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DEALING WITH CAPITAL FLOW VOLATILITY: IMPLEMENTATION ISSUES

IMF policy advice to countries for dealing with capital flow volatility has been broadly consistent with the IV framework. This was the finding of the staff's 2016 review (IMF, 2016c) and the country case studies and interviews with staff members suggest that attention to consistency issues has only increased following guidance in the 2017 IMFC Communiqué (IMFC, 2017). Consistency is achieved through an intense internal review process in which the area departments that conduct the Article IV consultation missions and hold direct discussions with country authorities interact with IMF functional departments (especially SPR, MCM, and LEG on capital flow issues) to ensure coherence with Fund policies such as the IV and more broadly the ISD.

Intense efforts to ensure consistency in application have also contributed to a perception that application of the IV has generally been evenhanded. The series of follow-up papers since 2012—such as the notes for the G20 and the Taxonomy report—have helped to explain to the membership the rationale behind classification of some measures as CFMs. Care taken to be evenhanded is illustrated by the staff's application of the IV framework to many advanced economy cases of capital account measures in the housing sector even though the IV was not designed with their situations in mind. Country officials interviewed for this evaluation generally appreciated these efforts, although, as discussed below, there have been concerns about the IV's application in particular circumstances.

It is also encouraging that countries' policy choices during periods of capital inflow surges and reversals seem to have been broadly in line with the IV's overall framework. Consistent with standard IMF guidance, countries typically have used the standard macroeconomic toolkit, such as monetary policy, fiscal policy, and exchange rate policy, when faced by these circumstances (Batini and Durand, 2020), and this seems to have been the experience thus far in response to the COVID-19 crisis as well (Batini, 2020). Restrictions on capital outflows have generally been used by only a few countries facing crisis or imminent crisis. Moreover, there is little evidence that capital account measures are systematically used as a substitute for other policy changes or to protect an undervalued exchange rate.[17]

Our country case studies discuss several instances in which the IV proved useful in guiding staff engagement with authorities on the use of CFMs in the face of capital flow volatility. The existence of a framework that recognized explicitly that CFMs could play a role in dealing with pressures arising from capital inflow surges provided a basis for policy discussion and for the Fund to provide an official blessing for unorthodox policy measures. One example is *Brazil*, which has long varied the level of a tax on certain foreign financial investments—referred to as the IOF—to manage capital flows. When the IOF was reintroduced in 2009 amid large inflows,

[17] There is some empirical work to suggest that use of capital account measures may occasionally encompass both precautionary and mercantilist motivations (see, for example, Choi and Taylor, 2017; Alfaro, Chari and Kanczuk, 2017; Pasricha, 2020).

the IMF staff took a pragmatic view of it as part of the "feasible policy response" and was concerned more about its effectiveness than its imposition (Batini, Borensztein, and Ocampo, 2020). The passage of the IV provided the staff and authorities with a clearer framework within which to discuss the use of the IOF. Likewise, when *Uruguay* placed limits on short-term capital flows in 2012, the staff essentially used the framework of the IV—which was then under discussion—to support the decision, noting that with Uruguay's exchange rate being fairly valued, foreign exchange reserves above the Fund's metric, and inflation well above target, there was no room to lower policy rates to curb inflows.

Nevertheless, the country case studies also suggest many examples where the IMF's advice has in practice been less well received and not gained much traction. Particular challenges to implementation of the IV included:

- Difficulties in measuring key concepts needed to assess whether the use of capital account measures is justified.
- Reliance on other Fund assessment tools such as the EBA and ARA.
- Challenges in making clear distinctions between capital flow and macroprudential measures.
- The application of the IV to housing-related measures.
- Application in some cases with heavy capital outflows.

CHALLENGES IN IMPLEMENTATION: CAPITAL INFLOWS

Difficulties in measuring key concepts

Key concepts used by the staff to judge whether to label certain measures as CFMs and to assess whether CFMs are justified have often proven difficult to measure. These include assessing when the country is facing an inflow surge and thus when a CFM could be justified under the IV; when a country is "in a crisis or near-crisis;" and whether the impact of a capital control is macro-relevant. While the recourse to staff judgment on these matters is useful to allow considerations of country circumstances, in practice the staff has faced difficulties in justifying the CFM label to authorities. This has on occasion led to perceptions of a lack of evenhandedness, especially since the same measure can in principle be classified differently depending on circumstances.

