocity agreements), (iii) related to AML/CFT measures implemented consistently with international standard, and (vi) arising from certain international cooperation standards against the avoidance or evasion of taxes. These measures should only be assessed under international standards.

**CFs may have asymmetric and long-term impacts on households' incomes.** Therefore, CFs can heighten inequalities, especially in countries where social safety nets are not functioning well. We are of the view that incorporating income distribution in the IV will strengthen the Fund's toolkits.

**Defining the principals of designing an effective and efficient CFM/MPM is warranted.** We share staff view that CFM/MPMs should be temporary, well targeted, calibrated to risks, and their use be transparent. We welcome the preparation of the Background Note 3, which summarizes these principles and allows conducting a cost-benefit analysis of the measures. However, we miss in the note a further elaboration on the effectiveness of the measures when deployed in countries.

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GRAY/22/824

March 17, 2022

**Statement by Mr. Mohieldin and Mr. Al-Kohlany on Review of the Institutional View on  
the Liberalization and Management of Capital Flows  
(Preliminary)  
Executive Board Meeting  
March 21, 2022**

We thank staff for the comprehensive report and helpful background papers on the Review of the Institutional View on the Liberalization and Management of Capital Flows (IV). We welcome this timely review and staff's proposals for further enhancements, building on analytical work under the Integrated Policy Framework, and informed by the Board's discussion of the IEO evaluation and by lessons drawn from different country experiences since the implementation of the IV. The IV should continue to help countries benefit from capital flows while effectively managing their associated risks and safeguarding stability.

We support the report's key proposals on the use of preemptive CFM/MPMs on inflows and on the special treatment for certain measures. The new additions would allow for more flexibility in managing capital flows under certain specified circumstances, with appropriate safeguards as described in the report. We invite staff to apply judgment and country-specific context when considering the appropriateness of measures evaluated under the IV. We agree that staff should continue to warn against measures that may be ineffective or distortionary or have adverse repercussions.

The use of preemptive CFM/MPMs measures to manage risk arising from disruptive capital inflows should be acknowledged as a part of a broader toolkit during an inflow surge or to avoid a crisis or near-crisis situation. Preemptive measures can be more effective, less disruptive, and less costly, especially when there is no space for additional macroeconomic adjustment. CFM/MPF measures can also be a valuable part of the financial stability framework in special circumstances and can increase the scope for stabilization policies. Moreover, when countries face serious external stresses and disruptive outflows, we

welcome staff's recognition that there would be value in taking preemptive policy responses well before a situation evolves into a crisis.

Countries with fixed exchange rate regimes may have a stronger case for using preemptive CFM/MPMs; this is particularly true for those with exports mainly denominated in dominant currencies. We agree with staff that such countries would face tighter constraints in the use of monetary policy or in allowing for nominal exchange rate flexibility to achieve external adjustment than those with more flexible exchange rate regimes. CFM/MPM measures should only be used temporarily and with all the safeguards in place, and should not be viewed as a substitute for needed macroeconomic and structural adjustments.

We appreciate the report's discussion on the issue of evenhandedness. Considerable effort should continue to be exhorted to ensure that advice is consistent, tailored to country circumstances, and evenhanded across countries. This is particularly relevant with regards to staff's proposals for the special treatment of certain types of measures. We note the special treatment status applied to measures introduced for security reasons, internationally agreed prudential standards, AML/CFT, and international cooperation standards against tax evasion or avoidance. We agree that these measures should not be assessed under the IV and can be reported under the regular surveillance products if deemed macro-critical.

Finally, digitalization and the use of digital money, Crypto assets and associated products have grown tremendously over the last few years and are expected to continue to increase in relevance. We invite staff to evaluate the potential impact of these innovations on the developments and volatility of capital flow and their future significance to the IV.

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GRAY/22/834

March 17, 2022

**Statement by Mr. Bhalla and Mr. Goyal on Review of the Institutional View on the  
Liberalization and Management of Capital Flows  
(Preliminary)  
Executive Board Meeting  
March 21, 2022**

1. We thank Staff for a very comprehensive report and bringing fresh thoughts to an issue which is so critical for the entire membership and operations of the IMF. We broadly agree with the suggestions and particularly welcome incorporating new elements drawn from the IPF workstream. Our observations on the paper are briefly set out below.
2. We fully support the case made out by the Staff for preemptive use of CFM/ MPMs. These are the key learnings from the analytically rich IPF workstream and have been recommended by the IEO report as well. Nevertheless, we agree with the analysis that preemptive CFM/ MPM should not substitute for market development or structural policies to reduce the underlying frictions. But as acknowledged in the report, such policies can take time to be implemented and become effective; preemptive measures CFM/ MPM are appropriate in the interim.
3. We agree with the proposed three-pronged criteria to determine the appropriateness of the CFM/ MPM, viz., 1. Are systemic financial risks are elevated? 2. Whether CFM/ MPM needed to address these risks and 3. Would the CFM/ MPM maintain or exacerbate divergence from the warranted external position?
4. Objectivity and evenhandedness would need to be ensured, particularly regarding the 3<sup>rd</sup> criteria above. This inter alia involves evaluating 3 key elements of the IV framework, viz., currency valuation, reserve adequacy and the output

gap. It is always preferable that authorities and the Staff are on the same page regarding the assessment of these three key parameters. But, given that there are alternative methodologies to determine each of these parameters, the views of authorities and the Staff do often vary. Significantly, results from 3 alternative methodologies diverge widely for currency valuation under the ESR. We note that Staff is engaged with the updation of ESR methodologies. Whether steps are being envisaged for other components so that views held by the authorities and the Staff narrow down? Nonetheless, we do take note of matrices proposed in the Heatmap analysis of capital flows in the report.

5. Moreover, the choice of pre-emptive measures may be guided by their efficacy in the past. But the CFM/MPMs - which may have worked well in the past – may not always be as effective in addressing future systemic risks. Therefore, it is often difficult to precisely measure the outcomes and assign them to one policy specific measure when various other factors are also at play. Since it is hard to make an objective assessment on the effectiveness of policy measures, assessment in terms of the appropriateness of pre-emptive CFM/MPMs would involve a lot of subjective judgement.

6. Further, more clarity and objective framework would be needed to assess whether a policy measure can be termed as CFM or MPM or CFM/ MPM. As such, Staff recognizes that "... delineation of CFMs from other policies and measures affecting capital flows can be challenging ... .". The role of judgement may be inevitable but then evenhanded would be imperative.

7. Paper also mentions that "While safeguard/contingency frameworks themselves do not constitute CFMs, newly introduced or revised frameworks will be reviewed, and advice will be provided on their use consistent with the IV". We agree with the proposal that safeguard/contingency frameworks themselves do not constitute CFMs until their activation. Some members may introduce legislations or regulation that can have enabling provisions allowing introduction of CFMs in certain extraordinary circumstances. We believe this procedure would be applicable for all including newly introduced or revised or existing frameworks. Staff may like to confirm.

8. Paper observes that CFMs should be used only in crises or imminent crisis situations and there is not a compelling case in the literature to propose using CFMs on capital outflows in a preemptive manner (page 32). We believe from emerging market and developing economies' (EMDEs) perspective, sudden

outflows may entail greater risks as compared with inflows. Use of pre-emptive CFM on outflows is particularly important for EMDEs, as a slight delay in taking appropriate measures may cost heavily to these economies.

