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GRAY/20/2891

September 15, 2020

Statement by Mr. Mouminah, Mr. Alkhareif, and Mr. Keshava on Independent Evaluation Office – IMF Advice on Capital Flows (Preliminary) Executive Board Meeting September 18, 2020

We commend the Independent Evaluation Office (IEO) for the insightful evaluation of the *IMF Advice on Capital Flows* and the Managing Director for her helpful statement. We also highly appreciate the outreach of the IEO team to our office. The evaluation's analysis and recommendations along with the work on the Integrated Policy Framework (IPF) will be key inputs for the review of the Fund's Institutional View on the Liberalization and Management of Capital Flows (IV), scheduled for 2021.

We are encouraged by the findings of the evaluation that countries' policy responses to the management of capital flows have generally been along the lines envisaged in the IV. Notably, we welcome that a mix of measures in line with the IV has been generally used rather than capital flow management measures (CFMs) to delay the needed policy adjustments. Even during the sharp outflows in March-April 2020 through the COVID-19 crisis, we note that CFMs were used parsimoniously, as part of multi-policy packages, in the face of an abrupt capital flow reversal. The Fund advice on use of CFMs through the COVID-19 crisis was also in line with the guidance in the IV, as noted in the background paper (Supplement 5).

That said, the evaluation has highlighted a number of challenges related to the Fund's advice in managing volatile capital flows, which support the case for revisiting the IV. These include inflexibility of the framework, excessive focus on identifying distinction between CFMs/MPMs and MPMs, the role of preemptive and long-lasting use of CFMs, and consideration of social and political objectives. The evaluation also appropriately highlights the need for recognizing the role of foreign exchange intervention (FXI) in supporting macroeconomic and financial stability. Indeed, we take note of the finding that "exchange rate flexibility may bring less stabilization benefits through the trade account than previously believed and that exchange rate movements can sometimes be a shock amplifier in the face of volatile flows, for instance when the balance sheet effects of such movements dominate competitiveness effects”. Thus, in light of recent research, the exchange rate regime should appropriately reflect the current structure of the economy and exchange rate flexibility should not be recommended arbitrarily in all cases.

We broadly support the IEO’s recommendations and would like to offer the following remarks:

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

- We agree that an update of the IV, drawing upon country experience, empirical evidence, and theoretical advances, would provide a strong basis for more fruitful policy dialogue with country authorities and increase the value added of Fund advice on the liberalization and management of capital flows.

- In this context, we echo the Managing Director’s remark that a revisit need not involve a wholesale overhaul of the IV. Indeed, the core principles of the IV remain valid, including the overall presumption that capital flows can bring substantial benefits for countries and that CFMs can be useful in certain circumstances. Notably, we underscore that any updated framework should provide staff the necessary flexibility to provide tailored policy advice to help countries derive full benefits of capital flows, while managing the risks.

- Allowing for preemptive CFMs will be a valuable part of the policy framework to mitigate risks to financial stability. Indeed, these measures can help plug gaps in MPM coverage. On the recommendation to allow long-lasting use of CFMs, we consider that safeguards would need to be developed to ensure the proper use of CFMs that takes into account country-specific circumstances. On the use of outflow CFMs to deal with disruptive outflows outside a “crisis or near-crisis” situation, the evaluation makes a strong case for allowing such a role for CFMs as part of a broader policy package to help respond to severe stresses amid diminishing policy buffers. We support this point, but we underscore the need to balance any possible short-term gains against the long-term costs related to market development and investor confidence.

- On considering distributional implications as part of the strategy for capital account liberalization within the IV, we consider that the IV’s current guidance on liberalization remains broadly appropriate. In this regard, we do not see a case for conducting analysis on implications of liberalization for income distribution to delay capital account liberalization when other institutional, financial sector and macroeconomic conditions have been met. In our view, inequality issues should be tackled by other tools such as fiscal policy and structural reforms.

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

- We support a sustained medium-term agenda of the monitoring, analysis, and research of capital flow issues, given its centrality to the Fund's mandate. In this regard, we welcome the work on the IPF, which is an important undertaking to advance the understanding of the policy options and the tradeoffs faced by policymakers. Analytical work on the role of fiscal policy as well as multilateral implications of IPF policies should also remain part of the agenda.

- We agree on the need for greater investment in the maintenance of the AREAER, which represents an important public good. We also see merit in the recommendation to construct in-house the indexes of capital account openness used widely in the Fund work than delegating the task to others.

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

- We concur with the recommendation. In this context, we welcome the MD's support for the Fund's continued collaboration with other multilateral organizations, with due regard of their different mandates, purposes, and memberships. We also take positive note of her support for work to strengthen the coordination of macroprudential and capital account policies together with the FSB and the BIS, and to address possible tensions between the IV and the Basel III framework. Strengthening Fund work on capital account provisions in trade and investment agreements will also be important to help promote a consistent approach on how to handle capital flows.

Resource implications

We welcome the IEO's assessment that the full implementation of its recommendations is likely to require a modest increase in net staff resources for the work on capital flows. Since advice on capital flows to member countries is at the core of the Fund's mandate, the work agenda should be moved forward, including by reprioritizing and relocating resources within the existing budget envelope if needed.