Two recent examples illustrate some of these challenges. In *Iceland*, as confidence returned in June 2016 eight years after the start of a deep crisis, the authorities introduced capital inflow measures out of concerns about "easily reversible inflows driven by short-term speculation" (Honohan, 2020). The Fund staff opposed the measure, in part because the surge was incipient and—at the point at which the measure was introduced—was much smaller than what had been experienced before the crisis. As Honohan (2020) notes, it is not surprising that the staff's judgment "did not resonate in a country whose 2008 crisis had been enabled by a lack of restraint on pre-crisis inflows." In other cases, the staff itself has had difficulty judging whether certain measures were macro-relevant. For instance, interviews indicate that there were a range of views within the staff on whether the housing-sector measures taken by two provincial authorities in *Canada* cleared the bar for macro relevance (Everaert, 2020). In the event, the judgment was reached that the measures were macro-relevant and were inconsistent with the IV, to the strong disagreement of the authorities.

Reliance of IV application on EBA and ARA assessments

Implementation of the IV in some cases requires judging whether a currency is undervalued or whether reserves are adequate using the EBA and the ARA metrics, whose findings the authorities have not always accepted as convincing. Under the IV, if a currency is undervalued then the country should let its rate appreciate rather than intervene or use CFMs in face of a capital inflow surge; similarly, if reserves are already adequate the country should desist from persistent one-way intervention. However, authorities have sometimes disagreed with the results of EBA and ARA exercises. The case studies provide some examples where officials felt that the Fund's models were not convincing and did not adequately reflect country circumstances, and thus they were unpersuaded by IMF advice drawing on these assessments.

Examples of disagreements over exchange rate assessment:

- In *Israel* for most of the period under review, the Bank of Israel's view, based on its range of in-house models, was that the shekel was overvalued and at times significantly so, partly because of portfolio flows driven by ultra-expansionary monetary policy in the major advanced economies. The Fund staff attributed the appreciation—more than 25 percent in real effective terms between 2009 and 2017—to fundamentals, allowing for some possibility of overvaluation only in the 2018 Article IV Report. As a result, it was generally less supportive of the Bank of Israel's foreign exchange intervention over this period (Flug and Towe, 2020).
- In *Poland*, large exchange rate movements in both directions were judged consistent with fundamentals in the 2008 and 2010 Article IV Staff Reports. Though the authorities did not question staff assessments at the time, such episodes of large apparent changes in the staff's view from year-to-year can undermine the credibility of staff models for judging deviations of exchange rates from fundamentals and raise questions about whether the models take sufficient account of the possible role of capital flows in driving such deviations (Flug and Towe, 2020).
- Other country cases where authorities were unconvinced by the EBA assessment of the appropriate level of the exchange rate include *Malaysia*, *Peru*, and *Thailand*.

Differences in view about the valuation of the exchange rate feed into different assessments about the role of foreign exchange intervention. A recurring theme in many Article IV reports is that a flexible exchange rate should be the first line of defense against the consequences of variations in capital flows and that FXI should be used only to moderate excessive exchange rate volatility, particularly in situations where the staff views the exchange rate as undervalued. However, the authorities have been more inclined to use FXI on a sustained basis. For example, in *Thailand* the authorities believed that exchange rate fluctuations were largely driven by temporary changes in risk preferences and herding behavior in the foreign exchange market, expressing doubts that the exchange rate can be a shock absorber under such conditions, and arguing that the Thai currency was already fairly valued (Everaert and Genberg, 2020).

Similarly, staff concerns about the use of capital account measures have sometimes been exacerbated by concerns that at least in part these measures were being used to keep the exchange rate weak. In practice, we did not find many cases of this. One example, discussed further below, relates to Korea, where the staff urged the authorities to phase out currency-based measures that the Koreans argued were intended for financial stability purposes rather than to contain capital inflows.

Examples of disagreements over reserve adequacy:

- In *China*, the IMF consistently weighed against one-way intervention against appreciation of the renminbi, arguing that international reserves were more than adequate according to the ARA (IMF, 2015a). However, the loss of about US$1 trillion of foreign exchange reserves (about 25 percent of the peak stock) over the next two years indicated to some officials that the Fund was being too sanguine about the level of reserves that even a large emerging market economy needs to protect itself from capital flow volatility (Patnaik and Prasad, 2020).
- By contrast, in *Poland*, the staff's 2010 call for increased reserves did not convince the authorities, who felt that the IMF Flexible Credit Line arrangement and EU transfers provided adequate insurance (Flug and Towe, 2020). Similarly, in Croatia, the authorities disputed the staff's call to boost foreign exchange reserves, arguing that the Fund's metric overestimated vulnerabilities to a capital flow reversal by not accounting for the limited scope to short the currency.