9. Even though CFM/ MPM provides interim relief to the economies witnessing surge and sudden capital outflows, use of these measures is not without cost. As noted in the report, these may have side effects, e.g., misallocation of resources and rent-seeking. Given that surge and reversal of capital flows may also reflect spillover of macro policy stance of source economies, policy actions need to be coordinated among the recipients and source economies. Not only will this reduce the overall need for adjustments and the economic cost, it would also meet the requirement of fair burden-sharing. We do not see any reference to source economies and their role and responsibility in addressing capital flow volatility. We would welcome Staff comments.

10. The point made in the report that the use of dominant currency dilutes the impact of currency depreciation on trade gains is quite intuitive and acceptable. This essentially refers to the transmission of changes in the exchange rate to prices of the tradable. However, we note that under the ESR, the impact of currency depreciation on BoP is based on trade elasticities with respect to REER and the impact of dominant currency and changes in prices of tradable are already factored in these elasticities. While the dominant currency pricing does explain the underlying dynamics and provide insights, it may not change the overall assessment with regard to currency valuation.

11. One minor point. Footnote 5 on page 11 states that FX mismatches can be offset by natural hedges such as export revenue or remittances or hedges. In our opinion, remittances may not help much in offsetting FX mismatches. Remittances are invariably received by the individuals and FX liabilities are largely held by the corporate or financial institutions.

12. We agree with proposed special treatment for certain categories, viz., measures related to national or international security, pursuant to internationally agreed prudential frameworks, AML/CFT measures and measures arising from international cooperation against evasion of taxes.

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GRAY/22/837

March 17, 2022

**Statement by Mr. Mozhin and Mr. Shestakov on Review of the Institutional View on the Liberalization and Management of Capital Flows  
(Preliminary)  
Executive Board Meeting  
March 21, 2022**

We thank staff for the set of informative papers and for the engagement with our office. **We welcome the timely Review of the Institutional View on the Liberalization and Management of Capital Flows and support the proposed policy changes.** The Institutional View (IV) has served the Fund well as a consistent framework for advice on capital flow management, and it does not need an overhaul, but a fine tuning to reflect new theoretical advances, as they were presented by the 2020 IEO evaluation, as well as staff's experience with the implementation.

**We strongly support the fact that the core of the IV remains unchanged.** Capital flows can bring substantial benefits for countries, including the ability to support high-return investment, to diversify risk across countries, and to increase domestic consumption smoothing through international borrowing and lending. Nevertheless, in some cases capital flow management measures (CFMs), or CFMs that are also macroprudential (CFM/MPMs) might be warranted to protect macroeconomic and financial stability.

**We see merit in recommending preemptive inflow CFM/MPMs to address systemic risks elevated due to FX mismatches.** During a capital flow reversal episode, a central bank faces a trade-off where raising the interest rate could result in tight domestic monetary conditions and exacerbate economic downturn, while lowering the interest rate will lead to further depreciation and tighter external borrowing constraints. Preemptive inflow CFM/MPMs limit accumulation of FX mismatches and enhance monetary autonomy. Actual decision to impose inflow CFM/MPMs should also take into consideration carry costs of FX reserve accumulation, as well as country-specific legal and administrative infrastructure.

**We concur that some categories of CFMs may be subject to special treatment and their appropriateness should not be assessed under the IV.** We agree with staff that the Fund is not an appropriate forum to discuss political and defense considerations regarding the appropriateness of FDI-screening on the grounds of national security. Measures based on internationally agreed prudential standards, AML/CFT measures applied on risk-sensitive basis in accordance with the FATF standards, and some measures arising from international cooperation against tax avoidance or evasion should also be considered CFMs, but there is no case for assessing them under the IV.

**We welcome the additional guidance provided during the Review on key concepts which matter for the implementation of the IV.** We particularly appreciate the proposed definition of macro-criticality and a stepwise procedure to detect an inflow surge through a heatmap of indicators. However, since many of the proposed concepts are of qualitative nature and lack specific numerical thresholds, transparency in application of the IV and dialogue with the authorities will be critical in specific cases.

**Implementation of the IV and communication of the Fund's advice in the program context should be more consistent.** While some countries might put redlines on the use of capital flow management in hopes of restoring market confidence, such decisions have no solid basis in macroeconomic theory and might result in the failure of the Fund's program, in which case the Fund will essentially finance the outflows of private capital. Country teams in program cases are responsible for clear communication of consequences of such decisions to the authorities.

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GRAY/22/839

March 17, 2022

**Statement by Mr. Jin, Mr. Zhang, and Mr. Law on Review of the Institutional View on  
the Liberalization and Management of Capital Flows  
(Preliminary)  
Executive Board Meeting  
March 21, 2022**

We thank staff for the comprehensive set of papers on reviewing the Institutional View (IV) on the Liberalization and Management of Capital Flows. We welcome staff's efforts to modernize the framework based on the main considerations of the recent work on the Integrated Policy Framework (IPF), the Independent Evaluation Office (IEO) report, country experiences, and other sources. While we broadly support the proposals, we think that certain operational details should be finetuned. We would like to offer the following comments.

**The core premises and objectives of the IV remain appropriate, but the Fund should work towards reducing the stigma associated with CFMs and CFM/MPMs.** The IPF has noted that MPMs, foreign exchange intervention, and CFMs can help enhance monetary autonomy, improve financial and price stability and reduce output volatility in the presence of financial frictions and balance sheet vulnerabilities. Experiences show that CFMs can be most effective when they are deployed alongside other policies as part of a multi-pronged approach, and not only as a last resort. We also continue to support the emphasis by the paper that there is no presumption that full liberalization is an appropriate goal for all countries at all times.

**We reiterate the importance that capital flows be regulated “at both ends,” i.e., in both source and recipient countries.** Central banks in advanced economies play a key role in global capital flows, but the IV has largely focused on the recipient countries and places the burden of management of capital flows on emerging market and developing economies (EMDEs). As mentioned by successive IEO reports, “IMF warnings to source countries about the implications of spillovers for their policy mix could have come earlier and been more forceful.”<sup>1</sup>, but we fail to see how this IEO recommendation has been addressed in the

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<sup>1</sup> See “IMF Advice on Capital Flows: Multilateral Issues”, IEO (2020), and “IMF Financial Surveillance”, IEO (2019)

review, particularly against the backdrop of policy normalization in advanced economies. *Staff's comments are welcome.* The IEO reports also noted that the WEO and GFSR had given “less attention to which countries were the source of the flows and whether spillover effects could be mitigated by a shift in policy mix.” We urge staff to act on the observations by the IEO and step up their focus on the source countries in the upcoming April flagships and future surveillance work.

