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# Curiouser and curiouser...: The IMF's (staff) institutional view on capital controls

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On 30 March 2022, the International Monetary Fund (IMF 2022) published its much-anticipated review of its institutional view (IMF 2012) on capital control policies. There was much hope (Stiglitz and Gallagher 2022) that this review of its 2012 view would make distinct progress towards a financial-stability-enhancing, development-friendly policy view among the IMF staff.

Instead, the evolution of the IMF's institutional view (IV), as a chapter 2 in the wonderland of international financial markets, is getting curiouser and curiouser. Singh (2022) presents a valuable attempt to decipher the implications on the IV from this review. This piece seeks to situate the curious evolution of the IV in the light of the policy dilemmas confronting developing-country officials. Policy authorities in developing countries will eventually learn, in their interactions with IMF staff, that the institutional view consists mainly of benchmarks, taxonomies and terminologies which have more to do with indicators of "temporariness" or of "openness" and mannerly terminologies.

**Terminologies, taxonomies, and benchmarks**

First, on mannerly *terminologies*. Article VI, Section 3, in the IMF's Articles of Agreement reserves for IMF members the right to "exercise such controls as are necessary to regulate international capital movements." The word used is "controls"; however, the IMF in its review chooses to use the more decorous phrase "capital flow management measures" (CFMs), apparently to avoid some unfortunate associations with the word "control."

Then, there are new *taxonomies* related to capital controls. Market economies apply macro-prudential measures (MPMs) for the systemic stability of the domestic financial sector. The 2012 view recognizes that open capital flows have undermined the financial systems of liberalizing countries. This creates a new category of policies, MPMs, related to capital flow management; the IMF's IV does not object to MPMs.

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In practice, unfortunately, routine MPMs apply only to the enterprises captured under the national banking supervisory net. As exemplified in South Korea's getting swept into the East Asian financial crises of 1997-98, non-supervised shadow banks and non-financial companies are important players in capital flow episodes. The need to cast a wider net for MPMs to include these other players has created a taxonomic challenge of differentiating between CFMs and MPMs. Thus emerged the hybrid "CFM/MPM", a category of policies to regulate capital flows to secure domestic systemic financial stability.

The 2022 review does provide additional guidance on this taxonomic challenge, which younger staff in developing-country central banks should familiarize themselves with, the better to defend MPM policies in policy discussions with the IMF. Singh (2022) highlights the cumbersome and time-consuming need to disentangle overlaps among MFP and CFM policies and the debates within IMF staff and with national staff on how to classify actually existing MPM policies.

The review reaffirms that "[t]here is broad consensus among the membership that the core principles underpinning the IV should be retained, namely that capital flows are desirable as they can bring substantial benefits for countries, and that CFMs can be useful in certain circumstances but should not substitute for warranted macroeconomic adjustment." The review reaffirms that this is a position of the IMF's membership and not necessarily a position derived from research and, perhaps, from the actual experience of many countries. This view delineates the Procrustean limits for the *benchmarks* over acceptable CFMs and CFM/MPMs.

In the first place, outflow controls are not acceptable even though IMF staff still can request members to impose controls (Montes 2013, p. 3). The view of the IMF membership thus places the burden on the staff to justify any positive feelings for capital controls.

In the second place, the 2022 review now recognizes the potential value of *temporary* inflow controls, amending the 2012 view, which took the position that these were not effective and were costly. This new position tacitly recognizes Malaysia's successful applications of controls in 1994 (Zeti 1994) and then again in 1998 (Zeti 1998). Both are generally seen to have been effective and least-cost policies, with the first notably directed against inflows, in the period leading to Mexico's Tesobono crisis.

**Episodic policy approach, and possibly pre-emptive**

The new position allows that "pre-emptive" inflow controls could possibly not violate the view of the IMF membership and in keeping with this view, such controls must be *temporary*. Within this overall presumption, the 2022 review engages in the issue of when a pre-emptive inflow control is legitimate.

