



The IMF's Institutional View on Capital Flows and Its Application in Surveillance

G20 Global Financial Stability Conference

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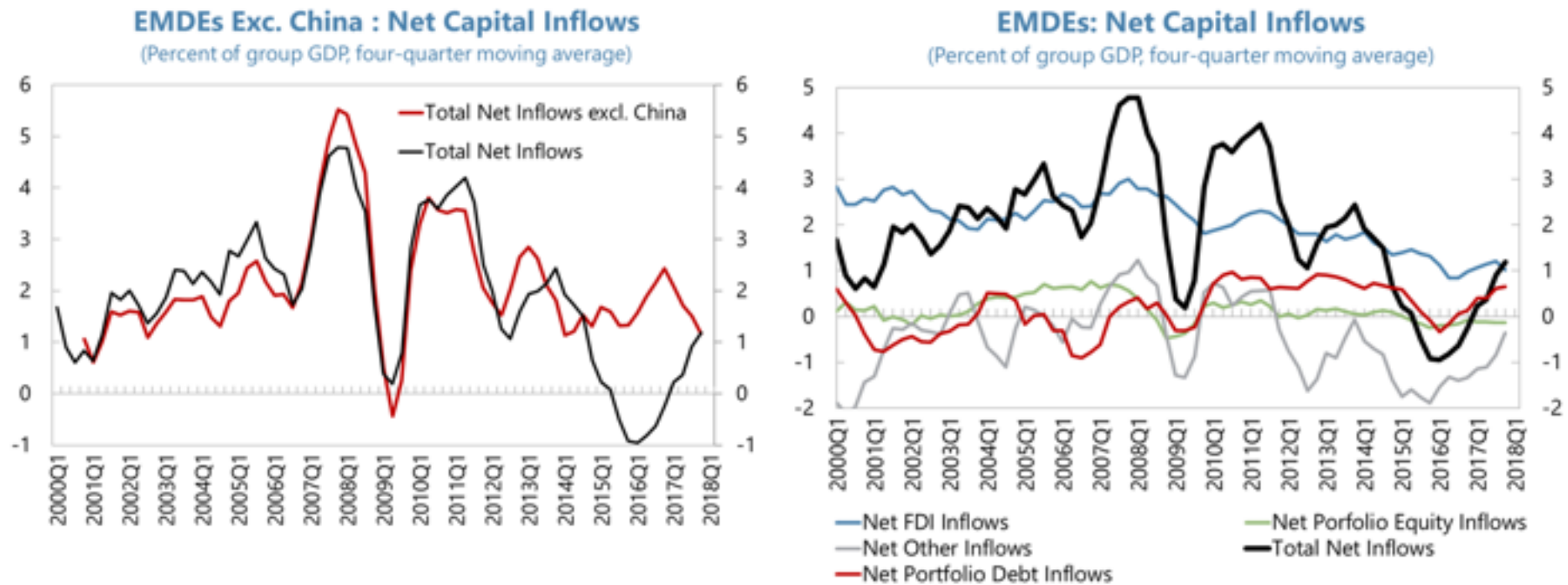
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Outline of Presentation

- I. Policy Challenges Associated with Capital Flows
- II. Overview of the Institutional View
- III. Application of the Institutional View
 - CFMs on Capital Inflows
 - CFMs on Capital Outflows
 - Other Measures
- IV. Key Messages