**We would appreciate more details on how “imminent crisis circumstances” would be identified in practice.** With monetary conditions tightening in advanced economies, the risk of “sudden stops” in EMDEs has heightened. However, as pointed out by the paper, crises are by nature difficult to predict. In the absence of a counterfactual (i.e. the actual crisis), we are unsure how the Fund can determine whether a crisis is “imminent” in practice. As in the recent case of Argentina, the Fund has admitted that in the absence of CFMs, the Fund disbursements “effectively financed capital flight of an historic size”. This Argentine experience shows that Fund staff are extremely reluctant to recommend CFMs, even as a last resort. A recent op-ed has called it “a decidedly ideological position with no basis in prevailing economic theory.”<sup>2</sup> Given the need for significant staff judgment, we would appreciate more details on how the Fund can ensure consistency and evenhandedness, and how the Fund would put in place the right incentives for frontline staff to recommend CFMs when needed. *Staff's comments are welcome.*

**Given the heightened geopolitical tensions around the world, we remain deeply concerned about the treatment in staff proposal related to national and international security, as we have mentioned in the informal Board meeting last year.** It cannot help prevent abuses that can generate long-lasting credibility damage to the international monetary and financial system that are public goods by nature. We would request for stronger safeguards to avoid mass destructive usage that destabilize the world economy as a whole. The review would have benefited from further analyses of the wide impact of financial sanctions on capital flows. We take note that the original 2012 paper mentioned that the IV “does not rule out the maintenance of... measures that members may maintain for reasons of national security.” *Could staff elaborate on how well this original formulation has worked in the past decade, and why staff considered it inadequate?* We view that there is a high risk of abuses by relying on members’ representation of the objective of the measure and we believe this is not beneficial to maintain the credibility of the existing international financial infrastructure. The Fund needs to retain its professional responsibility to check members’ representation, in a manner similar to Decision 144, to ensure that such measures are used only judiciously. We do not view that the more limited jurisdiction of the Fund over capital account restrictions precludes the Fund from making its technical and professional view in this regard. *Staff's comments are welcome.* Measures introduced solely for the

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<sup>2</sup> “The IMF’s Unfinished Business”, Joseph E. Stiglitz and Kevin P. Gallagher, Project Syndicate, March 7, 2022

preservation of national or international security on different levels should also be clearly highlighted to the Board and the public in the Staff Reports and other relevant documents.

**We generally welcome the proposed elaboration on macro-criticality.** However, we would appreciate more details by staff on how to assess the macro-criticality of measures related to national and international security. Given that sanctions are generally more likely to be macro-critical to the sanctioned country than the sanctioning country, staff should consider applying a reasonable threshold level of “macro-criticality” to ensure that those measures would not go undiscussed in relevant countries’ Article IV consultations. *Staff’s comments are welcome.*

**We agree that measures based on internationally agreed prudential standards could be carved out.** While we broadly support that regionally or even bilaterally agreed reciprocity arrangements that build on the Basel standards should also be carved out in the same manner, we stress the importance of strong safeguard to protect against inappropriate use and to ensure evenhandedness. *Could staff list out the regional and bilateral arrangements that are captured under the current proposal? Given that internationally agreed prudential standards do not include just the Basel standards, could staff clarify whether other prudential standards, such as those related to securities, insurance companies, or other non-bank financial institutions, would also be included in the proposal?*

**Staff should continue to engage the Executive Board on emerging issues related to CFMs.** Many of the topics mentioned in paragraph 7 of the paper are important, particularly on the use of outflow CFMs outside of (imminent) crisis circumstances, and it is unfortunate that they could not be covered in this review. Staff should also prioritize their research on areas including the distributional effects of capital flow liberalization and the effects of digitalization. Staff should engage the Board on these issues before the next review of the IV.

**Lastly, we suggest staff to come up with an alternative acronym for the framework.** The Fund has – and may have more in the future – “institutional views” on other policy areas, not just on the liberalization and management of capital flows. We do not see compelling reasons to reserve the acronym “IV” to this area of work. Acronyms such as “IVCFM” can be used instead. *Staff’s comments are welcome.*

## Review of the Institutional View on the Liberalization and Management of Capital Flows

Responses to Technical Questions Posed by Executive Directors in Advance of  
EBM/22/27—March 21, 2022

*Staff's responses to technical questions are below. Broader policy questions in the areas of operationalization of CFM/MPM assessments and communication issues will be addressed in staff's intervention at the Board meeting.*

### Assessment of preemptive CFM/MPMs

1. **We would welcome greater clarity from staff on who would be responsible for providing this assessment in practice, when, and whether there is sufficient and timely data available to facilitate such an assessment.**
  - An interdepartmental team comprising LEG, MCM, RES, and SPR will work with the relevant country team to undertake the assessment as part of bilateral surveillance and to report the findings in Article IV staff reports.
  - Regarding data availability in the assessment of systemic financial risks, Background Note 2 has outlined steps for staff to undertake, building on the guidance of the 2021 Comprehensive Surveillance Review. The note proposes the use of datasets which provide coverage for a great majority of the Fund's membership. It also proposes, that if data gaps are severe for the country in question, both quantitative and qualitative information regarding debt and asset positions should be uncovered as much as possible with the help of country authorities, who may have access to information which could help inform stress tests. Similar principles apply regarding the data availability for the other appropriateness criteria, where staff should additionally draw on other analyses already conducted as part of bilateral surveillance, such as the External Sector Assessment and Financial Sector Stability Assessments.
  
2. **While we appreciate efforts by staff to clearly outline the criteria to assess the appropriateness of preemptive use of CFM/MPMs, we are concerned about the possibility of the criteria being applied overly prescriptively.**
  - The assessments of appropriateness of CFM/MPMs will be informed by all available data and take into consideration country-specific circumstances. As such, they will involve discussions with the authorities, they will possibly need additional information from the authorities, and they will inevitably require an element of judgment. The assessment criteria discussed in the paper are intended to provide structure and transparency to the assessment process, and to make sure that assessments will be made consistently and evenhandedly across cases. To further ensure consistency and thoroughness, they will be facilitated and overseen by an interdepartmental team comprising LEG, MCM, RES and SPR as part of the internal review process.
  
3. **We would like to hear more details from staff on the implementation of the proposed change to the IV, especially when considering their dialogue with**

**authorities. We are also interested to know staff's opinion on the risk of the application of preemptive inflow CFM/MPMs turning into a permanent tool, which could substitute warranted macro-economic adjustment or postpone dealing with structural financial vulnerabilities.**

- The assessment will be undertaken by an interdepartmental group comprising staff from LEG, MCM, RES, and SPR, in collaboration with the country teams. Dialogue with the authorities will be an essential component of this assessment as necessary data is collected, analysis is conducted, and country-specific information is obtained, as has been under the 2012 IV. Consistent with the 2021 Comprehensive Surveillance Review, staff teams are required to have a well-articulated view on systemic financial risks grounded in a rigorous analysis of vulnerabilities; in addition, the other appropriateness criteria will be assessed in bilateral surveillance. Following Fund practice, any remaining differences in opinion between staff and the authorities will be reflected in the Article IV report.
  - Since preemptive CFM/MPMs are aimed to tackle stock vulnerabilities, they may need to be long-lasting. Therefore, it is crucial to avoid that these tools become permanent, substitute for warranted macroeconomic adjustment and, structural reforms, or undermine market development. To help ensure that this does not happen, the introduction of a preemptive CFM/MPM will be followed by periodic assessments in subsequent Article IV consultations of the measure and its effects. Such assessments will take into consideration any additional information available since the initial assessment was made, including whether MPMs might have become available that could address the financial stability risks in a less distortionary way. In addition, the Fund will continue to support structural policies and reforms to address the underlying frictions through capacity development (CD). Such structural policies may include, for example, developing local currency bond markets, boosting the credibility of the macroeconomic policy framework, and developing sound financial supervision and regulation. These CDs aim to help countries to address the frictions and thus reduce the need to rely on CFM/MPMs.
- 4. Do the policy changes imply that a country that meets the assessment criteria will be subject to this policy prescription?**
- Staff does not propose changes to the approach that has been followed since 2012 with the implementation of the IV. Staff will follow the same approach with preemptive CFM/MPMs as it followed with CFMs and other CFM/MPMs until now. Staff will advise on the use of preemptive CFM/MPMs according to the criteria outlined in the review paper.
- 5. We welcome that Background Note 2 includes a two-step process to assess systemic risks from FX mismatches, but continue to believe that transparently identifying those countries that meet Step 1 would be useful for country teams as well as the Board ... To this end, it would be helpful if staff could regularly update the Board on which countries meet Step 1. Further, we also ask staff to provide a brief update on how many countries may be affected by lack of data availability in conducting this two-step analysis.**

