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Statement by Ms. Levonian, Ms. McKiernan, and Ms. Vasishtha on Independent Evaluation Office – IMF Advice on Capital Flows
(Preliminary)
Executive Board Meeting
September 18, 2020

We thank the Independent Evaluation Office (IEO) for their timely and comprehensive review of Fund advice on capital flows, and the Managing Director for her helpful Buff statement.

We welcome the IEO's recognition of the many initiatives undertaken by the Fund over the past decade to upgrade the framework for its advice on handling volatile capital flows. The *Institutional View on the Liberalization and Management of Capital Flows* (IV) has become established as the cornerstone for Fund advice and staff has devoted considerable effort to ensuring that the advice is consistent, evenhanded, and tailored to country circumstances. Nevertheless, concerns have remained about the coherence, value-added, and influence of policy advice – as clearly laid out by the IEO evaluation – suggesting a need to revisit the Fund's approach to dealing with capital account volatility. **To that end, we support the IEO's high-level recommendations**. Furthermore, the IEO's assessment and recommendations provide very timely and complementary perspectives on the issues addressed in the Integrated Policy Framework (IPF) workstream and the Comprehensive Surveillance Review (CSR).

Recommendation 1: Revisit the Institutional View in the light of recent experience and research.

We support a refresh of the Fund's approach to dealing with capital account volatility in light of country experiences, research, and changing circumstances. Since the broad principles underlying the IV remain valid and are supported by the membership, such a revisit need not involve a major overhaul of the IV. Rather, the emphasis should be on updating and clarifying the IV taking into account the lessons from the IPF work program and this evaluation, both of which should serve as critical inputs into the review of the IV currently planned for 2021.

We welcome the recommendation to re-evaluate the excessive focus on the sharp distinction currently made in the IV between CFMs/MPMs and MPMs. We, however, do not see this as a way to relax the framework. Rather, we see the need to clarify and update the framework, such that the focus of policy discussions is shifted from dwelling on labelling issues, which have been at the root of some repeated disagreements between the Fund and authorities, towards the more substantive issue of the effectiveness of the tools in meeting financial stability objectives, and on more concrete policy advice.

While the evaluation aptly documents significant concerns around the application of the IV to housing-related issues, the role of social and political objectives needs to be approached very carefully. Strengthening our understanding of the distributional impacts of policy advice is certainly desirable. However, we are concerned about the potential risks around a broad inclusion of social and political considerations into the Fund's policy advice, unless accompanied by a clear framework. Specifically, this could potentially open the door to a world where any policy action could be justified once such objectives are included. It will be important to ensure adequate safeguards are in place to prevent such an outcome and preserve the effectiveness of Fund advice. *Staff views are welcome.*

Further, the evaluation voices some concerns about the way the Fund currently provides bilateral advice on capital flows. In particular, it notes that the advice tends to be generic at times, not providing countries with detailed assessments of the benefits and costs of alternative approaches. Additionally, in several cases the Fund's advice has not been well received or has not gained much traction. This concern could be further reinforced if the Fund considers broadening the set of admissible policies in the future, such as in the case of social and political considerations, as noted above. When policies are not in line with the IV, we would urge staff to provide alternative policy recommendations tailored to a country's need and circumstances. To give one example, some recent research shows that macroprudential FX regulations can have leakages into other sectors of the economy. A fruitful area of research for the Fund would be in finding solutions to extend the perimeter of macroprudential policies beyond the banking system so that countries do not have to resort to CFMs to address associated vulnerabilities.

Recommendation 2: Build up the monitoring, analysis, and research of capital account issues as part of a sustained Fund-wide medium-term agenda.

We agree that the Fund should remain at the forefront of analytical work on capital flow issues and ensure that the IV and the macroprudential framework remain grounded in solid research. The evaluation rightly notes that research on capital flow issues has so far been limited by lack of a well-defined research agenda and limited resources.

We strongly support prioritizing more research on the costs and benefits of capital account and macroprudential measures, **including potential cross-border spillovers and impact on market development.** This research area also overlays well with the ongoing work on the IPF. We also reiterate the need to focus on both source and destination countries in the analysis of financial spillovers. While we acknowledge that the Fund has worked hard to strengthen spillover analysis, there are concerns about the traction of advice to source countries – an issue that was also identified in the IEO report on *Fund Advice on Unconventional Monetary Policies*. In addition, cutting edge analysis on financial spillovers should include both advanced economies and EMEs as source countries, given that EMEs are increasingly becoming a source of capital for advanced economies as well as for other EMEs.

Another fruitful area of research relates to understanding the effectiveness of macroprudential policy measures, particularly in interaction with other policy tools. Attention should also be given to macroprudential tools to reign in vulnerabilities outside of the banking sector, such as in market-based finance, shadow banking, and the non-financial corporate sector, as highlighted in recent editions of the *Global Financial Stability Report*. We would also encourage further work on CFMs and MPMs in the context of countries with fixed exchange rate regimes as well as on the use and effectiveness of these measures in developing economies

Recommendation 3: Strengthen multilateral cooperation on policy issues affecting capital flows.

The Fund can play an important role in encouraging a consistent multilateral approach to promoting good policy practices on capital flows. Considering the issues of consistency and coherence between the IV and the OECD Code identified in certain case studies, we see merit in further strengthening cooperation between the Fund and the OECD to minimize inconsistencies. Likewise, we encourage greater cooperation with the FSB and the BIS to strengthen the monitoring and coordination of capital flows and macroprudential policies, as well as the spillover effects of such policies.

Resource implications

We appreciate the IEO's initial views on the resource implications that would arise from implementing the recommendations. A careful consideration of these budgetary implications as well as those arising from other workstreams would be needed within the context of the overall budget envelope. The medium-term budget discussions should include an overview of budget priorities and the associated trade-offs across various workstreams.