I. Policy Challenges Associated with Capital Flows

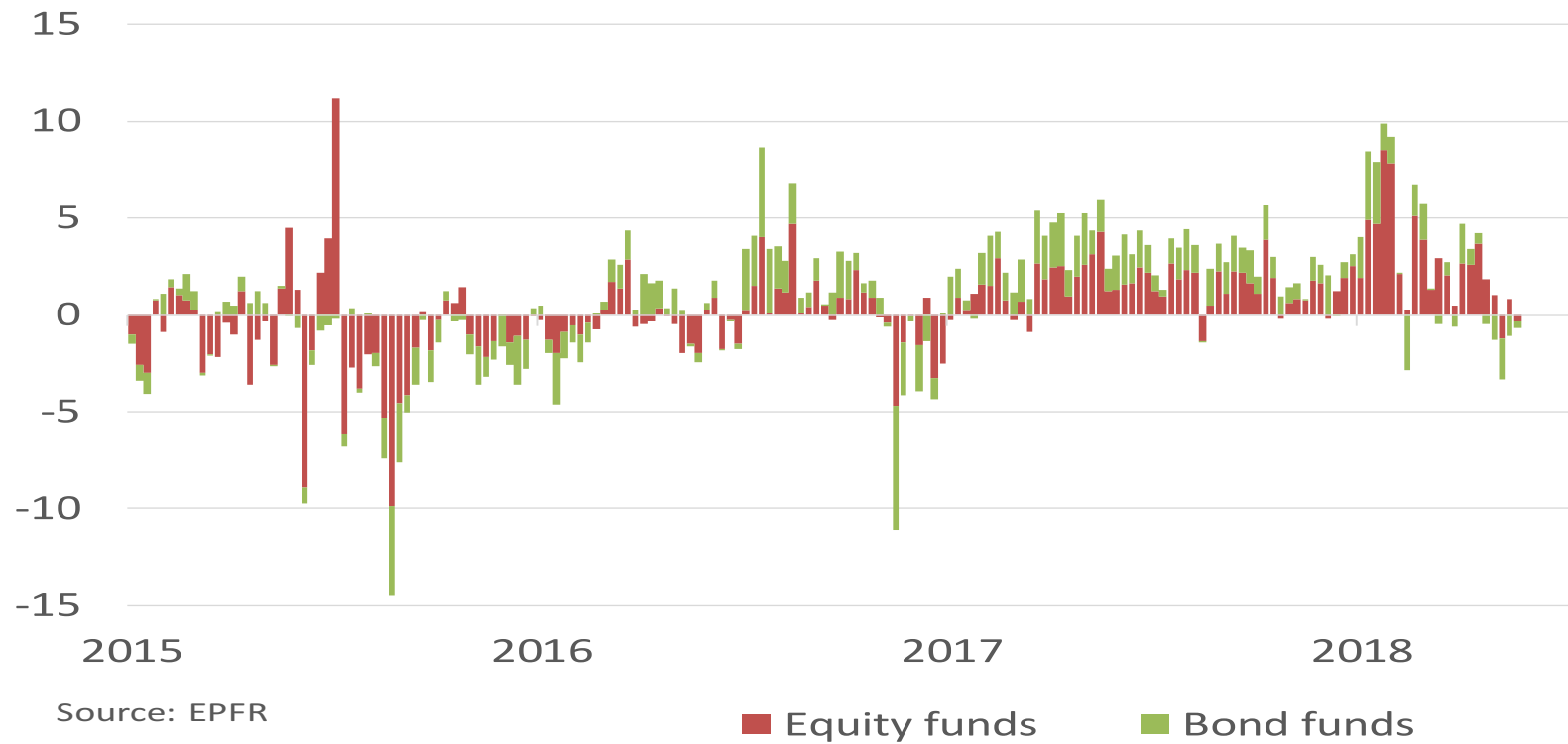
Net Capital Flows to EMDEs Remain Volatile



Sources: IMF Financial Flows Analytics and BOP Statistics, and IMF staff calculations.

... Especially Since Mid-April

Flows to Emerging Market Investment Funds
(In billions of U.S. dollars)



Source: EPFR

Equity funds

Bond funds

Capital Flows Provide Benefits but Can Also Carry Risks

Benefits

- **Direct benefits:** Risk diversification, financing for investment, consumption smoothing, transfer of new technologies and management practices (FDI)
- **Collateral benefits:** Promote financial sector development, macroeconomic policy discipline, trade, and economic efficiency

Risks

- Macroeconomic, financial stability
- Even for countries that have long been open and drawn benefits from capital flows
- Risks can be magnified by macroeconomic vulnerabilities and gaps in financial and institutional infrastructure

Challenge: Harness Benefits while Managing Risks

II. Overview of the IMF's Institutional View (IV)

Role of the IV

Guides Fund advice

- Guides general policy advice to members, including in the Article IV consultations.
- Does not provide guidance on the scope of members' obligations under Article IV(1).