- The assessment of the systemic financial risks which may justify preemptive CFM/MPMs relies on both step 1 and step 2. Moreover, we have advised that, if the results of step 1 are ambiguous, staff should err on the side of caution and proceed to step 2, where the more substantive and resource-intensive analysis of adverse scenarios is conducted, and the amplifying and mitigating factors are incorporated. As a result, identifying countries which meet step 1 would be unrepresentative of the countries which would satisfy both steps, and the resources required for step 2 would not be best spent in those countries not considering preemptive CFM/MPMs. Given these considerations, the preference is that both parts of the systemic risk assessment be conducted as part of bilateral surveillance. As described in Background Note 2, staff has proposed the use of datasets which provide coverage for a great majority of the Fund's membership, but the lack of data availability, and the steps taken to remedy it, will be documented in the relevant Article IV staff reports. Separately from the assessment of preemptive CFM/MPMs, any lack of data availability to assess systemic financial risks would be gradually identified over time as staff implement the recommendations of the 2021 Comprehensive Surveillance Review, including the mandate to have a well-articulated view of systemic financial risks.
- 6. For significant systemic risks, policymakers may find it useful to focus on measures to mitigate such risks, while macroeconomic adjustment and current account imbalances run their course ... However, this does not come across as clearly as it could in the text, which emphasizes the negative conditions for withholding MPM/CFMs, rather than the positive ones. This distinction is relevant from a communications perspective, even if logically equivalent. We therefore suggest staff to consider an alternative drafting on this specific issue. In the same vein, we suggest reverting from Figure 3 to the more informative flow chart in Slide 16 of the staff presentation for the informal Board discussion last July.**
- The discussion in the board paper aims to provide a balanced treatment between positive and negative conditions. Positive conditions include the assessment of systemic financial risks and the effectiveness of the proposed preemptive CFM/MPM in addressing these risks. Negative conditions cover those under which the preemptive CFM/MPMs would not be appropriate, such as when they substitute for warranted macroeconomic adjustments or structural reforms and when they help maintain or exacerbate a stronger-than-warranted external position that is mostly caused by domestic policy gaps. This balance in the discussion is intended to facilitate implementation of the assessment criteria: provided these conditions are respected, staff can discuss the proposed preemptive CFM/MPM and appropriate policy combinations using additional analytical arguments, e.g., the Integrated Policy Framework, as well as country-specific considerations, e.g., those in Background Note 1.
  - Figure 3 is a simpler version of the flowchart from slide 16 in the informal Board discussion, the only difference being that in figure 3 the assessments do not need to be undertaken in the same rigid sequence, e.g., if the external balance test is not satisfied, i.e., one of conditions 3a or 3b hold in figure 3, the proposed CFM/MPM would clearly be inappropriate, without the need to assess systemic financial risks. After discussions with country teams, it has become clear that this freedom in sequencing would facilitate

implementation by making it more practical and less resource-intensive for staff to conduct the relevant analyses, while respecting the assessment criteria.

**7. We seek staff’s assurance that the assessment of appropriateness of pre-emptive CFMs/MPMs accommodates the fact that drivers of spillovers from AEs to EMDEs and the related capital flow deflections, are critical for retaining pre-emptive CFMs for some countries.**

- The assessment of the appropriateness of preemptive CFM/MPMs will be based on the vulnerabilities and the policies of the country that receives the flows. Staff will analyze whether systemic financial risks (stemming from stock vulnerabilities) are elevated and whether the preemptive CFM/MPM is needed to address such risks and does not help maintain or exacerbate a stronger-than-warranted external position. The criteria discussed in the paper should be met for the CFM/MPMs to be considered appropriate. While loose global financial conditions per se would not alone justify the use of preemptive CFM/MPMs, they could well be a factor causing the build-up and persistence of stock vulnerabilities in EMDEs, which can affect the appropriate duration of preemptive CFM/MPMs.

**8. Staff’s elaboration on how countries should proceed in imposing preemptive CFM/MPMs without compromising their liberalization plans would be highly appreciated.**

- The proposed CFM/MPM should be considered in the context of the liberalization plan. The IV guidance on capital flow liberalization emphasizes that liberalization is more beneficial and less risky if countries have reached certain levels or thresholds of financial and institutional development. Therefore, liberalization needs to be well planned, timed, and sequenced to ensure that its benefits outweigh the costs and to reduce the risks of potentially costly backtracking that may undermine the credibility of the liberalization plan. Such a strategy should involve supplementary reforms to safeguard financial stability and facilitate market development, including by strengthening financial supervision and regulation, enhancing the macroprudential policy framework, and fostering local capital markets. Reforms undertaken in support of the liberalization strategy may reduce the underlying frictions that make preemptive CFM/MPMs necessary; while conversely, a premature liberalization may increase the risk that stock vulnerabilities will build up, necessitating the use of preemptive CFM/MPMs. If stock liabilities do accumulate and pose financial stability risks, the use of preemptive CFM/MPMs may be appropriate under the revised IV even in countries that are in the process of liberalizing their financial account, provided that the conditions in Section II of the paper are met. The proposed CFM/MPM would not be appropriate if owing to its design, it undermines or substitutes for market development or structural policies that are part of the liberalization plans and could reduce the underlying frictions.

**9. We would encourage the Fund to be more explicit about the preferred hierarchy of policies. ... Background Note 3 mentions that “Where measures that do not discriminate by residency are available and effective, they should be preferred”, but we think this point would warrant mentioning in the main document.**

**We believe the main document could have given this hierarchy more explicit emphasis.**

- The 2012 IV and the current review already contain guidance on the preferred hierarchy of MPMs and different kinds of CFM/MPMs, while bearing in mind that, in practice, the precise design of the specific measures is important in determining the ranking between them. Both the 2012 IV (paragraphs 34 and 35) and the current review (paragraph 18) judge CFM/MPMs to be a needed instrument to address systemic financial risks only if MPMs are insufficient to accomplish this task. Moreover, as stated in paragraph 34 of the 2012 IV and paragraph 6 of Background Note 3 in the current review, CFM/MPMs should seek to treat residents and non-residents in an evenhanded manner; consequently, where measures that do not discriminate by residency, for example currency-based measures, are available and would be effective, they should be preferred.

**10. We note that staff spell out in paragraph 65 treatment of cases where CFMs/MPMs are applied to FX purchases between residents. We agree that such policies should be treated as CFMs/MPMs and assessed under the IV. CFMs/MPM policies that target currency rather than residency could be preferable if the underlying vulnerability is FX mismatch or other sources that would be best addressed by targeting currency specifically. ... This view is similar to some of the material in Background Note 3, but we think they also merit inclusion in the main Review document.**

- The 2012 IV defines CFMs as measures designed to limit capital flows. Currency-based measures are considered CFMs when they are designed to limit capital flows. This definition continues to apply. Paragraph 65 clarifies that certain restrictions on transactions in FX between residents can affect the balance of payments and international investment position of the country, i.e., can be assessed as designed to limit capital flows, depending on the circumstances in which these are used. As stated in the 2012 IV, and as will continue to apply following the review of the IV, measures which are not residency-based, such as currency-based CFMs or CFM/MPMs, are generally preferred to residency-based measures.

