



May 12, 2021

IMPLEMENTATION PLAN IN RESPONSE TO THE BOARD-ENDORSED RECOMMENDATIONS FROM THE IEO EVALUATION ON IMF ADVICE ON CAPITAL FLOWS

EXECUTIVE SUMMARY

This Management Implementation Plan (MIP) proposes actions in response to the Board-endorsed recommendations provided by the Independent Evaluation Office (IEO)'s report on IMF Advice on Capital Flows. Staff has already begun addressing some of the IEO recommendations and several of the actions proposed in this MIP reflect initiatives in train. Resource implications are therefore expected to be manageable in the near term as these actions have mostly been incorporated into departmental work plans and budgets for fiscal year (FY) 2021. Medium-term resource implications will be discussed in the context of the FY 2022-FY 2024 medium-term budget proposals.

The actions in this MIP aim at:

- **Bringing the Fund's framework for advice on capital flow policies up to date with recent research and lessons from experience**, by reviewing the Fund's Institutional View for the Liberalization and Management of Capital Flows.
- **Enhancing and coordinating a Fund-wide research agenda** to position the Fund at the cutting edge of work on capital flow issues, with proposals to conduct more research on the costs and benefits of capital account and macroprudential measures, deepen work on the Integrated Policy Framework, and explore refinements to analyze the effects of capital account-related issues on external balances.
- **Ramping up the monitoring and analysis of capital flows**, with proposals to increase resources committed to the Annual Report on Exchange Arrangements and Exchange Restrictions (AREAER), produce indices of capital account openness, and update the IMF Taxonomy of Capital Flow Management Measures.
- **Strengthening multilateral cooperation on policy issues affecting capital flows**, with proposals to deepen cooperation with the Organization for Economic Cooperation and Development (OECD), and work in collaboration with other international organizations on how best to address systemic concerns affecting the global financial system.

Approved By
Uma Ramakrishnan
and **Ratna Sahay**

Prepared by a staff team led by Annamaria Kokenyne Ivanics (MCM) and Pablo Morra (SPR) and comprising Juan Manuel Jauregui and Marco Rodriguez Waldo (SPR), and Thorvardur Olafsson and Gurnain Pasricha (MCM), under the guidance of Martin Kaufman and Delia Velculescu (SPR).

CONTENTS

| | |
|--|-----------|
| INTRODUCTION | 3 |
| IEO RECOMMENDATIONS, BOARD REACTIONS, AND IMPLEMENTATION PLAN | 3 |
| RESOURCE IMPLICATIONS | 10 |
| BOX | |
| 1. The IEO Recommendations | 4 |
| ANNEX | |
| I. IEO Evaluation of IMF Advice on Capital Flows: Recommendations, Board Responses, and Proposed Follow-up | 11 |

INTRODUCTION

1. The Executive Board and Management broadly welcomed the thrust of the findings and recommendations of the IEO evaluation on IMF advice on capital flows. The evaluation was discussed by the Board on September 18, 2020. Directors welcomed the finding that the adoption of the Institutional View for the Liberalization and Management of Capital Flows (“the IV”), along with the development of other frameworks and additional tools, represented a major advance in the Fund’s policy framework to provide systematic advice to member countries on the management of capital flows and capital account liberalization. Directors also noted the conclusion that, in its application, the Fund generally followed the IV and other policy frameworks to ensure that the advice was consistent, tailored to country circumstances, and evenhanded across countries. Concurrently, the Managing Director’s statement showed appreciation for the report’s valuable analysis on how to further improve the IMF’s advice on capital flows and therefore broadly supported the general thrust of the IEO’s recommendations.

2. This paper presents a Management Implementation Plan (MIP) to take forward the Board-endorsed recommendations from the IEO evaluation, including specific actions, timing, and responsibility for implementation. As staff has begun responding to some of the IEO recommendations, some actions discussed in this MIP are already incorporated into departmental work plans and budgets for FY2021. Budget implications of this MIP for the medium term will be discussed in the context of the FY2022–24 budget proposals as work progresses. The full implementation of the MIP will help the Fund remain a key partner to the membership when designing and implementing policies related to capital flows.

IEO RECOMMENDATIONS, BOARD REACTIONS, AND IMPLEMENTATION PLAN

3. The IEO report made three recommendations to help raise the value added and traction of the IMF’s advice on capital flows. This section summarizes Directors’ reactions to the recommendations, reports on actions taken or initiatives in train since the completion of the IEO report, and proposes “SMART” (Specific, Monitorable, Achievable, Realistic and Timebound) actions to address the recommendations.

Recommendation 1. Revisit the IMF’s Institutional View in the light of experience and recent research.

4. The Executive Board endorsed recommendation 1, with specific proposals to be discussed during the upcoming review of the IV.