No implications for Fund members' rights and obligations

- Does not change members' rights/obligations under the IMF Articles.
- Has no automatic implications for the Fund's financing operations.

Strengthens multilateral collaboration

- Facilitates collaboration with other institutions involved in the design and promotion of international frameworks.

Countries' obligations under international agreements unaltered

- Even where CFMs may be judged an appropriate policy response, they may still violate a member's obligations under other agreements.

Overview of the IV

- Macroeconomic policy framework to harness the benefits of capital flows while managing the risks
- Helps ensure consistent policy advice across all member countries taking consideration of country-specific circumstances
- Framework to foster multilateral discussions of capital flow issues to promote macroeconomic and financial stability
- Guidance on:
 - Managing capital inflows and outflows
 - Capital account liberalization
- Fund continues learning from experience

Managing Capital Flows

- To manage risks associated with inflow surges or disruptive outflows, a **key role** needs to be played by **macroeconomic policies** (monetary/fiscal/exchange rate), as well as **sound financial supervision and regulation** and **strong institutions**.
- In certain circumstances, **CFMs** can be useful.
- However, they should **not substitute for warranted macroeconomic adjustment**.
- It is necessary to evaluate on an ongoing basis the **economic usefulness** of maintaining CFMs against their **costs**.

Capital Flow Management Measures (CFMs)

- **Capital flow management measures (CFMs)** refer to measures that are designed to limit capital flows, comprising residency-based CFMs and other CFMs.
- **Residency-based CFMs** discriminate between residents and nonresidents, and are always CFMs by virtue of their own design.
- **Other CFMs** do not discriminate on the basis of residency, but are nonetheless designed to limit capital flows (e.g., currency-based measures).
- The **determination of whether a measure is a CFM takes into account country-specific circumstances**, including the context in which the measure was introduced, regardless of the stated intent or motivation behind the adoption of the measure.

CFMs, MPMs, and CFM/MPMs

- IMF's definition of CFMs and MPMs:
 - **CFMs** are measures designed to limit capital flows.
 - **MPMs** are primarily prudential measures designed to limit systemic financial risks.
- Some measures can be both CFMs and MPMs:
 - **CFM/MPMs** are measures that are designed to limit capital flows and to reduce systemic financial risk stemming from such flows.
 - For this type of measures, the IMF's two frameworks for capital flow management and macroprudential policies apply.

CFM/MPMs

Three Key Questions for the Classification of CFM/MPMs:

- Whether and how the financial system, in particular banks, is exposed to **systemic financial risk** stemming from capital flows.
- Whether and how the measures would contribute to **reducing such risk**.
- Why tightening standard **macroprudential tools** on banks cannot achieve the same objective.

Capital Account Liberalization

- **Capital account liberalization** refers to the removal or relaxation of CFMs.
- Capital flow liberalization is more beneficial and less risky if countries have achieved certain levels of **financial and institutional development**.
- Liberalization needs to be **well planned, timed, and sequenced** in order to ensure that its benefits outweigh the costs.
- There is **no presumption that full liberalization is an appropriate goal for all countries at all times**.
- The Fund provides **advice on liberalization strategies** based on the IV.