**11. Footnote 5 on page 11 states that FX mismatches can be offset by natural hedges such as export revenue or remittances or hedges. In our opinion, remittances may not help much in offsetting FX mismatches. Remittances are invariably received by the individuals and FX liabilities are largely held by the corporate or financial institutions.**

- The analysis of vulnerabilities in each country context should focus on whether the economic agents that hold the FX liabilities in that country have any hedges that mitigate such liability. In the example presented, it is correct to conclude that the remittances would not mitigate the vulnerability of the corporate or financial institutions that hold the FX liabilities. However, remittances could in other cases provide hedging for individuals who have FX liabilities.

**12. Local-currency debt vulnerabilities do not generally justify preemptive CFM/MPMs, given the availability of better-suited ex-post policy instruments. Could staff provide a more precise explanation of the specific narrow and exceptional circumstances under which preemptive CFM/MPMs are deemed appropriate? Concrete examples would be very appreciated.**

- The board paper allows for narrow and exceptional circumstances where local currency debt vulnerabilities may justify preemptive CFM/MPMs. As part of the assessment of systemic financial risks, the conditions (i)-(iv) in paragraph 16 must be jointly satisfied, and we can provide some illustrative, but not exhaustive, examples. Condition (i) captures those cases where the exit of some foreign investors from some parts of the local currency debt market generates excessive premia and fire sales, e.g., when the domestic investor base (including pension and mutual funds) is poorly developed and cannot absorb the assets except at a large discount. Condition (ii) captures those cases where depreciations are especially destabilizing, e.g., when there are large FX mismatches or it has been established that de-anchoring of inflation expectations in the past has been caused by sharp movements in the exchange rate and the costs of these depreciations have as a result outweighed the benefits, such as from an improvement of net exports. Condition (iii) captures cases where, e.g., low FX reserves would prevent intervening to dampen the depreciation and the policy rate is also not available. Condition (iv) captures substantial impediments to, or unavailability of, other key tools such as local currency lender-of-last-resort facilities.

**External sector related issues**

**13. We call for continued work to enhance the External Sector Assessment (ESA) methodology. This is important, as the exchange rate assessments under the ESA will play a key role in evaluating the appropriateness of preemptive inflow CFM/MPMs.**

**The limitations of the External Sector Assessment (ESA) should be properly reflected. We call upon staff to remain mindful of the caveats associated with the ESA and to properly account for them in the CFM/MPM assessment.**

**Reasonable judgment is especially important when the IV relies on assessment tools that present its own set of shortcomings and challenges (e.g., EBA, ARA). ... We urge staff to recognize these limitations and exercise flexible judgment when assessing the appropriateness of CFMs, to avoid the perception of the IV being another rules-based assessment. In fact, while the rationale and validity of the EBA tool remains contentious, it would be best to avoid making the IV assessment conditional on it.**

**As the suggested framework for CFM/MPM assessment incorporates the external position assessments as a key element, the improvements to the EBA model need to be made as well.**

- Staff periodically refines the External Balance Assessment (EBA) and EBA-lite frameworks, which inform External Sector Assessments (ESAs) (the most recent round of refinements was just presented to the Board this week). The ESAs are an input into the assessments of the appropriateness of preemptive CFM/MPMs as they help determine whether the CFM/MPM could help maintain or exacerbate a stronger-than-warranted external position, and whether those positions are mostly caused by domestic policy gaps. A discussion of the methodologies that underlie the ESAs is outside the scope of the review of the IV. For consistency in Fund surveillance, assessments under the IV must rely on the ESAs presented in the staff reports. As changes to the EBA and EBA-lite frameworks are introduced, in consultation with the Board, these will automatically feed into the assessments of CFM/MPMs under the IV.

**14. As regards the assessment method of the appropriateness of a preemptive CFM/MPM ... adroitness is still required in determining whether the CFM/MPM is used to gain an unfair competitiveness advantage. Staff's view is welcome.**

- The external balance portion of the assessment aims to determine whether the use of the proposed preemptive CFM/MPM could help maintain or exacerbate a stronger-than-warranted external position that is mostly caused by domestic policy gaps. Inputs from the External Sector Assessment (ESA) as well as staff judgment must be carefully combined to ascertain the strength of the external position, the contribution of domestic policies, the expected effect of the preemptive CFM/MPM on the external position, whether the country is undertaking, or committed to undertake, corrective actions, and the effectiveness of these actions compared with the strength and duration of the external position and the extent of the systemic financial risks. Such an analysis can be undertaken without the need to ascertain the intent of the proposed preemptive CFM/MPM. Separately from this assessment, it continues to be the case that if it can be ascertained that the intent of any policy measure (including but not limited to preemptive CFM/MPMs) is to gain an unfair competitive advantage, the use of the measure would breach the member's Article IV obligations.

**15. This inter alia involves evaluating 3 key elements of the IV framework, viz., currency valuation, reserve adequacy and the output gap... We note that Staff is engaged with the update of ESR methodologies. Whether steps are being envisaged for other components so that views held by the authorities and the Staff narrow down?**

- Staff periodically refines the External Balance Assessment (EBA) and EBA-lite frameworks (the most recent round of refinements was just presented to the Board this week). There is no current plan to update the methodologies for assessing reserve adequacy and the output gap. Any advances in such methodologies over time will feed into Fund policy advice, including assessments under the IV.

**16. The point made in the report that the use of dominant currency dilutes the impact of currency depreciation on trade gains is quite intuitive and acceptable. ... However, we note that under the ESR, the impact of currency depreciation on BoP is based on trade elasticities with respect to REER and the impact of dominant**

**currency and changes in prices of tradable are already factored in these elasticities. While the dominant currency pricing does explain the underlying dynamics and provide insights, it may not change the overall assessment with regard to currency valuation.**

- The appropriateness criteria for preemptive CFM/MPMs draw on ESA outputs, specifically the overall assessment and the decomposition of the assessment into domestic and foreign policy gaps. The exchange rate adjustment which may be needed to achieve external adjustment depends on the elasticity of the current account to the exchange rate. The literature on currency of trade invoicing (for a summary, see Gopinath and Itskhoki, 2021) suggests that currency movements may have relatively modest effects on trade and current account balances in the near term. At the same time, for the five-year-ahead horizon on which external assessments focus, the ESR medium-term REER elasticities for deriving REER gaps is appropriate.

### **Design of CFM/MPMs**

**17. We welcome the preparation of the Background Note 3, which summarizes these principles and allows conducting a cost-benefit analysis of the measures. However, we miss in the note a further elaboration on the effectiveness of the measures when deployed in countries.**

- Consistent with Background Note 3, when designing preemptive CFM/MPMs in a way that they achieve their intended goal and are not easily circumvented, it is important to identify the source of the risks and to consider country-specific circumstances. For example, in countries where FX mismatches arise mainly through bank-intermediated debt inflows, the most effective measures are likely to be bank-centered (e.g., higher reserve requirements on banks' FX borrowing from abroad), while in countries where FX mismatches mainly arise in the corporate bond market, measures may target such flows (e.g., via unremunerated reserve requirements). The design and calibration of such tools should reflect country-specific features, including financial market development and the cross-border interest rate differential, to effectively reduce incentives to borrow in FX rather than domestic currency. The effectiveness of CFM/MPMs may be limited if they are not accompanied by the needed macroeconomic adjustment. To remain effective, some recalibration may also be needed to stem circumvention.
- Background Note 1 summarizes some empirical evidence on the effectiveness of CFMs and CFM/MPMs more broadly. For example, it notes that CFM/MPMs can have a complementary role in reducing systemic vulnerabilities to MPMs. Paragraph 16 notes that the use of MPMs on domestic lending may increase cross-border borrowing (borrowing directly from abroad or from foreign branches), justifying a complementary use of residency-based measures to contain such "leakage" (Nier and others, 2020; Ahnert and others, 2020). Paragraph 28 notes that targeted measures may be more subject to leakages, especially where the financial system is relatively well developed, underscoring the need for carefully calibrating the tools to country circumstances. The note also refers to IMF (2017), which contains eight background case studies that draw on a range of country experiences and discusses policy effectiveness.