- Board reactions: Directors broadly agreed on the need to revisit the IV in the light of recent experience and research. They underlined that the core principles of the IV remained valid. They

Box 1. The IEO Recommendations

#1—Revisit the IMF’s Institutional View in the light of experience and recent research.

In particular, consider:

- Allowing for preemptive and more long-lasting use of capital flow management measures (CFMs) in some circumstances, by:
 - Reducing the distinction between macroprudential policy measures (MPMs) and CFM/MPMs for policy purposes;
 - Recognizing that CFMs may have a valid role to address social issues, such as housing affordability;
 - Recognizing that CFMs can play a useful role in increasing macro policy space, especially for dealing with disruptive outflows.
- Contemplating distributional implications as part of the strategy for capital account liberalization within the IV.
- Rethinking the concept of CFMs.

#2—Build up the monitoring and research of capital account issues as part of a sustained Fund-wide medium-term agenda.¹ Specifically:

- Conduct more research on the costs and benefits of capital account and macroprudential measures.
- Ramp up and ring-fence resources committed to the AREAER to carry out needed quality checks of the data, construct indices of capital account openness and monitor the use of capital account measures.
- Conduct further research on capital account issues in the External Balance Assessment (EBA) and Assessing Reserve Adequacy (ARA) exercises.

#3—Strengthen multilateral cooperation on policy issues affecting capital flows. Specifically:

- Sustain efforts to ensure that the OECD and IMF work coherently on capital account issues.
- Address possible tensions between the IV and the Basel III framework.
- Work together with the Financial Stability Board (FSB) and the Bank for International Settlements (BIS) to strengthen the monitoring and coordination of macroprudential and capital flow policies, including the spillover effects of such policies.
- Step up the Fund’s interactions with the FSB, the International Organization of Securities Commissions (IOSCO), and national regulators to promote regulation to address systemic concerns from securities markets.
- Launch a new initiative to promote coherence between the treatment of capital account issues in international trade and investment treaties and the IMF’s approach to capital account issues.

¹ This paper uses “capital account” to also refer to the financial account of the balance of payments.

also emphasized the importance of ensuring that the Fund’s policy framework on capital flows maintained adequate safeguards against possible misuse of CFMs and that it be applied evenhandedly across countries. There were different views on the extent of revisions required on specific elements of the IV and the role of foreign exchange intervention (FXI). Many Directors thought that the IV could be more flexible in allowing preemptive and more long-lasting use of CFMs on inflows in specific circumstances. Views were mixed on allowing the use of outflow CFMs outside of crisis or near crisis circumstances, reconsidering differences in advice between CFMs, MPMs, and CFMs/MPMs, recognizing that CFMs may have a valid role to address social issues, and rethinking the definition of CFMs. Many Directors agreed that capital account liberalization strategies should consider distributional implications.

Implementation Plan

- Staff will undertake a review of the IV, informed by the IEO’s recommendations, the insights from the work on the Integrated Policy Framework (IPF), other relevant research, feedback from country authorities and other stakeholders, and lessons learned in the implementation of the IV. It will also consider the lessons from the COVID-19 crisis. Staff will hold an informal presentation to the Executive Board to discuss preliminary proposals in July 2021 (see proposed action in Annex I). Staff intends to complete the review in the second half of 2021. The review will seek to bring the Fund’s framework for advice on capital flows up to date with theoretical advances, empirical evidence, and lessons from experience, as envisaged when the IV was adopted. It will preserve the core principles underpinning the IV, i.e., the overall presumption that capital flows can bring substantial benefits for countries and that CFMs, while useful in certain circumstances, should not substitute for warranted macroeconomic adjustment. The IV will continue to aim to help countries reap the benefits of capital flows, while managing the associated risks to ensure macroeconomic and financial stability.

Recommendation 2. Build up the monitoring and research of capital account issues as part of a sustained Fund-wide medium-term agenda.

5. The Executive Board endorsed recommendation 2 and some actions to implement it are already in train.

- Board reactions: Directors broadly supported strengthening monitoring, analysis, and research of capital account issues as part of a Fund-wide medium-term agenda to help maintain the Fund as a thought leader in this area and increase traction of Fund policy advice. They emphasized the need for better understanding the long-term costs and benefits of CFMs and MPMs. Some Directors supported further developing the Fund’s own indices of capital account openness based on the AREAER. Directors indicated that these efforts should be coordinated with other workstreams to ensure efficiency and coherence, with due attention to resource constraints.

