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**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.