Capital flow measures vs. macroprudential measures

The distinction made in giving policy advice on use of CFMs and CFMs/MPMs vs. pure MPMs raises some conceptual concerns, as noted earlier, and has proven a challenge in practice as well. The implementation of the IV has led to some differences of opinion between staff and country authorities, driven by difficulties in deciding

whether a particular measure was taken for financial stability reasons or with the intent of limiting capital flows or both. In some cases, the staff and authorities have disagreed on the intent of the measure, with the staff arguing that measures have been taken to limit capital flows rather than for, or in addition to, financial stability purposes, and the authorities maintaining that the measure was solely for financial stability purposes without any intent to limit capital flows. Even in cases where the staff and authorities (eventually) agreed on the classification of a measure as a CFM, MPM, or CFM/MPM, interviews with staff members and authorities suggest that an inordinate amount of time during policy discussions has been taken up with making that determination; in cases of disagreement, the time and attention taken up by issues of classification has been greater still.[18] Sometimes the staff had difficulty identifying good alternative measures when it advocated the removal of CFMs or CFMs/MPMs—for example, alternative forms of MPMs that avoided discriminating by residency or currency. Such difficulties are perhaps not surprising when the source of the vulnerability relates to currency mismatches or when purely domestic MPMs may not have much impact on external financing that does not pass through the domestic banking system.

Disagreement over the labeling of *Korea's* currency-based measures is a case in point. Korea has had in place certain CBMs since 2011, which the authorities have viewed as prudential measures that have proven useful for financial stability reasons after a series of external crises in part related to excessive short-term foreign currency indebtedness (Everaert and Genberg, 2020). The staff offered guarded support for these measures when they were first introduced, and maintained this stance for some years after the adoption of the IV. However, by 2017 the Article IV Staff Report explicitly referred to the measures as CFMs/MPMs and called for their removal, since the capital flow surge that had prompted the introduction of the measures had by then receded. The authorities strongly rejected the designation of their measures as partly CFMs, emphasizing that they were not residency-based and had never been designed to limit capital flows but only to reduce systemic risk. They felt that the measures were an integral part of their macroprudential framework and essential to boosting Korea's resilience to external market volatility and that they therefore ought to be classified as MPMs. In interviews, staff members noted that they had had difficulty suggesting alternative measures that the Korean authorities could adopt; they considered a currency-differentiated net stable funding ratio as a broader measure to achieve the same outcome but were not sure if it would avoid the CFM designation.

Similar disagreements have surfaced in ASEAN (Everaert and Genberg, 2020). In all three ASEAN countries featured in the case studies, the authorities have introduced measures that they consider as motivated by purely macroprudential reasons and therefore should not be labeled as CFMs or CFMs/MPMs. In *Thailand*, the Fund staff advised in 2019 that "the recent tightening of existing CFMs to address speculative flows should be phased out" in favor of "appropriate" traditional policies. The authorities pushed back on the grounds that: the CFM "neither prevents nor limits the quantity of inflows into Thai financial markets" and that their goal of countering risks to financial stability was more directly met by such measures "to address the source of the pressure" than by alternative policies such as raising interest rates. In *Indonesia*, authorities objected in 2019 to the CFM/MPM label given to a foreign exchange hedging requirement for domestic corporates, arguing that the "regulation aims to ensure macro-financial stability through the adoption of prudential principles on corporate foreign borrowing." In Malaysia, the authorities disagreed with the IMF's assessment and advice to phase out measures taken in 2016 and 2019—classified respectively as CFMs and CFMs/MPMs—arguing that the former were needed to prevent excessive exchange rate volatility and the latter to limit speculative demand in real estate markets.