III. Application of the Institutional View (IV)

Application of the IV

- **Assessment of macro-relevant measures**
- **Assessment of introduction/changes in CFMs since the adoption of the IV in 2012**
 - New CFM
 - Tightening CFM
 - Easing CFM
 - Tighter/looser enforcement of CFM

Assessment of Appropriateness of CFMs

	CFMs on Inflows	CFMs on Outflows
Guiding principle	<ul style="list-style-type: none"> Warranted macroeconomic adjustments should not be substituted by CFMs. 	
Circumstances in which CFMs may be appropriate	<ul style="list-style-type: none"> Capital inflow surge Limited room to adjust policies, or adjustments take time to take effect Financial stability risks 	<ul style="list-style-type: none"> Crisis or imminent crisis Broad policy response
	<ul style="list-style-type: none"> Premature or improperly-sequenced capital account liberalization 	
Desirable features of CFMs	<ul style="list-style-type: none"> Transparent Do not discriminate between residents and nonresidents Temporary 	
	<ul style="list-style-type: none"> Targeted 	<ul style="list-style-type: none"> Comprehensive enough to be effective

CFMs on Capital Inflows

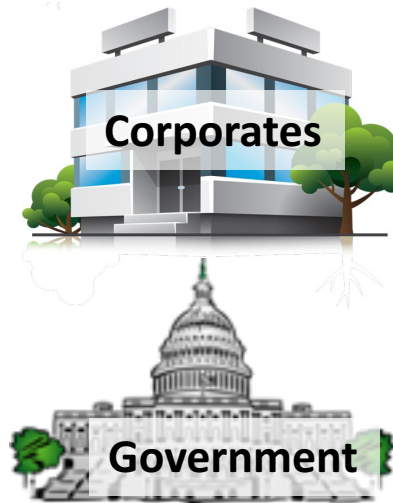
Measures on Portfolio Inflows and External Borrowing

Nonresident
investors



**Limit,
Tax,
Reserve and
Other
Requirements**

Residents



Illustrative Examples: Measures Limiting Portfolio Inflows and External Borrowing

		Case A	Case B
Classification	Measure	Hedging requirement for corporate external borrowing	Unremunerated reserve requirement on certain debt inflows
	Designed to limit inflows?	Yes	Yes
	Residency-based?	Yes	No
	Systemic financial risk?	Yes	No
Appropriateness	Classification	CFM/MPM	CFM
	Inflow surge?	Yes	No
	Room for macroeconomic adjustment?	No	Yes
	Available alternatives?	No	Yes
	• Non-discriminatory measures	None	None
	• Other policies	None	FX appreciation/Reserve accumulation/Fiscal tightening
	Appropriateness assessment	Appropriate	Inappropriate
	Staff recommendation	Apply on all corporate FX liabilities; Phase out as weak financial supervision capacity is strengthened	Remove given no inflow surge