- In addition, Erten et al (2021) provide an overview of the empirical findings on the effectiveness of capital controls. They find that capital controls are consistently found to have a robust impact on the composition of capital flows (channeling them toward longer-term flows) without generally having a significant effect on the total volume of flows. They also cite studies that find that inflow controls are associated with a lower proportion of FX lending in total domestic bank credit, and with a lower proportion of portfolio debt in total external liabilities. Both findings are relevant for the case of preemptive CFM/MPMs on debt inflows.

### The role of source countries

- 18. Given that surge and reversal of capital flows may also reflect spillover of macro policy stance of source economies, policy actions need to be coordinated among the recipients and source economies. Not only will this reduce the overall need for adjustments and the economic cost, it would also meet the requirement of fair burden-sharing. We do not see any reference to source economies and their role and responsibility in addressing capital flow volatility. We would welcome Staff comments.**

**We reiterate the importance that capital flows be regulated “at both ends,” i.e., in both source and recipient countries. As mentioned by successive IEO reports, “IMF warnings to source countries about the implications of spillovers for their policy mix could have come earlier and been more forceful.”, but we fail to see how this IEO recommendation has been addressed in the review, particularly against the backdrop of policy normalization in advanced economies. Staff’s comments are welcome.**

- Box 1 summarizes the IV’s advice on source countries and provides examples of the treatment of spillovers in recent Fund documents. The review maintains the principle that source country policies have a role in mitigating the multilateral risks associated with capital flows. It continues to recognize that surges in cross-border flows may indicate a need for adjustment in both recipient and source countries; that countries should consider measures to address the macroeconomic and financial stability risks associated with cross-border activities of markets and institutions in their jurisdictions; and that cross-border policy coordination between source and recipient countries would help to mitigate undesired spillover effects of policies. Spillovers from source country policies and coordination of policies are addressed in the context of the Fund’s multilateral and bilateral surveillance with member countries, consistent with the Integrated Surveillance Decision (ISD).
- Recent examples of when source policies have been discussed are the 2021 US Article IV Consultation, where substantial consideration was given to the importance of careful communication of policy changes, so that adverse spillovers could be minimized. The October 2021 IMF WEO also emphasized the importance of clear and state-contingent forward guidance and communication from advanced economy central banks during the period of normalization to avoid taper-tantrum-like scenarios. Finally, the March 2022

Staff presentation to the Board on Central Bank Exit Strategies also discussed potential spillovers from monetary policy normalization in advanced economies to EMs.

### **The Institutional View and the Integrated Policy Framework**

#### **19. We would like to hear how the policy change under IV will feed into the existing interim staff guidance for the IPF. Staff's comments are welcome.**

- Upon completion of the IV review, a Staff Guidance Note on the revised IV will be prepared and shared with the Board for information. The IPF workstream will continue to make progress in identifying appropriate combinations of policy tools (encompassing monetary, fiscal, FXI, MPM, as well as CFMs and CFM/MPM) for various shocks and country characteristics. This workstream may eventually feed into a separate Staff Guidance Note, while the IV will continue to guide the use of CFMs and CFM/MPMs in the IPF framework.

### **Special treatment for certain categories of measures**

#### **20. Capital inflow screenings introduced or expanded in some countries have had significant adverse spillovers on other economies, while leaving little room to assess their appropriateness and judiciousness. Staff's comments on this issue would be welcome.**

- If a capital inflow screening is introduced solely for national or international security reasons, and it is assessed as macro-critical or if it triggers significant outward spillovers that may influence the effective operation of the international monetary system, the proposal in the IV review is that the economic significance and potential macroeconomic effects of such measures and/or their spillover effects would be discussed in the Article IV staff report as required under the Integrated Surveillance Decision but its appropriateness will not be assessed under the IV. The expectation would be that such measure would be directly targeted at the relevant security risk and be used judiciously.
- Like in the streamlined procedure for the approval of exchange restrictions introduced solely for reasons of national or international security, the determination of whether the CFM is motivated solely by such considerations would be made based on the representation of the member to the Fund and the Fund, as a matter of policy, will not challenge such representation. If an Executive Director disagrees with the member's representation that CFMs are introduced solely for reasons of national or international security, such views will remain on record and can also be included in the Summing Up for the Board discussion of the relevant country report.

#### **21. We would emphasize that the exclusion based on national or international security reasons should be used sparingly. Do Staff intend to add any further detail on what constitutes an emergency use of CFMs, especially given the current geopolitical sanctions?**

**We generally welcome the proposed elaboration on macro-criticality. However, we would appreciate more details by staff on how to access the macro-criticality of measures related to national and international security. Given that sanctions are generally more likely to be macro-critical to the sanctioned country than the sanctioning country, staff should consider applying a reasonable threshold level of “macro-criticality” to ensure that those measures would not go undiscussed in relevant countries’ Article IV consultations. Staff’s comments are welcome.**

- The paper proposes to exclude from the assessment of appropriateness under the IV all CFMs introduced solely for national or international security reasons on the basis of the authorities’ representation with regard to the security justification. This approach is consistent with the long-standing principle that the Fund does not provide a suitable forum for discussion of the political or military considerations leading to actions imposed for national or international security, and the recognition that other international fora are better placed for such discussions.
- It would be for the member to represent to the Fund that CFMs are introduced solely for reasons of national or international security. The expectation would be that such measures be directly targeted at the relevant security risk and be used judiciously.
- While the appropriateness of CFMs that are security measures imposed by members will not be assessed under the IV, they will be discussed in Article IV consultations with the relevant member if these measures are considered macro-critical for the member, or if they general significant outward spillovers that may significantly influence the effective operation of the international monetary system, in accordance with the Integrated Surveillance Decision. For members subject to sanctions, staff's policy advice takes into account the economic impact of the sanctions as inward spillovers. If such impact is significant, it will be - and has been-- discussed in the staff report of the sanctioned country, even if the sanctions are not macro-critical for the country that imposed sanctions.
- Staff does not anticipate any other changes to the treatment of CFMs adopted for national or international security reasons beyond those proposed in the paper.