Implementation Plan

- Staff will brief the Executive Board in May 2021 on progress on operationalization of the IPF, including on: (i) the development of metrics to measure financial frictions, (ii) the long-term consequences and side effects of CFMs and other IPF tools,¹ (iii) other considerations in guiding policy advice not covered in the IPF models, (iv) safeguards to prevent misuse of CFMs and other IPF tools, (v) the interaction between fiscal policy and IPF tools, and (vi) the multilateral implications of the use of IPF tools (see proposed action in Annex I).
 - The work on metrics will seek to identify variables and indicators that can be used to measure the main frictions featured in the IPF models. In particular, it intends to propose measures for (i) foreign exchange market depth, (ii) exposure to currency mismatches and sudden stop risk, and (iii) degree of inflation expectations anchoring. These metrics will help translate the insights of the IPF work into implementable policy advice.
 - The work on long-term consequences will review the existing literature and case studies on the longer-term effects of CFMs, MPMs, and FXI. It will summarize the empirical evidence of the long-term consequences of unrestricted use of these tools, and explore whether these relationships may be modified by how they are used under the IPF umbrella –including whether the tools are targeted or broad-based, and temporary or permanent. It will also examine the scope for complementary policies that offset or mitigate potential adverse effects.
 - The work on other considerations will contribute to operationalizing the IPF by distilling factors that are outside the IPF models, which may nonetheless be important for developing the appropriate policy advice. Some of these considerations may argue for the use of IPF tools in certain additional circumstances, while others may argue for caution in the use of such tools based on country-specific circumstances. This work will be informed by a review of other theoretical literature, pertinent empirical findings, and staff’s ongoing engagement with country authorities.
 - The work on safeguards will build on the above workstreams to develop considerations to help differentiate between appropriate and inappropriate deployment of IPF tools, including CFMs. In particular, it will develop considerations to prevent the use of these tools to support misaligned exchange rates, substitute for warranted macroeconomic adjustment, allow unsustainable policies to persist, or impede price discovery and competition.
 - To incorporate fiscal policy more deeply into the IPF analysis, the conceptual IPF model will be extended to explore the substitutability/complementarity of fiscal policy and the IPF tools, and the role of fiscal policy in the presence of the effective lower bound or fixed exchange rate regimes. The quantitative models will be used to consider how the

¹ IPF tools refer to capital flow management measures, macroprudential policy measures, and foreign exchange intervention.

- fiscal stance affects the monetary stance and the use of IPF tools, and how fiscal policy affects vulnerabilities to shocks (e.g., how expansionary fiscal policy may increase the chances of a sudden stop).
- Staff is also studying the multilateral implications of the use of IPF tools by developing quantitative models. In addition, the conceptual model is being extended to include multiple regions to better understand the cross-border transmission of shocks and the effects of IPF tools.
 - Staff will also brief the Executive Board by 2021Q4 on progress made on analytical work on capital flow-related issues as part of a broader, medium-term oriented research agenda, and as continuation of the IPF empirical work to further support staff's policy advice on capital flow issues. As part of this agenda, empirical work is continuing on the use and effects of CFMs (see proposed action in Annex I). Specifically, staff will examine various aspects of the interplay between capital flows, CFMs, and crises, including: (i) the impact of preemptive CFMs on financial stability and growth; (ii) the effects of pre-emptive tightening of inflow CFMs on the probability of future inflow surges; (iii) the role of CFMs in preventing the build-up of leverage in the financial sector; (iv) the impact of long-standing CFMs on the probability of crises; (v) the impact of introducing outflow CFMs during crises on sovereign debt ratings; and (vi) the interaction of MPMs with other policies, including CFMs.
 - MCM will allocate by 2021Q2 an additional 1.5 FTE staff to work on maintaining and updating the AREAER database, which is an important public good (see proposed action in Annex I). This will support research efforts on capital account issues based on this database, including the construction of indices of capital account openness (see below).
 - Staff will construct and publish on the IMF external website indices of capital account openness using the AREAER database by end 2021 and end 2023, respectively (see proposed action in Annex I).
 - For capital account openness, two forms of indices will be made available by end 2021, a binary index based on existing controls and another one that also incorporates changes to them over time. The indices will cover the full membership starting from 1999 to the present. Staff plans to prepare a working paper with a detailed technical appendix to accompany the publication of the indices, which will provide information on their construction. Users will be able to download the indices directly from the AREAER website and these will be updated annually in tandem with the annual update of the AREAER database.
 - In addition, staff will construct and publish by end 2023 indices of capital account openness accounting also for the diversity in the type of CFMs. The dataset will try to address some of the weaknesses in the traditional binary indices of capital account openness, most of which do not take into account the nature of the measures, thereby

addressing one of the measurement challenges in capital flow-related research. Over time, once the indices have been tested, staff intends to extend the dataset to cover all member countries.

