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# Statement by Mr. Beblawi and Ms. Merhi on Independent Evaluation Office – IMF Advice on Capital Flows (Preliminary) Executive Board Meeting September 18, 2020

We thank the IEO team for a well thought-out and comprehensive set of reports, which evaluate the value added and influence of the Fund's advice on capital flows, since the approval of the Institutional View on the Liberalization and Management of Capital Flows (IV) in 2012. We welcome this timely review, as the COVID-19 pandemic has highlighted the continuing relevance of capital flow volatility with the dramatic stop in capital flows to EMDEs in March 2020. We agree that the IMF is to be commended for upgrading the framework for its advice on handling volatile capital flows over the past years. We welcome the report's overall findings that IMF policy advice to countries has been broadly consistent with the IV, that countries' policy choices have also been broadly in line with the IV, even during the COVID-19 crisis, and that capital flow management measures (CFMs) have not generally been used to substitute for warranted policy adjustments. In this regard, the IEO reports draw useful lessons for the Fund's future work and suggest valuable ways to enhance the fund's effectiveness in this area going forward. We appreciate the Managing Director's broad support to the IEO recommendations and broadly agree with her informative statement.

**We agree that the adoption of the IV represented a major step in the IMF's policy framework.** The Fund supported the active use of macroprudential policies (MPMs) after the GFC but has been less welcoming of the use of CFMs. The development of the IV on Capital Flows was therefore a welcomed step even though this shift in position had materialized after many of the countries had introduced CFMs. Following the review of experience with the IV in 2016 and the Fund's further work to clarify the relative role of CFMs and MPMs, broad concerns remain that the IV was applied too rigidly by the Fund, with insufficient flexibility to respond to country circumstances.

**In light of these concerns, we agree that it is time to refresh and revisit the IV and look forward to its upcoming review in 2021.** Indeed, our chair's position has been and remains since the adoption of the IV, that any institutional framework should be flexible and not remain static and should continue to support domestic and global stability, while taking into account country-specific macroeconomic circumstances in recommending policy responses and while preserving enough flexibility to policy makers in their policy responses. Having a more flexible approach to country's specific circumstances does not mean that this will lead to an "anything goes" environment, and staff should continue to warn against measures that may be ineffective or distortionary or have adverse repercussions.

**We agree with the IEO concerns about the limited traction achieved in adapting the Fund's multilateral surveillance to address concerns about spillovers and volatility of capital flows.** Spillovers from UMP continue to raise challenges as countries receiving net capital inflows believe the Fund could do more to encourage more balanced macroeconomic policies. This has also led to an increase in the perceived lack of evenhandedness among the membership. Even though, the Fund monitored the potential build-up of financial stability risks from UMP and was at the forefront of international efforts to develop a new macroprudential policy toolkit to manage such risks, it took some time to reconsider advice on CFMs to countries being affected by these spillovers in a new Institutional View on managing capital flows. In addition, and as elaborated in IEO review on The IMF Advice on Unconventional Monetary Policies, the new products introduced to analyze cross-border spillover did not capture well the essence of the challenges faced by EMEs. We agree that in order to address the concern that CFMs may be used to manipulate exchange rate, more rigorous empirical tests and further research for the Fund's external balance assessment (EBA) will be needed.

**We broadly support the specific recommendations in the paper with the following emphasis:**

- **We strongly support the Recommendation 1 to revisit the IV and modify several aspects.** We agree with the IEO that the general principles of the IV remain broadly valid, and that adjustments should be considered to adapt the IV guidance for some specific issues that have led to disagreements between the authorities and staff.

    - **We believe there is scope for CFMs to be used pre-emptively in order to manage risk arising from disruptive capital flows as a part of a broader toolkit during an inflow surge or to avoid a crisis or near-crisis situation** and not just used only after appropriate macroeconomic adjustment has been made as a last resort, as waiting for signs of an imminent crisis may be too late and costly, especially when there is no space for additional macroeconomic adjustment. As the report suggests, capital account measures can be a valuable part of the financial stability framework in some circumstances and can usefully increase the scope for stabilization policies. Moreover, when countries face serious external stresses and disruptive outflows, we agree that there would seem to be value to thinking out-of-the-box about possible policy responses well before the situation evolves into a crisis.

