FOSTERING INTERNATIONAL MONETARY COOPERATION[15]

Since the GFC, the IMF has been active through multiple channels to foster international monetary cooperation, including to address the concerns of EM officials that UMP in AEs were creating difficult challenges for their economies. As described earlier, many EM policy-makers were concerned about potentially adverse spillovers on their economies, especially as UMP remained in place for a prolonged period. While initially accepted as necessary for the recovery of AEs and good for global growth by fostering increased trade, over time UMP were seen as increasingly challenging EMs, by prompting large and volatile capital flows that could damage competitiveness, fuel excess leverage, and threaten asset market overheating. Concerns continued, even amplified, as AEs (notably the United States) pivoted towards monetary tightening, leading to periods of risk aversion and stress for EMs. The IMF responded through: (i) broader efforts to strengthen international policy cooperation, including by adopting the ISD and working with the G-20; (ii) intensified analysis of cross-border spillovers, embodied in the launch of Spillover Reports; (iii) the development of the IV for guiding advice on capital flows; and (iv) reinforcing the global financial safety net, notably through the establishment of the FCL.

THE IMF'S ROLE IN INTERNATIONAL POLICY COOPERATION

The Fund's role since 2008 in attempting to foster international policy cooperation has some similarities with earlier periods of crisis and reform. Almost from the beginning of its existence, the Fund has made commendable efforts but nonetheless struggled to fulfill its mandate in the Articles of Agreement to promote international monetary cooperation. Since the 1940s, the MAE governments have zealously guarded sovereignty over their exchange rate and monetary policies, and key decisions regarding the international monetary system were usually taken in small settings (e.g., G-5/G-7) with a limited Fund role. The initiative to establish the SDR in response to the "dollar problem" in the 1960s did not prosper, while the collapse of the Bretton Woods system of fixed exchange rates in the 1970s eroded the IMF's formal jurisdiction over exchange rates, leading to an approach to bilateral surveillance largely based on advice and peer pressure with limited statutory sanctions for national policy choices potentially disruptive to stable global conditions. Nevertheless, the Fund's lending facilities, technical expertise in crisis management, and ability to be a forum for regular discussion among senior officials have meant that the Fund invariably plays an important role, particularly in providing financing in times of balance of payments stress. This was certainly the case after the GFC as the Fund deployed its traditional facilities to provide crisis financing to both AE and EM members, introduced new precautionary facilities, and mobilized a rapid augmentation of its financial resources (IMF, 2016b; 2016d).

Since the GFC, the IMF has worked intensively with the G-20 on initiatives to strengthen international cooperation on countries' broad economic policy agendas, with mixed success. With the addition of the "leaders track" in 2008, the G-20 emerged as the leading global body

[15] This chapter draws on Schenk (2019) and Klein (2019).

for international policy cooperation. The G-20 has no permanent secretariat and relies on support from the IMF and other international organizations. The IMF contributed significantly to successful efforts to mobilize an initial coordinated fiscal stimulus alongside UMP in response to the GFC. As recovery appeared to take hold, the G-20 asked for IMF analysis of the principles that should govern the exit from UMP (G20, 2009). One of the principles included a call for coordination to prevent adverse spillovers. When the G-20 set up the Mutual Assessment Process (MAP) in 2009 to encourage countries to adopt monetary, fiscal, and structural policies that would boost their own as well as global growth, the IMF provided the technical analysis to assess the policy plans put forward by members. At its launch, the MAP was heralded as an important improvement in international policy cooperation, with the IMF's Chief Economist, Olivier Blanchard, known to be a skeptic of previous such efforts, writing that "a problem shared is a problem halved." Since then, although the IMF has continued to prepare detailed diagnostics and policy recommendations for further actions, the MAP has had limited traction in nudging countries toward the broader mix of monetary, fiscal, and structural policies needed to achieve strong, sustainable, and balanced growth.

The Fund has also overhauled its own surveillance framework to strengthen attention to spillovers, most notably through the adoption of the ISD in 2012 (IMF, 2012a). The ISD requires the Fund, in fulfilling its multilateral surveillance mandate, to assess the spillovers from a country's policies—including domestic policies—during the bilateral Article IV consultations if these spillovers could significantly affect the operation of the international monetary system. The hope was that recognition of spillovers arising from domestic policies would encourage countries to consider alternatives, although, as in the past, there was no obligation for them to change policies. In addition, the IMF's technical approach to external assessment was overhauled, and the Fund's views on global imbalances were given greater profile in an external sector report (see IEO, 2017; IMF, 2018c).