**22. Given the heightened geopolitical tensions around the world, we remain deeply concerned about the treatment in staff proposal related to national and international security, as we have mentioned in the informal Board meeting last year. It cannot help prevent abuses that can generate long-lasting credibility damage to the international monetary and financial system that are public goods by nature. We would request for stronger safeguards to avoid mass destructive usage that destabilize the world economy as a whole. The review would have benefited from further analyses of the wide impact of financial sanctions on capital flows. We take note that the original 2012 paper mentioned that the IV “does not rule out the maintenance of... measures that members may maintain for reasons of national security.” Could staff elaborate on how well this original formulation has worked in the past decade, and why staff considered it inadequate?**

- Under the 2012 IV, a determination of whether a measure is a CFM is made regardless of the stated intent or motivation behind the adoption of the measure. This principle is retained. As explained in the paper, the current proposal to clarify the treatment of the CFMs introduced for security reasons is motivated by the recent proliferation of such measures, which prompted staff to seek further guidance from the Board, in order to ensure consistent approach to such measures. In recent staff reports staff included a factual description of screening mechanisms represented to be introduced for security reasons when macro-critical but refrained from an appropriateness assessment in the absence of sufficient guidance on it in the IV

**23. We view that there is a high risk of abuses by relying on members' representation of the objective of the measure and we believe this is not beneficial to maintain the credibility of the existing international financial infrastructure. The Fund needs to retain its professional responsibility to check members' representation, in a manner similar to Decision 144, to ensure that such measures are used only judiciously. We do not view that the more limited jurisdiction of the Fund over capital account restrictions precludes the Fund from making its technical and professional view in this regard. Staff's comments are welcome.**

- The Fund has a long-standing approach to approval of exchange restrictions adopted solely for reasons of national or international security. These approval procedures are set forth in Board decision No. 144. Under that framework, the Fund's practice has been to rely on members' representation that a measure has been adopted solely for reasons of national or international security, and to grant approval for such exchange restrictions under Article VIII based on a non-objection procedure. While the Fund could challenge a member's representation, it has not done it in practice, although in a few cases a challenge was brought by another member. In all those cases the relevant exchange restrictions were deemed approved by the Fund.
- As explained in the 2012 IV and in the current review, in contrast to its jurisdiction over current account policies under Article VIII, the Fund has limited jurisdiction over members' policies respecting capital flows. Specifically, members have broad authority under Article VI, Section 3 to impose controls over capital movements and CFMs are not subject to Fund approval. Acknowledging a long-standing view that the Fund is not a proper venue to discuss political and military considerations that may lead to the imposition of certain measures, and following the approach under Decision No.144, the review proposes to rely on a member's representation that a CFM was adopted solely for reasons of national or international security. Concerns about the representation made by a member on the security justification for introducing such CFMs could be raised by Executive Directors in the context of those Article IV consultations. Such views could be reflected in the Summing Up of the Article IV consultation. The Fund's surveillance framework, in particular, the ISD, will continue to define the circumstances in which capital account policies, including CFMs introduced for national or international security reasons, are covered in Fund surveillance.

**24. Considering institutional and administrative capacity gaps and the lack of financial resources, levying discriminatory taxes on powerful multinational**

**enterprises may be challenging for poorer members. Staff's comments on how LICs are implementing measures through international cooperation to enhance tax compliance by MNEs, and better combat tax avoidance or evasion are welcome.**

- The proposal not to assess the appropriateness of a “residency-based” CFM that is based on and implemented in accordance with international cooperation standards against tax avoidance and evasion ensures consistency with current international trends, e.g., the adoption of defensive and discriminatory tax measures against jurisdictions—through which multinational enterprises commonly invest—that have been objectively determined to have failed to implement relevant international cooperation standards effectively. These measures can be resolved at different levels, e.g., regionally or unilaterally by individual countries—including by LICs—following the relevant international standards and based on the identification of countries that fail applicable peer review processes with respect to the implementation of those international cooperation standards.
- Fund staff continue to support LICs in their efforts to design and implement appropriate measures to combat tax avoidance and evasion, taking into account their capacity and resource constraints, through the Fund’s extensive capacity development program. Staff also support ongoing international cooperation efforts (e.g., in the OECD and United Nations)—which includes supporting the participation of LICs in those efforts—to enhance tax compliance and better combat all forms of tax avoidance and evasion.

**25. We note the special treatment status applied to measures introduced for security reasons, internationally agreed prudential standards, AML/CFT, and international cooperation standards against tax evasion or avoidance, and welcome that while not assessed under the IV, they will be classified as CFMs when they meet the criteria and will be discussed in surveillance when macro-critical. Could staff comment on the possibility of misclassification of these measures, and whether this could give rise to unintended effects and inappropriate assessment under the IV?**

- In most cases, staff does not foresee difficulties in determining whether a CFM falls into one of the categories that are proposed for the exemption from the general appropriateness criteria under the IV.
- For CFMs adopted solely for reasons of national or international security, the only criteria for classification of the measure as a security-based CFM is the authorities’ representation that the measure was introduced for these reasons. As a matter of policy, the Fund would not challenge such representation. If the measure is macro-critical, it will be mentioned as a CFM along with a discussion of its macroeconomic impact in the relevant Article IV consultation staff report. Concerns about the representation made by a member on the security justification for introducing such type of CFMs could be raised by Executive Directors in the context of those Article IV consultations. This in turn would provide for a mechanism for the Board to discuss concerns about possible abuses of the security justification for use of CFMs by members.

- With respect to tax measures constituting CFMs, such tax measures will only be excluded from the assessment of appropriateness under the IV when they are: (i) based on and implemented in accordance with certain agreed international cooperation standards (which greatly reduces the risk of misclassification given these standards are known and typically peer reviewed); and (ii) designed to prevent the avoidance or evasion of taxes (which significantly narrows the range of tax measures eligible for this special treatment, thereby further reducing the risk of misclassification).
- Should a member represent a CFM as an AML/CFT measure, such a measure should be in line with the international AML/CFT standard (i.e., it should be introduced with a view to mitigate a ML/TF risk).
- The scope for inappropriate use of internationally agreed prudential measures is likely to be limited in practice. This reflects that the CFM/MPM would have to be in line with known mutually agreed-upon international prudential standards. In addition, in the application to country cases, the interdepartmental group will work with country teams to assess whether any measure would fall outside of these agreements, thereby further protecting against inappropriate use.

**26. We agree that measures based on internationally agreed prudential standards could be carved out ... Could staff list out the regional and bilateral arrangements that are captured under the current proposal? Given that internationally agreed prudential standards do not include just the Basel standards, could staff clarify whether other prudential standards, such as those related to securities, insurance companies, or other non-bank financial institutions, would also be included in the proposal?**

- The scope for inappropriate use of internationally agreed prudential measures is likely to be limited in practice. This reflects the fact that the CFM/MPM would have to be in line with known mutually agreed-upon international prudential standards. In addition, in the application to country cases, the interdepartmental group will work with country teams to assess whether any measure would fall outside of these agreements, thereby further protecting against inappropriate use and serving as an important safeguard in that regard. This process could draw on expertise and capacity available at the Fund, as well as the norms set out in the Fund's macroprudential policy framework.
- Examples of regional and bilateral arrangements that are captured include the regional mechanisms operated by the European Systemic Risk Board (ESRB), which expands reciprocity to all exposure-based measures (i.e., beyond the countercyclical capital buffer, and including all exposure-based tools) among EU member countries. Another example is the agreement (via a memorandum of understanding) among the Nordic and Baltic countries, which has facilitated reciprocity of various macroprudential policies. Note that these are simply examples, not an exhaustive list.

**27. Given that internationally agreed prudential standards do not include just the Basel standards, could staff clarify whether other prudential standards, such as those related to securities, insurance companies, or other non-bank financial institutions, would also be included in the proposal?**

- Only those measures that are implemented in accordance with the Basel prudential standards outlined in paragraph 32 of Board Paper are proposed not to be assessed for appropriateness under the IV. These are the cases where staff are aware that tensions arise with regard to the IV.

### **Elaboration of important policies and concepts**

#### **28. Could staff comment on plans to deploy CD/TA and to develop guidance notes to help members with appropriate models and analytical tools (including high-frequency indicators) to help identify imminent crisis circumstances and define preemptive CFM/MPMs?**

- Following the completion of the review, staff will prepare a Guidance Note which will provide further guidance on the implementation of all the elements of the review, including the assessment of preemptive CFM/MPMs, the identification of imminent crisis circumstances (e.g., potential models and other analytical tools), and other issues.
- Staff will work with Area Departments to identify capacity development needs related to capital flow issues and incorporate them into the capacity development plans as appropriate.