A curious *benchmark*, for example, can be seen in a figurative diagram in the review (IMF 2022, Figure 3) which specifies that CFM/MPMs are not appropriate when a "preemptive CFM/MPM would help maintain or exacerbate a stronger-than-warranted external position mostly caused by domestic policy gaps." The existence of CFMs, MPMs, and CFM/MPMs – domestic interventionist measures – indeed is easily identified in comparison to the case of no-intervention.

But what if a "stronger-than-warranted external position" is caused by policy gaps *external* to the country being advised, such as quantitative easing in dominant financial markets? These kinds of "stronger-than-warranted external positions" have been the origins of the capital account dilemmas in countries considered "successful" (oftentimes called "miracle economies") by international portfolio investors. Is there possibly a case of a "stronger-than-warranted" position stemming, say, from a weaker exchange rate arising from generous monetary easing policies on the part of advanced countries? (If the adjective "stronger" is about the real exchange rate, would there be a category for "weaker-than-warranted" positions for economies with chronic current account surpluses, a group that includes Germany?) In fact, the review begins to wander into the arena of global competition policy when it states that "CFM/MPMs may help maintain or exacerbate a stronger-than-warranted external position or gain an unfair competitive advantage" (IMF 2022, p. 12, para. 13).

While advanced-country authorities could find the episodic approach to capital control policy apropos (and congenial to the global activities of private equity firms), it can be argued that developing-country authorities would prefer a policy stance rooted in their need to facilitate financing for physical investments that bring national benefits over the long term. How can control policies respond in a timely manner to profitable arbitrage opportunities opened up by uncoordinated but sovereign macroeconomic stances? How can control policies be incessantly calibrated to match, to employ the Freudian terms already in use in public policy debates, "tantrums" and "mood swings" of private portfolio investors to obtain long-term physical investments?

**The unknown known of international capital flows**

Starting from the Southern Cone crises in the early 1980s (Corbo and de Melo 1987, Diaz-Alejandro 1985), the capital control debate is rooted in the numerous cases in which successful but capital-needy economies have seen their growth trajectories reversed in a widespread economic crisis after massive capital inflows stimulated by liberalization. This pattern is the unknown known of international capital flows.

The public *mea culpas* of liberalization proponents in the early 1980s spawned the "order of liberalization" literature (McKinnon 1982), an academic instruction rarely obeyed. Thus, at its origin, the capital control controversy arises from the *cry of the liberalizers*, exporters of manufactures – such as Southeast Asian economies in the late 1990s (Montes 1997, 1998) and reputed "miracle economies." Current and former IMF staff Ostry, Loungani and Furceri (2016, p. 39) offer an update: "Among policymakers today, there is increased acceptance of controls to limit short-term debt flows that are viewed as likely to lead to – or compound – a financial crisis."

Bouts of policy liberalization themselves, which seemed to signal the potential for faster growth, have triggered inflow surges culminating in domestic financial crises which take longer to recover from. There are indeed developing countries that apply capital controls to cover up deep-seated weaknesses. It is unlikely that deep-seated economic problems can be resolved by capital account liberalization. However, the unknown known pattern can also apply to these countries when their experiments with liberalization trigger indiscriminate private inflows creating the environment for yet another crisis.

The 2022 review of the IV leaves aside wide-ranging research including that coming from the IMF itself. The IMF's 2018-21 programme for Argentina rediscovered this unknown known, when capital account liberalization triggered massive short-term inflows (IMF 2021, p. 29) and facilitated capital flight. Montiel's background paper for the IMF's (2020) Independent Evaluation Office report on IMF advice on capital flows highlights the evidence of some successes in developing countries in deploying capital controls to lengthen the maturity of external inflows.

One "miracle economy", China, has famously succeeded in sustaining capital inflows while operating capital controls. But very few developing countries are like China, and they must instead navigate the IMF's *benchmarks, taxonomies, and mannerly terminologies* to build their domestic financial sectors and strengthen domestic investment.

Given that the IMF's IV is the consensus of the membership – a membership whose votes are heavily weighted in favour of advanced countries – fiscal and monetary authorities in developing countries must accept that their lived capital control practices are ahead of those of global authorities. Their practice must continue to plough ahead of inflexible policy straitjackets emanating from the IMF staff.

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*The author is solely responsible for all errors, opinions and analyses.*

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