    - **We see merit in the IEO suggestion to reduce the hard distinction made between MPMs and CFMs/MPMs**, as this had led to repeated disagreements between staff and the authorities which has derailed the policy discussions from what tools should the authorities focus on more to meet most effectively financial stability objectives to labeling issues. Moreover, it will not be an easy task to make a clear-cut policy recommendation, given than an MPM could also be assessed as a CFM/MPM depending on the context, calibration of the measure, and other circumstances. We agree in this regard that greater flexibility on how capital account measures could be appropriately used, there would be less attention to labeling issues, leaving more time for policy dialogue. Similarly, we support introducing more flexibility to allow for housing-related restrictions on non-resident investments to alleviate house price pressures when it cannot be achieved more effectively by other means.

- **Considerable effort has gone into ensuring that advice is consistent, tailored to country circumstances, and evenhanded across countries. However, there has been some growing concerns regarding the restrictive Fund advice on the use of both CFMs and FXI, and the perceptions of a lack of evenhandedness by countries' officials,** including in the case of serious disagreements about the labeling of a measure. Moreover, and regarding the technical challenges to applying the IV, our chair has expressed many reservations and concerns about both the exchange rate valuation and the adequacy of foreign exchange reserves methodologies. Despite recent upgrades to the Fund's methodologies, we continue to question some specific assessments. We share the IEO's views that staff has sometimes had difficulty recommending specific alternative measures to the use of CFMs and FXI, or had difficulty providing convincing evidence that alternative measures would be more effective. We concur with the report that policymakers would value more granular guidance on how best to use different policy instruments in particular circumstances.

- **We agree with the need to pay more attention to the broader implications of capital account liberalization, whether it was related to the need to strengthen the macroeconomic policy framework following very rapid capital account opening, or to the social and distributional effects and how to mitigate any adverse consequences.** We therefore consider that it is important to consider the distributional implications of capital account liberalization and provide guidance on appropriate ways to mitigate an adverse impact where there is a concern for the authorities. Indeed, limiting non-residential inflows can be a helpful tool for achieving a country's social objectives, in the case where non-resident inflows are impacting housing affordability.

- **We support Recommendation 2 related to build up monitoring and research as part of a sustained Fund-wide medium-term agenda.** We believe this is very important to enable the Fund to remain at the forefront of providing cutting-edge advice on dealing with capital flows and financial spillover analysis. In this regard, we seek clarification, including from staff, on how this will proceed given the overlap of the ongoing work on an Integrated Policy Framework. We see merit in more research on the costs and benefits of capital account and macroprudential measures to provide a more granular assessment.

We also support continued efforts to draw on countries' experiences to increase the understanding of the benefits, costs and effectiveness of capital account measures and macroprudential measures and to integrate these findings into the Fund's surveillance and technical assistance. It will also be important to ramp-up the resources committed to ARREAR to ensure that the Fund can effectively monitor the use of capital account measures. Budgetary constraints should not be a reason for not subscribing to some commercial databases needed for high-frequency monitoring and analysis of capital flows.

- **We support Recommendation 3 regarding the strengthening of multilateral cooperation on policy issues affecting capital flows,** including with the OECD, FSB, BIS and IOSCO. Ensuring greater coherence between the IMF and other multilateral frameworks will be important to address possible tensions between the IV and the Basel III framework, including on treatment of reciprocity arrangements and liquidity regulations and measures classified as CFMs/MPMs under the IV.

- **We appreciate the paper's coverage on resource implications.** We welcome the Managing Director's indication that resource implications of the recommendations 2 & 3 will be considered in budget discussions, and that these will be undertaken once the covid-19 related crisis work abates.