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INTRODUCTION

This evaluation assesses the value added and influence of IMF advice on capital flows, focusing on the period since the approval of the Institutional View on the Liberalization and Management of Capital Flows (IV) in 2012.

Safe handling of the capital flows associated with increasing international integration of financial markets has long been a concern for policymakers and has remained a major challenge in recent years. While total flows recovered quickly after the Global Financial Crisis (GFC), capital flows to emerging market and developing economies (EMDEs) in particular have been subject to repeated surges and reversals. Sources of volatility have included shifts in risk appetite and policy expectations in the major source countries as well as shifting policies in the recipient countries. Capital flow dynamics have also been affected by very easy global liquidity conditions, by the increasing importance of portfolio inflows and resident outflows, by the growing role of institutional investors, by rising foreign currency indebtedness, and by the emergence of significant "South-South" flows, particularly out of China. The continuing relevance of capital flow volatility was underlined by the dramatic sudden stop in capital flows to EMDEs in March 2020 in the wake of the COVID-19 pandemic.

Drawing lessons from experience, national policymakers have adjusted policies and regulations to handle capital flow and asset price volatility and associated risks within their broader macroeconomic policy frameworks. Different countries have followed different approaches, reflecting different national circumstances. While advanced economies (AEs) with open capital accounts and deep financial markets have generally allowed their exchange rates to float freely and avoided any measures to interfere with capital movement, many EMDEs have actively used foreign exchange intervention (FXI), macroprudential measures (MPMs), and capital account measures, together with monetary and fiscal policy tools, to meet stabilization objectives. EMDEs have also taken different approaches toward further capital account liberalization, balancing hoped-for long-term gains from increasing integration and market development against the potential short-term risks from capital flow volatility.

IMF policy advice on capital flows has continued to evolve as the Fund has sought to help countries garner the benefits of international financial integration while containing the risks associated with volatile conditions and dealing with crises when such risks materialize. After the emerging market crises of the 1990s, the IMF emphasized the importance of appropriate pace and sequencing of capital account liberalization. Since the early 2000s, the IMF has strengthened the underpinnings of its advice on the policy toolkit that countries can use to deal with capital inflow surges. This work intensified after the GFC as capital flows rebounded to EMDEs in the context of exceptional easing by major advanced economy central banks and the recovery of global economic conditions. Two important milestones were the adoption of the IV (IMF, 2012), which provided a detailed framework for providing consistent advice on when capital account measures could be justified, and the development in parallel of a macroprudential framework aimed at safeguarding financial stability (IMF, 2013b), including in the face of large and volatile capital inflows (IMF, 2017). The IMF has also taken steps to understand and draw lessons from countries' experience with FXI (for example, Chamon and others, 2019), as well as refining tools to assess external imbalances and foreign exchange reserve adequacy. Recently, the staff has embarked on an ambitious agenda to develop an Integrated Policy Framework (IPF) to consider how best to combine the use of monetary policy, foreign exchange intervention, macroprudential measures (MPMs), and capital account measures to deal with external volatility, including capital flow shocks.

Despite this attention, IMF advice on these issues has continued to be criticized from various angles. While the IV was generally regarded as an important step forward and has become established as the cornerstone of IMF advice in this area, concerns have remained about the value added and influence of IMF advice. Some policymakers and experts, drawing from their own experiences of handling volatile flows and recent research, feel the Fund is still too unwilling to recognize that nonstandard policy elements such as capital account measures and FXI can play a useful role in handling particular challenges. Specific issues, related to the design of the policy frameworks the Fund uses and to how they are applied in practice, may reduce the traction of the Fund's advice. And there are concerns that the Fund may not pay sufficient attention to multilateral aspects and spillovers—including macroeconomic and regulatory policies in source countries that affect capital flow volatility—and to coherence with other policy frameworks like the OECD's Code of Liberalization of Capital Movements (OECD, 2018, 2019).

This evaluation aims to assess how well IMF advice on capital flows has succeeded in recent years in helping countries garner long-term benefits from international financial integration while containing short-term risks from volatility.[1] It focuses primarily on IMF advice in Article IV surveillance but also occasionally in the context of financial support and technical assistance. It is intended to shed light on a broad range of issues about how much value added and influence IMF advice on capital flows has had over the years since the IV was approved. Building on extensive country case studies, it pays particular attention to the role of capital account measures but also considers the role of FXI and macroprudential measures and how such measures fit within the macroeconomic policy toolkit. Together with the more model-based and empirical work program being advanced in the IPF, it can provide useful material for the review of the IV that is scheduled to take place in 2021.

