Appendix 3 Public Communications

This appendix reviews public speeches and statements of IMF management during 1990–2004, in order to see what messages were communicated to the public on capital account issues. Much of the information in this appendix relies on various issues of the *IMF Survey*.

In the early 1990s, IMF management viewed capital account liberalization, along with macroeconomic discipline and IMF financial support, as essential ingredients of sustained growth for developing countries. Management, however, was explicit in spelling out the potential risks of capital account liberalization. In 1994, for example, the Managing Director stated: "The Fund encourages countries to liberalize their capital account restrictions, while adopting policies that ensure that the risks involved are avoided and the potential benefits fully realized."[1]

Following the Mexican crisis, management focused on the need for strong financial institutions, a competitive domestic financial system, and effective supervision and regulation; it opposed use of capital controls, including market-based ones. In 1995, the Managing Director stated that the IMF's response to the challenges of globalization was to strengthen surveillance and to secure appropriate resources to assist countries. Surveillance needed to be strengthened, particularly in terms of attention to capital account developments and financial flows. At a seminar held in April 1995, the First Deputy Managing Director said that the pace of capital account liberalization depended on the liberalization process of the domestic financial sector and that a strong financial system was a prerequisite.

In September 1995, in responding to criticisms that the IMF was an impediment to capital account liberalization, the Managing Director wrote an article for the *Wall Street Journal* emphasizing that freedom of capital movements is "an objective that the IMF seeks to promote." At the same time, he stated that, in the absence of certain prerequisites, "open capital accounts may impose considerable costs in terms of financial and economic instability, and risk costly reversal" and listed as the necessary prerequisites a strong financial system and macroeconomic stability. He then noted that, in the circumstances of some developing countries, "certain kinds of measures to discourage capital inflows or influence their character might be appropriate" (*Wall Street Journal*, September 27, 1995).

In 1997, there was a marked change in management's view of capital controls. While fiscal discipline and greater exchange rate flexibility remained the preferred policies, the First Deputy Managing Director stated that market-based controls were less harmful than administrative ones, which were ineffective and costly. He continued to advocate liberalization of outflows as a tool to manage capital inflows. In 1998, he again reiterated the same views, namely, that controls on outflows should be removed as the country circumstances became appropriate, but market-based controls could be retained to discourage short-term inflows.

At the same time, management began to pay more attention to sequencing and gradualism. The Managing Director emphasized the importance of sound macroeconomic policies, a strong domestic financial system, phased capital account liberalization, properly sequenced reforms, and timely and accurate dissemination of information. At a meeting of the Pacific Basin Economic Council held in May 1999, the Managing Director stated that controls were more effective on inflows than on outflows, and that they worked best when they were market-based and temporary. He then added that stronger macroeconomic policies and banking sectors—not the controls per se—were the key factors behind the success of the countries that imposed controls after the crisis.

The Managing Director, at the January 2001 Asia-Europe Meeting of finance ministers from Asia and Europe, conceded that there had been excessively rapid capital account liberalization in some emerging market countries, and emphasized the need for preconditions to be met before proceeding with full liberalization. At the same time,

[1]Transcript of remarks made at a meeting of financial and business leaders in Korea in October 1994.

he advised countries with open capital accounts not to reimpose controls, but rather to strengthen institutions. He then noted the mixed experience with the use of capital controls and called for "further research and analysis to assess the costs and benefits of controls in particular circumstances." In 2003, at the January Asia-Pacific Economic Cooperation meetings, the Managing Director stressed the need for sequencing, saying: "Ensuring careful sequencing, particularly in relation to the development of well-regulated and well-managed financial sectors, is a critical ingredient to success."