Stamp Duties on Property Transactions

Foreign investors



FC



Property markets



Domestic investors



LC

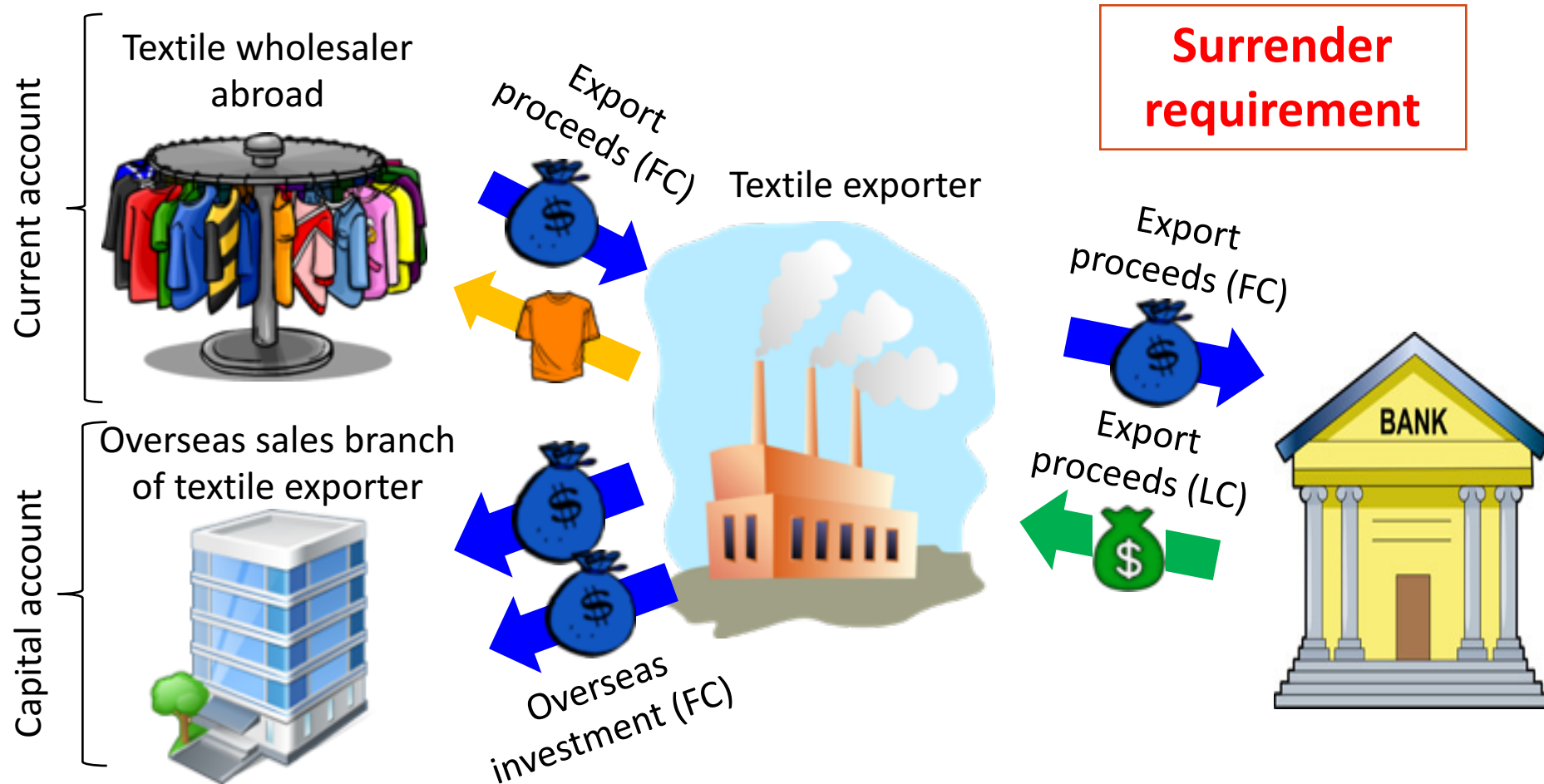


Illustrative Examples: Stamp Duties on Property Transactions

	Case A	Case B	Case C	
Classification	Designed to limit inflows?	Yes	Yes	Yes
	Residency-based?	Yes	Yes	Yes
	Systemic financial risk?	No	No	Yes
	Classification	CFM	CFM	CFM/MPM
Appropriateness	Inflow surge?	No	Yes	Yes
	Room for macroeconomic adjustment?	No	No	No
	Available alternatives?	Yes	No	No
	• Non-discriminatory measures	Yes	None	None
	• Other policies	Tighten MPMs	None	None
	Appropriateness assessment	Inappropriate	Appropriate	Appropriate
	Staff recommendation	Replace with alternative non-discriminatory measures	Phase out once the capital inflow surge abates	Phase out when systemic financial risks dissipate

CFMs on Capital Outflows

Surrender Requirements

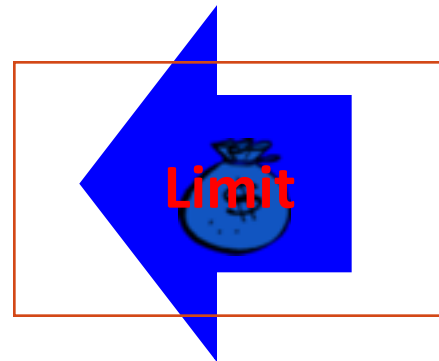


Illustrative Examples: Surrender Requirements

		Case A	Case B	Case C
Classification	Designed to limit outflows?	Yes	Yes	Yes
	Crisis or imminent crisis?	Yes	Yes	No
Appropriateness	Broad macroeconomic policy response?	Yes	No	No
	Appropriateness assessment	Appropriate	Inappropriate	Inappropriate
	Staff recommendation	Phase out as policy adjustments are implemented and crisis risk abates	Implement policy adjustment and remove as crisis circumstances abates	Remove given no crisis and with available room for policy adjustment