These new approaches have generally been regarded as technically well-founded but have not succeeded in making multilateral concerns an effective influence on members' policy decisions. The legacy of the Bretton Woods emphasis on the exchange rate system as the core of international monetary cooperation and the Fund's limited mandate over capital as opposed to current account transactions constrain the scope and traction of the Fund's surveillance and monitoring in an environment of floating or more flexible exchange rates and increasingly open capital markets. The ISD has allowed external stability consequences of domestic policies including UMP to be discussed but its application has not been very effective in internalizing these issues in "source" country policy decisions.[16] Similarly, the external balance assessment has been a valuable lens to assess current account and exchange rates but has not proven an effective tool to pressure countries' policy choices (IEO, 2017).

SPILLOVER ANALYSIS

Spillover Reports (published from 2011 through 2015) represented an early effort to examine the impact of UMP, as well as other policies and developments, on other countries. The reports used an eclectic mix of approaches in the absence of any established model in the academic literature. The core of the reports was the use of macroeconomic models, including Dynamic Stochastic General Equilibrium (DSGE) models and VAR analysis, which were broadly consistent with work by others looking at this issue in academia and central banks, except in the case of estimates from a new Global Financial Model. Interviews with experts indicate that the IMF models were considered as useful particularly in the early years but did not develop innovative research methodologies. Since 2016, spillover analysis at the Fund has been incorporated in the *WEO*, which includes a chapter a year on some aspects of spillovers. So far, the analysis has mostly been of real-side (trade, migration, productivity) rather than financial spillovers.

The Spillover Reports had only limited success in assessing the financial channels for adverse spillovers that caused major concern for EM policymakers. The most harmful effects of spillovers may well be through financial channels rather than through the trade account, and the modeling of such spillover channels is still not fully developed. As discussed in Klein (2019), while the Fund was an early

[16] See IMF (2016a) for an overview of the application of the ISD framework to UMP.

mover in attempting to incorporate financial spillovers in DSGE models, the Spillover Reports did not in the end succeed in the admittedly difficult task of making breakthroughs in ways that would have been useful for policymakers. Financial channels are difficult to embed in a large-scale macroeconomic model and, when they have been included in the Fund's spillover modeling, have often appeared as factors like exogenous shifts in the term premium or risk factors, which are too vague a means to truly understand these effects and do not yield clear policy prescriptions. There has been some recent progress in the modeling of financial spillover channels but mainly in research by central banks and academics (see, for example, the papers presented at the IMF's 2018 Annual Research Conference).

Officials appreciated the Spillover Reports as signaling the Fund's desire and efforts to help EMs but questioned their practical impact. The Spillover Reports were generally welcomed by authorities as a useful attempt by the Fund to understand the spillovers from UMP and other policies and developments. Some considered them a useful tool to motivate the discussion of cross-border effects in international forums such as the G-20. Nevertheless, the reports gained little traction with the authorities in the countries carrying out UMP. Hence, many shared the view of an official in Brazil that the reports were "interesting but not very relevant for policy-making." Chinese authorities also felt that Spillover Reports had not fully captured the effects of UMP for China; UMP in their view "not only fueled inflation pressures but also constrained the options regarding policy mix, as well as the timing, path, and pace of the monetary policy normalization in emerging market economies." In India as well, senior officials felt that the Spillover Reports were not in the end very useful because they did not adequately capture the impact through financial channels. Moreover, it seemed that the ultimate policy message was always going to be "grin and bear it" when it came to any effects on EMs from AEs. Under this view, the IMF needed to press harder in its policy advice to the source countries if it wanted to be of help to EMs.