Application of the IV in Latin American dollarized economies further demonstrates the difficulties of judging which label to pin on currency-based measures (Batini, Borensztein, and Ocampo, 2020). In *Peru*, the authorities have long used a variety of CBMs to discourage dollar deposits, and currency mismatches as a tool to reduce financial vulnerabilities. After considerable and often contentious debate, the IMF staff accepted some of these measures as MPMs and judged them as useful but assessed

[18] The discussions have on occasion been further complicated by external communication challenges as a lot of these discussions tend to be kept confidential in order to avoid adverse market reactions.

others as CFMs or CFMs/MPMs and encouraged the authorities to find alternative tools for the purpose. In *Costa Rica*, another dollarized economy, an MCM team encouraged the use of a combination of CBMs as a financial stability tool—a recommendation that the Article IV Report endorsed, classifying the package as a pure MPM since it was not designed to limit capital flows.

Application of the IV to housing-related measures

Assessment of the housing sector measures implemented by some advanced economies in recent years has proven quite contentious. Typically, these have been residency-based measures, such as a residency-based stamp duty, and thus automatically qualified as CFMs. Sometimes, for example, with *Australia*, *Hong Kong SAR*, and *Singapore*, these measures have been supported but only on a temporary basis in the face of a capital inflow surge, and only until nondiscriminatory measures could be identified or until the surge dissipated (Box 2). In other cases, such as *Canada* and *New Zealand*, where there is no evidence of an inflow surge, the staff has found the measures to be inconsistent with the IV and called for their removal.

In all these cases, the authorities have resisted staff advice. Comprehensive packages of housing measures to manage supply and demand as well as financial stability risks were already in place, but had not proved sufficient to deal with the price impact of foreign investments in real estate markets, particularly since such purchases were not subject to macroprudential measures on domestic bank lending and were not subject to local taxes. Officials judged that measures discriminating against foreign buyers tackled a specific source of imbalance and using more macroeconomic measures to deal with these foreign inflows would have created more distortions than it solved. A recent BIS report notes that the growing importance of foreign investors in real estate markets presents policy challenges since "foreign demand is less sensitive to macroprudential measures that affect the supply of domestic credit for property investments" (BIS, 2020). Interviews with staff

BOX 2. IMF JUDGMENTS ON HOUSING-RELATED MEASURES

Australia: MPM/CFMs, consistent with the IV. Residency-differentiated stamp duties adopted by some regional authorities responded to a capital inflow surge and did not substitute for other policies. However, the staff urged that the measures be replaced with non-discriminatory policies as soon as feasible.

Canada: CFMs, inconsistent with the IV. An additional property transfer tax and a non-resident speculation tax adopted by selected provinces were not designed to deal with financial stability risks and there was no evidence of a capital inflow surge.

Hong Kong SAR: CFM/MPM, consistent with the IV. Stamp duties on non-residents were designed to stem a surge in capital inflows, not used as a substitute for appropriate macroeconomic adjustment, and imposed because macro-prudential measures would not be effective to deal with systemic risks arising from non-resident investment in the housing sector. However, staff reports have consistently called for phasing out the measure once the systemic risk dissipates.

New Zealand: CFM, inconsistent with the IV. A ban on non-resident investment in the housing sector implemented in October 2019 was seen as unjustified as there was no evidence of a surge in capital inflows or a link between house prices and activity by foreigners, while macroeconomic and macroprudential policy settings were broadly appropriate.

Singapore: CFMs/MPMs consistent with the IV. The IMF supported the continued use of an additional stamp duty on non-residents, first introduced in 2011 and increased in 2013 and 2018, in the face of systemic risks, given comprehensive property market cooling measures in place and an evident link between foreigners and property price developments. However, staff reports have urged phasing out the measure once the systemic risk dissipates.

Source: Everaert (2020).

members suggest that they are well aware of such considerations, with which they have often had sympathy although they also felt that the authorities' housing goals could often be achieved with non-discriminatory measures. At the same time, the staff emphasized the need to be evenhanded in ensuring that Fund advice is fully consistent with the IV.

The process of applying the IV in these cases was regarded as a cumbersome and time-consuming labeling exercise by country authorities, even when measures were ultimately judged to be consistent with the IV. Authorities interviewed observed that discussions of how to characterize a given measure (CFM, CFM/MPM, or MPM) took too much time away "from a more substantive discussion on how to maintain a stable domestic housing market in the presence of volatile capital flows," with some calling the labeling "a distraction or an irritant" (Everaert, 2020). Similarly, Executive Board discussions of Article IVs of countries where such measures had first been labeled as CFMs devoted a lot of their time (more than half in some cases) to clarifying these issues.