The evaluation is organized around four main themes:

- Managing capital flow volatility:
  - The IMF's frameworks: Has the development of the Institutional View and the Macroprudential Framework, along with refinements of related frameworks for external sector and reserve adequacy assessments, provided an effective basis for IMF advice to countries on how to deal with capital flow volatility? (Chapter 3)
  - Issues in implementation: What issues have arisen in the implementation of these frameworks and how have they affected the value of the IMF's advice on dealing with capital flow volatility? (Chapter 4)
- Garnering net benefits from open capital markets: How well has the IMF advised countries that are still well short of full capital account liberalization on the best approach for achieving the likely net benefits from further liberalization? (Chapter 5)
- Multilateral considerations: How well has IMF analysis and advice on capital flows contributed to the Fund's multilateral mandate to strengthen the operation of the international monetary system? (Chapter 6)
- Monitoring, analysis, and research on capital account issues: To what extent has the IMF provided useful data, analysis, and research on capital account issues? (Chapter 7)

Chapter 2 sets the context for the evaluation, first highlighting some recent developments in capital flows and the use of capital account measures, and then laying out the evolution of Fund policies on these issues. Chapter 8 concludes by summarizing the main findings of

[1] Earlier IEO work in this area includes *The IMF's Approach to Capital Account Liberalization* (IEO, 2005) and the update of that evaluation (IEO, 2015).

BOX 1. LIST OF BACKGROUND PAPERS

Thematic papers:

- Managing Capital Flows: Theoretical Advances and IMF Policy Frameworks (Korinek)
- IMF Advice on Capital Flows: How Well is it Supported by Empirical Evidence? (Montiel)
- Analysis and Advice on Capital Account Developments: Flows, Restrictions, and Policy Toolkits (Batini and Durand)
- IMF Advice on Capital Flows: Multilateral Issues (Towe)
- The COVID-19 Crisis and Capital Flows (Batini)

Country case studies cover IMF advice on capital flows to:

- Selected countries in Latin America (Argentina, Brazil, Chile, Colombia, Costa Rica, Mexico, Peru, Uruguay) (Batini, Borensztein, and Ocampo)
- Korea and selected ASEAN economies (Indonesia, Malaysia, and Thailand) (Everaert and Genberg)
- China and India (Patnaik and Prasad)
- Selected European countries (Croatia, Israel, Poland) (Flug and Towe)
- Crisis-driven capital controls in Europe (Cyprus, Iceland, Ukraine) (Honohan)
- Sub-Saharan Africa and MENA (broad coverage with particular attention to Ethiopia, Kenya, and Morocco) (Balasubramanian and others)
- Advanced economies with housing-related issues (Australia, Canada, Hong Kong SAR, Singapore, New Zealand) (Everaert)

the report and provides recommendations to improve the quality and influence of IMF policy advice in this area.

The findings of the evaluation are based on case studies covering a broad range of country experience and on several background papers on thematic issues (Box 1), as well as extensive interviews and desk reviews of documents.[2] The country case studies cover 28 countries spanning a wide range of experience: a wide selection of countries in Asia and Latin America demonstrating a rich variety in the use of policy approaches to address concerns from volatile flows; three countries in Europe that have refrained from use of capital account measures, given their commitments to supranational institutions;[3] three other European countries that used capital outflow controls in the face of balance of payments crises; some frontier economies that have tapped into global capital markets; and five AEs that have acted to dampen house price appreciation in the face of capital inflows. Two of the thematic background papers assess how well IMF advice is grounded in empirical support and reflects recent advances in professional research on the use of capital account and macroprudential measures. The other three cover multilateral issues; provide an overview of recent developments in capital flows, use of capital account measures, and policy toolkits; and provide a factual overview of the impact of the COVID-19 crisis on capital flows and the policy responses thus far. More than 200 interviews were conducted with IMF staff members, current and former policymakers, experts on capital flow issues, and market participants. The evaluation also draws on the discussion of capital flow issues and findings of the

[2] The interviews and document review were largely completed before the onset of the COVID-19 crisis. While the study has been updated to report on recent developments, it does not seek to evaluate the recent experience.

[3] Israel is included with the European case studies here, mirroring its inclusion in the group of countries for which the IMF's European Department conducts surveillance.

IEO's recent evaluation of *IMF Advice on Unconventional Monetary Policies* (IEO, 2019).[4]

A note on terminology: This evaluation uses the term "capital account measure" to refer to the broad set of measures that affect the terms of capital account transactions covered in the IMF's *Annual Report on Exchange Arrangements and Exchange Restrictions (AREAER)*. These measures are either residency-based (RBMs) or currency-based (CBMs) (see Batini and Durand, 2020). The term "capital flow management measure" (CFM) is reserved for the group of measures judged by IMF staff to be designed to limit capital flows, as defined in the IV.[5] Under the IV, all RBMs are classified as being CFMs. Whether a CBM is a CFM is judged depending on country circumstances—the same measure may be classified as a CFM or not in different countries and at different times in the same country. The more common term in the academic literature, "capital control," is used more strictly to refer to residency-based restrictions on capital flows.

4 That evaluation includes background papers on the Fund's macroprudential framework (Turner, 2019) and spillover analysis (Klein, 2019), and case studies of China and India (Mohan, 2019), South Africa (Darius, 2019), and Turkey (Kalemli Ozcan, 2019a).

5 Most CFMs but not all of them are covered in the *AREAER*.