THE INSTITUTIONAL VIEW AND ADVICE ON CAPITAL FLOWS

IMF staff have worked intensely to develop an approach for coherent policy advice on dealing with volatile capital flows. While EM policymakers took the lead in innovating in this area, IMF staff followed quickly with detailed review of country experience as well as conceptual work to develop an IV on capital flows to guide IMF policy advice, approved by the Board in 2012. The IV is intended to provide a template for the IMF to give coherent and consistent advice to countries differing across a range of relevant dimensions such as macroeconomic frameworks, exchange rate regimes, regulatory frameworks and institutional structures, including on the role and use of CFMs. While the IV was a compromise after considerable discussion, senior officials confirmed that the IV has succeeded in becoming the central framework for policy discussions on responding to capital flows between the Fund and the members. Experience with the IV was reviewed in 2016, and the Fund has done further work to clarify the relative role of CFMs and macroprudential policies (IMF, 2017b). Staff has also engaged with authorities to promote better understanding of the country application of the IV, for instance through workshops with government officials at recent Bank-Fund Spring and Annual Meetings and the compilation of a taxonomy of CFMs (G-20, 2018).

While policymakers see the IV as an important step forward in framing advice on capital flows, they also have raised three areas of concern.

First, the effectiveness of CFMs is still subject to considerable debate and remains an open area of research. Some experts find that episodic capital controls on a limited range of assets could be leaky and ineffectual, especially as these controls stay in place and people find ways to circumvent them (Klein, 2012). Others argue that all policies can be circumvented to some extent, so the relevant question is whether CFMs can be circumvented more easily than other measures that would be adopted instead such as MPPs (Ostry, Ghosh, and Korinek, 2012). EM policymakers themselves have quite varying assessments of the impact and value of the CFMs that they have introduced in recent years. Thus, there is a need for continuing assessment of experiences and willingness to adapt in the light of the findings.

Second, some advanced and EM officials have raised concerns that the IV is applied too rigidly. Considerable efforts have been made by Fund staff to apply the IV in an evenhanded way across countries. Nevertheless, officials sometimes feel that the results do not adequately reflect differences in circumstances. As noted above, an issue regarded as irksome by some country officials was the Fund's labeling as CFM steps that countries view as having been taken for financial stability reasons or to ensure affordable housing, undoing some of the goodwill generated by the perception that the IMF was becoming less doctrinaire.

Third, though CFMs have been used actively over the past decade, some countries have expressed dissatisfaction that the IV does not adequately expand their policy choice set. As noted above, one issue relates to whether CFM should be regarded as a part of a broader toolkit which could be used pre-emptively and kept in place, or whether, as currently presented in the IV, CFM would be used only after appropriate macroeconomic adjustment and then only on a temporary basis.

REINFORCING THE GLOBAL FINANCIAL SAFETY NET

The IMF's track record with precautionary lines of credit before the GFC had not been promising. Over the years, the IMF has experimented with a range of liquidity facilities, particularly schemes with ex ante qualification and no ex post conditionality. A Short-Term Financing Facility was considered in 1994 but not in the end adopted because the Board was concerned about the lack of conditionality, the challenge in defining eligibility and overlap with other facilities. The Contingent Credit Line, introduced in 1999, was another attempt at developing a pre-qualification borrowing facility after the EM financial crises in 1998 showed that contagion effects could hit otherwise sound economies. But it was allowed to lapse in 2003 given the lack of use (IMF, 2003).

In 2009, however, the Fund successfully introduced the FCL. The FCL provides a precautionary line of credit to countries with very strong economic fundamentals and institutional frameworks and a sustained track record of implementing very strong policies. The expectation was that the lack of ex post conditionality and the seal of approval for the member's economic policies ex ante would make this an attractive facility for a range of countries. To date only three countries—Colombia, Mexico, and Poland—have obtained approval for an FCL. Mexico's praise for the FCL was noted earlier. Polish officials and Colombian officials also found that the FCL has helped to reinforce market confidence (IMF, 2017c; 2018a). In addition, in 2011, the Precautionary and Liquidity Line (PLL) was introduced, for countries with sound economic fundamentals but with some limited remaining vulnerabilities which preclude them from using the FCL. Only two countries (the Former Yugoslav Republic of Macedonia and Morocco) have used this instrument so far.

Limited pickup of the FCL and PLL by other countries that could qualify for these instruments seems to reflect concerns on a number of fronts. In explaining why they had not pursued this option, officials pointed to the potentially adverse impact from losing qualification for access, uncertainty over continued availability when most needed, and lingering stigma of IMF borrowing even without ex post conditionality. The Fund has continued to explore various options for liquidity instruments that could attract wider use, but to date has not been able to find designs that can receive broad support among the membership and attract interest from potential users (IMF, 2017d).