Measures Limiting Outward Investment and Transfers

Overseas investment



Residents



Illustrative Examples: Measures Limiting Outward Investment and Transfers

	Case A	Case B	Case C	
Classification	Measures	Limit on banks' gross FX derivatives position	Limit on banks' transfers abroad	Limit on investment abroad by financial institutions
	Designed to limit outflows?	Yes	Yes	Yes
Appropriateness	Premature liberalization?	Yes	No	No
	Crisis or imminent crisis?	No	Yes	No
	Broad macroeconomic policy response?	Yes	Yes	No
	Appropriateness assessment	Appropriate	Appropriate	Inappropriate
	Staff recommendation	Adopt supporting reforms for capital account liberalization	Phase out as crisis circumstances abate	Remove given no crisis circumstances and adopt macroprudential measures

Considerations on CFM Assessment

Considerations on CFM Assessment

1. Lack of macro-criticality

- **Increase in foreign investment application fees:** The increase was *de minimis*.
- **Increase in minimum foreign investment amount in a specific sector:** The sector accounted for a small fraction of overall FDI.

2. Lack of capital flow implications

- **Increase in capital gains tax on nonresidents:** The hike equalized the treatment between residents and nonresidents, in the context of no capital flow pressure.
- **Prohibition of FX loans under a certain amount in a highly dollarized economy:** The measure was introduced as a de-dollarization strategy.

3. Lack of material evidence

- **Tighter enforcement of CFMs:** No official documents were issued to confirm the tightening of enforcement.

IV. Key Messages

- The IV is a **macroeconomic framework** for consistent policy advice on managing risks from capital flows, taking account of **country-specific circumstances**, including macroeconomic conditions and financial stability risks.
- The IV requires staff to discuss capital flow policies when they are assessed to be **macro-relevant**.
- The IV is applied in the Fund's interactions with **all member countries**. **The criteria to apply the IV is the same for all countries**.
- The practice is to **assess CFMs when they are actively changed for managing capital flows**. This implies discussing:
 - New CFMs (i.e., those introduced since the adoption of the IV);
 - CFMs existing before the IV only when their settings/calibration are changed or their enforcement tightened.
- The Fund continues **learning from experience**.

IV. Key Messages (continued)

- **Measures that discriminate based on residency** limit capital flows by the virtue of their design, and therefore **are always assessed as CFMs. Non-discriminatory measures may also be CFMs if they are designed to limit capital flows.**
- **Measures assessed as CFMs and CFM/MPMs may or may not be appropriate.**
- CFMs should **not substitute** for warranted macroeconomic adjustment.
- **Use of CFMs may be appropriate:**
 - Under inflow surges if room for policy adjustment is limited, adjustment takes time to take effect, or there are financial stability risks;
 - In (imminent) crisis situations, as part of a broad policy package;
 - In cases of premature or improperly sequenced capital account liberalization.
- CFMs and CFM/MPMs should **not be used pre-emptively.**
- CFMs should be **transparent, (when possible) non-discriminatory, and temporary,** being phased out when capital flow pressures abate.

Useful Information Sources

- The Liberalization and Management of Capital Flows – An Institutional View, IMF (2012)
- Guidance Note for the Liberalization and Management of Capital Flows, IMF (2013)
- Managing Capital Outflows – Further Operational Considerations, IMF (2015)
- Capital Flows – Review of Experience with the Institutional View, IMF (2016)
- Increasing Resilience to Large and Volatile Capital Flows—The Role of Macroprudential Policies, IMF (2017)