Interviews indicate lack of internal agreement within the IMF staff on the validity of the label ultimately chosen in some cases. For instance, in the case of *Canada*, area department staff were not fully comfortable with the CFM designation on the grounds that there was no intent to curb capital inflows and that the effect of the tax on aggregate capital flows was likely to be minimal. Other staff felt that the measure was a legitimate MPM in response to pressures facing the housing sector. In the end, a relatively strict reading of the IV prevailed, centered on the key feature that the measure made a clear and explicit discrimination between residents and non-residents and was therefore a CFM, and was not explicitly put in place for financial stability reasons and was therefore not a CFM/MPM.

CHALLENGES IN IMPLEMENTATION: DISRUPTIVE CAPITAL OUTFLOWS

The IV's guidance on how to deal with episodes of disruptive capital outflows tries to balance a pragmatic recognition that limits on capital outflows can play a useful role when a country faces extreme capital account pressures, against the recognition that measures that interfere with investors' existing rights and expectations can have damaging long-term consequences for investor confidence and capital allocation. Too-rapid recourse by a country to measures that impose losses will encourage both domestic and foreign investors to find ways over time to move their capital elsewhere. On the other hand, in extreme circumstances, recognition from the Fund that capital controls are part of a coherent plan to deal with a clearly unsustainable situation can itself play an important stabilizing role, because IMF support can influence whether or not a given policy will hurt investor confidence. If a country in crisis imposes outflow controls that the IMF judges to be necessary to restore economic stability, their effect on investor confidence is likely to be far more benign.

In practice, the staff provided useful advice on capital outflow restrictions in three recent crisis cases with IMF-supported programs—*Cyprus*, *Iceland*, and *Ukraine*—which paved the way for restoring investor confidence and eventual removal of the controls (Honohan, 2020). The case studies found that the Fund staff was "not in the driving seat for some of the major initial steps in these key episodes" and not immediately supportive of the need for capital outflow restrictions—which is not surprising since such measures are typically introduced suddenly and without extensive consultation with IMF staff.[19] Nevertheless, the staff broadly supported the measures that were announced in all three cases and the authorities generally reported getting good technical advice on the implementation of outflow controls to maximize their effectiveness, which seems to have helped limit the degree of leakages.[20] In *Ukraine*, the authorities resisted IMF staff concerns about how controls were being implemented and failed to stabilize their situation under the 2010 Stand-By

[19] In *Croatia*, officials had developed a contingency plan in 2009 if outflow pressures intensified but this was not discussed in detail with the Fund (Flug and Towe, 2020).

[20] In the case of *Cyprus*, Honohan (2020) discusses some concerns about the timing and design of outflow restrictions, but in this case the IMF's role was constrained by its participation in the "Troika" with the European Central Bank and the European Commission.

Arrangement, but subsequently they were more successful with outflow controls in the context of a broader reform package supported by the 2015 Extended Fund Facility Arrangement after following Fund guidance more closely.

A challenging issue in each case was the pace at which controls should be liberalized. The IV guidance is that while outflow controls should be temporary, the timing of liberalization needs to reflect country circumstances, in particular when macroeconomic stability is restored and confidence is regained. In the three program cases just discussed, controls were successfully dismantled with limited problems; indeed, national authorities often wanted to remove them more quickly than the Fund staff considered advisable.

In the surveillance context, Fund advice has generally been less supportive of the use of capital account measures in the face of capital outflows, raising the issue of whether the IV's guidance to limit such measures to crisis or near-crisis situations is too constraining. In two of our case studies, for *China* and *India*, Fund advice when these countries faced outflow pressures in 2013 and 2015, respectively, received mixed reviews from authorities, with suggestions that the Fund could have been more helpful as the countries grappled with difficult circumstances (Patnaik and Prasad, 2020).

- In mid-2015, authorities in *China* responded to depreciation pressures on the renminbi and persistent heavy net capital outflows by tightening outflow controls as well as taking other steps to clarify the foreign exchange regime and stabilize domestic markets. Officials interviewed for this evaluation felt that the country team was reasonably supportive of the capital account measures taken to stem the outflows. However, these officials felt that the IV, while giving the country team the room to approve outflow measures in exceptional circumstances, also constrained them by requiring that measures be justified and vetted internally within the Fund on an item-by-item basis rather than being seen as components of an overall strategy, and they observed that the Fund did not provide overall public support for these measures until early 2016. Even some staff members felt the Fund could have provided earlier broad strategic support instead of a bottom-up analysis using the complex criteria embedded in the IV. During this period, the Chinese authorities also undertook aggressive measures to intervene in foreign exchange markets, both onshore and offshore, in order to support the currency and they introduced a "countercyclical adjustment factor" intended as a signal to markets that the Central Bank would intervene to prevent rapid currency depreciation. The Fund took issue with this approach, arguing that it would hurt the Central Bank's credibility with market participants and make it harder to eventually transition to a more market-determined exchange rate. Some officials felt that the Fund overemphasized the benefits of exchange rate flexibility at such a critical time.