#### **29. Could staff confirm whether the (interdepartmental group) will also be working on evenhanded treatment in the application of IV to imminent crisis situations, and in advising against premature liberalization?**

- The interdepartmental capital flows group comprising LEG, MCM, RES, and SPR will continue to work with country teams and oversee the policy advice on capital-flow-related issues as part of the internal review process to ensure an evenhanded treatment of the application of the IV. This practice includes assessments of imminent crisis situations or premature liberalization, as well as other issues covered in the IV. We note that, according to the 2020 IEO evaluation on IMF Advice on Capital Flows, staff's implementation of the IV was perceived by member countries as generally evenhanded.

#### **30. As in the recent case of Argentina, the Fund has admitted that in the absence of CFMs, the Fund disbursements “effectively financed capital flight of an historic size”. This Argentine experience shows that Fund staff are extremely reluctant to recommend CFMs, even as a last resort. A recent op-ed has called it “a decidedly ideological position with no basis in prevailing economic theory.” Given the need for significant staff judgment, we would appreciate more details on how the Fund can ensure consistency and evenhandedness, and how the Fund would put in place the right incentives for frontline staff to recommend CFMs when needed. Staff's comments are welcome.**

- The IEO Report on IMF Advice on Capital Flows recognized staff's "conscientious efforts to implement the IV in a consistent and evenhanded manner" (paragraph 70) and found that "the Fund's bilateral advice on capital flows has generally followed the IV and other

policy frameworks quite carefully" (paragraph 118). Staff will continue their efforts to ensure consistency and evenhandedness.

- Staff will continue to generally follow the current practice under the IV. Staff will provide advice on any proposed CFMs or CFM/MPMs, including preemptive CFM/MPMs, according to the criteria outlined in the paper. The decision to use CFMs or CFM/MPMs remains that of the authorities, who may weigh other valid considerations in their decision such as those highlighted in Background Note 1 (for example, administrative infrastructure to implement CFMs, international agreements, or past experience with using CFMs).

**31. As macro-criticality of CFMs will be determined on a case-by-case basis with much of the evaluation relying on staff judgement, could staff elaborate on safeguards to ensure evenhanded treatment?**

- Determining macro-criticality is a core criterion for all Fund surveillance, and always requires staff judgment. In the case of CFMs, the interdepartmental capital flows group comprising LEG, MCM, RES, and SPR works with country teams to conduct the assessment. The involvement of the interdepartmental team ensures that the assessment is done consistently and evenhandedly across country cases.

**Other operational issues**

**32. We agree on the treatment of other measures that could be CFMs whose parameters are set at zero or are unenforced CFMs; where they are assessed under the IV once they are activated (parameters tightened). Could staff comment on how the degree of tightening or the duration of activation of the measure might affect macro-criticality?**

- When such CFMs are activated, they would be discussed in staff reports if macro-critical, based on the considerations elaborated in paragraphs 41 -44. The degree of tightening and even the duration of activation (if clear at the outset) are part of the considerations considered in the assessment of macro-criticality, as these would affect the expected impact of the measure on the targeted flows and on other relevant macroeconomic variables.

**33. We agree with the proposal that safeguard/contingency frameworks themselves do not constitute CFMs until their activation. Some members may introduce legislations or regulation that can have enabling provisions allowing introduction of CFMs in certain extraordinary circumstances. We believe this procedure would be applicable for all including newly introduced or revised or existing frameworks. Staff may like to confirm.**

- According to the proposal, enabling provisions that do not restrict capital flows immediately, but which allow the introduction of CFMs in contingent circumstances, are not in and of themselves CFMs before those contingencies arise and the relevant measures are enacted. This applies to both newly introduced, revised or existing frameworks meeting these criteria.

## Other issues

- 34. We suggest staff to come up with an alternative acronym for the framework. The Fund has – and may have more in the future – “institutional views” on other policy areas, not just on the liberalization and management of capital flows. We do not see compelling reasons to reserve the acronym “IV” to this area of work. Acronyms such as “IVCFM” can be used instead. Staff’s comments are welcome.**
- While the Fund could in principle have more institutional views on other policies, in practice it only instituted one for capital flow management, owing to its complexity and the need to forge an agreement between heterogeneous views across the membership.

## CONSTITUENCY CODES

### OEDAE

Angola, Botswana, Burundi, Eritrea, Eswatini, Ethiopia, The Gambia, Kenya, Lesotho, Liberia, Malawi, Mozambique, Namibia, Nigeria, Sierra Leone, Somalia, South Africa, South Sudan, Sudan, Tanzania, Uganda, Zambia, and Zimbabwe

### OEDAF

Benin, Burkina Faso, Cameroon, Central African Republic, Chad, Comoros, Democratic Republic of Congo, Republic of Congo, Côte d'Ivoire, Djibouti, Equatorial Guinea, Gabon, Guinea, Guinea Bissau, Madagascar, Mali, Mauritania, Mauritius, Niger, Rwanda, São Tomé & Príncipe, Senegal, Togo

### OEDAG

Argentina, Bolivia, Chile, Paraguay, Peru, and Uruguay

### OEDAP

Australia, Kiribati, Korea, Marshall Islands, Federated States of Micronesia, Mongolia, Nauru, New Zealand, Palau, Papua New Guinea, Samoa, Seychelles, Solomon Islands, Tuvalu, and Vanuatu

### OEDBR

Brazil, Cabo Verde, Dominican Republic, Ecuador, Guyana, Haiti, Nicaragua, Panama, Suriname, Timor-Leste, and Trinidad and Tobago

### OEDCC

China

### OEDCE

Colombia, Costa Rica, El Salvador, Guatemala, Honduras, Mexico, and Spain

### OEDCO

Antigua and Barbuda, The Bahamas, Barbados, Belize, Canada, Dominica, Grenada, Ireland, Jamaica, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines

### OEDEC

Austria, Belarus, Czech Republic, Hungary, Kosovo, Slovak Republic, Slovenia, and Turkey

### OEDFF

France

### OEDGR

Germany

### OEDIN

Bangladesh, Bhutan, India, and Sri Lanka

### OEDIT

Albania, Greece, Italy, Malta, Portugal, and San Marino

### OEDJA

Japan

### OEDMD

Afghanistan, Algeria, Ghana, Islamic Republic of Iran, Libya, Morocco, Pakistan, and Tunisia

### OEDMI

Bahrain, Egypt, Iraq, Jordan, Kuwait, Lebanon, Maldives, Oman, Qatar, United Arab Emirates, and Yemen

### OEDNE

Andorra, Armenia, Belgium, Bosnia and Herzegovina, Bulgaria, Croatia, Cyprus, Georgia, Israel, Luxembourg, Moldova, Montenegro, Netherlands, Republic of North Macedonia, Romania, and Ukraine

### OEDNO

Denmark, Estonia, Finland, Iceland, Latvia, Lithuania, Norway, and Sweden

### OEDRU

Russian Federation and Syrian Arab Republic

### OEDSA

Saudi Arabia

### OEDST

Brunei Darussalam, Cambodia, Fiji, Indonesia, Lao People's Democratic Republic, Malaysia, Myanmar, Nepal, Philippines, Singapore, Thailand, Tonga, and Vietnam

### OEDSZ

Azerbaijan, Kazakhstan, Kyrgyz Republic, Poland, Serbia, Switzerland, Tajikistan, Turkmenistan, and Uzbekistan

### OEDUK

United Kingdom

### OEDUS

United States