- *India* came under significant market pressure in the summer of 2013 after the "taper tantrum." Debt and equity outflows both accelerated and the rupee depreciated by 15 percent over just three months, as the Central Bank struggled to convince markets that the outflow from India was not in line with fundamentals of the Indian economy. These developments led to a wide-ranging and heterodox response from the authorities that included monetary policy tightening (through both the policy rate and direct controls) as well as changes to a number of current account and capital account measures, primarily restrictions on gold imports and lending against gold, direct dollar sales to oil marketing companies, and subsidized foreign exchange swaps to attract inflows from non-resident Indians. Interviews with staff members indicate that the authorities would have welcomed a statement of Fund support for the various measures they were undertaking to help calm markets. While this was discussed within the Fund, and there was considerable sympathy for the measures taken—including many of the capital account measures—the IMF did not in the end make a public statement, in part because of difficulties in quickly assessing the consistency of some measures with the IV. The various actions taken by the authorities were eventually endorsed in the 2014 Article IV Report and in a speech by the IMF Managing Director during a visit to India in 2015.

Most recently, in response to the COVID-19 crisis, EMDE policymakers have followed an aggressive multi-pronged approach that was broadly consistent with the IV (Batini, 2020). Countries responded to the devastating health shock and heavy exogenous blow to the real economy with aggressive fiscal and monetary easing and used financial policies to maintain financial market functioning and avoid cascading bankruptcies. Countries with flexible exchange rates have been willing to let depreciations take the brunt of the adjustment to capital outflow pressures in line with the IV, while many intervened in spot or derivative foreign exchange markets to avoid market disruptions. The scale of foreign exchange intervention was generally limited, as aggressive easing by advanced-economy central banks and actions by the U.S. Federal Reserve to support dollar liquidity helped to rally international financial-market conditions by mid-year. Capital account measures were not extensively used. Only about a third of the countries among our EM case studies used measures classified as CFMs or CFMs/MPMs by the Fund under the IV and most of these cases involved relaxation of inflow controls.

The Fund's financial support to help member countries tackle the COVID-19 crisis has been provided through a variety of channels. More than 70 countries had accessed emergency financing facilities with no ex post conditionality by end-June 2020, while other countries have benefited from augmentation of existing arrangements.[21] There was also increased interest in precautionary facilities. The Fund approved two new Flexible Credit Line arrangements (Peru and Chile) and renewed the FCL arrangement for Colombia, while Morocco drew on its existing Precautionary Liquidity Line. The Fund also introduced a new precautionary facility, the Short-term Liquidity Line, specifically to be used to address balance of payments needs from volatility in international capital markets, although this facility has not been used so far.

One striking feature of the policy response to the crisis was that a number of EMDE central banks have resorted to unconventional monetary policies and other new tools. In some cases, such as Poland, central banks turned to asset purchase programs to ease monetary conditions further as the room for cutting policy rates dwindled, but several central banks, for example in Colombia, Indonesia, South Africa, and Turkey, have used asset purchases more to support local currency government bond markets disrupted inter alia by heavy foreign investor sales. The Fund staff quickly prepared a special series of technical guidance notes on the use of these and other tools to respond the COVID-19 crisis.[22]

The Fund's counsel on external sector issues during the crisis seems to have been closely aligned with the IV.[23] The flagship multilateral documents counseled that in the "face of an imminent crisis," capital outflow measures could be part of a broad policy package but that they should not substitute for warranted macroeconomic adjustment. An April 2020 *GFSR* chapter that focused on the challenge of managing portfolio flows suggested that temporary and transparent minimum holding periods and caps and other limits on non-resident transfers abroad could be considered if non-resident outflows are a significant driver of overall outflows. Similarly, it proposed that macroprudential buffers, such as foreign currency reserve requirements, could be relaxed to mitigate foreign exchange funding pressures (as done by Peru). In addition, MCM provided a "how to" note to area department teams to guide country advice on how to handle the large challenges of volatile flows or external pressures in the COVID-19 crisis.

Assessment

Overall, the staff deserves credit for conscientious efforts to implement the IV in a consistent and evenhanded manner. The process has worked well in many countries, with officials expressing broad satisfaction with the design and implementation of the IV as marking a significant step forward in facilitating policy discussions on how to address capital flow issues.

Nevertheless, authorities interviewed in our case studies often felt that Fund advice on dealing with capital flows in the surveillance context does not bring much value added

[21] Twenty-seven of the poorest members have also benefited from debt service relief under the Catastrophe Containment and Relief Trust.

[22] See for example "Monetary and Financial Policy Responses for Emerging Market and Developing Economies" (IMF, 2020f).

[23] This report does not attempt to evaluate Fund advice during this period since the experience is too recent to allow adequate perspective and in view of the limited opportunities to interview staff and policymakers involved.

and is not very influential on their policy choices. These concerns reflect a number of challenges in implementing the IV.

Discussions about the appropriate labeling of measures have sometimes become quite contentious, squeezing the time available for policy discussions. In many of the cases mentioned above, authorities expressed concerns that implementation of the IV can become a cumbersome and rigid labeling exercise, with discussions revolving around disagreements on classification issues, crowding out time and staff attention to more concrete policy advice. In part this attention to labeling relates to the constraints built into the design—once a measure receives a "CFM" label, that limits the circumstances in which it can be judged as appropriate under the IV and limits the scope for staff support. Officials also raised concerns about "stigma effects:" countries still see a CFM label as suggesting that a measure is not approved by the IMF staff and therefore bodes badly for market or political acceptance.

A related concern is that the staff's advice on capital account issues has tended to be quite generic rather than granular and not provided countries with detailed assessments of the benefits and costs of alternative approaches. The staff has typically not provided detailed suggestions about how to use CFMs most effectively in circumstances when they could be useful or are being used quite actively to address financial stability concerns—as, for example, in ASEAN (Everaert and Genberg, 2020) and dollarized Latin American economies (Batini, Borensztein, and Ocampo, 2020). The staff has been more willing to provide specific advice on other instruments such as FXI, although even here it has often been prone to stick with general advice to confine intervention to address disorderly conditions, rather than to offer specific advice on the practice of intervention. In this area, there has been a willingness to learn from authorities' innovations, e.g., on use of discretionary rather than pre-programmed intervention and intervention in the non-deliverable forward market rather than the spot market, as discussed in the Latin American case studies. In monetary policy too, IMF advice has often been kept at a rather general level. By contrast, advice on the use of MPMs is one policy area where the IMF has consistently taken the lead in analyzing polices and promoting best practices.[24]

A clear exception must be made for IMF advice on handling disruptive capital outflows in the program context, where advice has been more granular and influential. In these circumstances, the Fund staff has generally been fully engaged with authorities in advising on approaches taken even though initial steps may have preceded the IMF's involvement. The Fund staff deserves credit for being willing to support strong actions judged as necessary in very difficult circumstances, even while pushing back in some cases where actions have been judged as likely to be ineffective or to encourage corrupt practices inconsistent with program success.

IMF advice on handling disruptive outflows from countries in a surveillance context has tended to be much less detailed and engaged. The staff has generally followed the IV's guidance closely, which encourages use of the exchange rate as shock absorber as part of a broader policy package and discourages use of CFMs unless a country faces a crisis or imminent crisis. The China and India case studies suggest that the Fund staff was not particularly proactive in giving specific advice or being supportive as these countries faced difficult external circumstances.

A further challenge for the staff in implementing the IV is the important role of the exchange rate assessment provided by the EBA, which the authorities have not always found convincing. Part of the Fund's general reluctance to advise on active use of CFMs and FXI seems to stem from concern that these measures could be used to depress a currency's value. The staff has also been ready to push against use of CFMs in circumstances where the EBA has found the country's exchange rate to be undervalued, as in Korea in 2013. However, country authorities have often argued that EBA assessments are not convincing and do not pay enough attention to local circumstances, while maintaining that the principal purpose of their measures is to promote financial stability, not to reduce capital inflows or depress the exchange rate.

[24] This assessment chimes with IEO (2019); see in particular, Klein (2019), which evaluated advice to countries being affected by spillovers from unconventional monetary policies in major advanced economies.