- Staff will publish an update of the IMF Taxonomy of CFMs on the IMF external website by end 2021 (see proposed action in Annex I). The Taxonomy contains information about measures assessed by Fund staff as CFMs or CFM/MPMs and discussed in published IMF staff reports since the adoption of the IV. It serves as a reference for the various types of measures that have been introduced or adjusted by countries to manage and liberalize capital flows during that period. Like the AREAER, the CFM Taxonomy is a public good that serves both to monitor capital flow policies as well as to undertake research on capital flow-related issues.^{2 3}
- Staff will explore refinements to capital account-related aspects in the EBA models and brief the Executive Board, together with other refinements to the EBA models, by 2022Q1 (see proposed action in Annex I). The external sector assessments of the countries that comprise about 90 percent of global GDP is conducted using the EBA methodology, which is anchored on regression analysis of current account balances and real effective exchange rates (REER). The models currently being used take into consideration the capital account through two variables, the net foreign assets and a third-party index of de jure capital account openness. Staff will review the EBA models and assess the usefulness of alternative indicators that capture de jure and de facto capital account openness and financial integration.

Recommendation 3. Strengthen multilateral cooperation on policy issues affecting capital flows.

6. The Executive Board endorsed recommendation 3 and some actions to implement it are already in train.

- Board reactions: Directors agreed with the need to strengthen multilateral cooperation on policy issues affecting capital flows to improve coherence of policy frameworks. They called for close collaboration with other multilateral organizations, including the OECD, the BIS, and the FSB to promote a consistent and comprehensive approach to the handling of capital flows, with due regard to their different mandates, purposes, and memberships.

Implementation Plan

² Research, monitoring and analysis of capital flow-related issues are also supported by continued efforts to close data gaps through the Data Gaps Initiative (DGI) in the areas of securities issuance, international banking statistics, portfolio and direct investments, international investment positions, and cross-border exposures of nonbank institutions.

³ To enhance the monitoring of capital flow developments, the Monetary and Capital Markets department produces and disseminates monthly reports that track hard currency debt issuance by emerging market and frontier economies and a quarterly report on capital flows that covers non-resident flows, foreign direct investment, other investment flows, and resident flows. The department also tracks other variables, such as FX interventions, central banks' asset purchase programs, and market expectations of inflation and monetary policy.

- Staff will strengthen collaboration with the OECD on policy issues and research (see proposed actions in Annex I).
 - Staff will continue to participate actively in the work of the OECD’s Advisory Task Force on the Codes (ATFC) on capital account issues, where views on capital flow management policies are exchanged from the vantage points of both the OECD Codes of Liberalization and the IMF’s IV. To facilitate greater understanding of the two frameworks in both institutions, staff have invited OECD staff to present their revised Codes of Liberalization at the IMF’s Capital Flows Group forum and will brief the OECD as the review takes place and on the results of the review once it is completed. Subsequently, staff will brief the Executive Board on the key pillars of the IV and the OECD Codes, including remaining differences, and discuss the scope and modalities for cooperation on common issues.
 - Following a successful event in 2020, staff will organize a joint workshop with the OECD, the Bank of England, and Banque de France to discuss new empirical work by external researchers and those of the organizing institutions on topical capital flow-related issues.
- Staff will present a proposal to the Executive Board by 2022Q1 to consider the use of the assessment letter framework to respond to OECD requests for information on the macroeconomic and financial stability conditions of countries (see proposed action in Annex I). The recent amendments to the OECD’s Codes of Liberalization envisage that the OECD may ask for the Fund’s views "on any questions relating to the balance of payments and the state of the monetary reserves of a [OECD] Member" and on "any questions relating to the liberalization of capital movements." The Fund has a long history of providing staff assessments on a member's macroeconomic conditions and policies to other international financial institutions (IFIs), creditors and donors, in circumstances where the most recent staff report is older than six months or in the event of new developments. The current assessment letters policy has been used to provide assessments to other IFIs and donors/creditors and would need to be amended to cover the OECD.
- Staff will review the IV with a view to avoid potential inadvertent and unintended tensions between the IV and the Basel III framework (see proposed action in Annex I). Tensions may arise, for example, in cases when the implementation of the Basel III reciprocity recommendations result in CFMs on capital outflows imposed outside of crises circumstances, which would be considered inappropriate under the IV. This could be related to the use of the countercyclical capital buffer (CCyB), whereby the host authorities take the lead in setting buffer requirements that would apply to credit exposures held by local entities located in their jurisdiction and the home country reciprocates ensuring that the banks in the home country calculate their buffer requirements based on the geographic location of the exposure. The reciprocated CCyB of the home country would be considered as a residency-based outflow CFM, and under the IV it would only be considered appropriate if the country reciprocating the CCyB were in (imminent) crisis circumstances. The review of the IV will examine cases of potential tensions and propose possible ways of addressing them.

- Staff will prepare a Departmental Paper on “Non-Bank Financial Institutions (NBFIs) and Market-Based Intermediation” by 2021Q2 (see proposed action in Annex I). The paper will discuss and analyze policy options to strengthen the resilience-to-stress of NBFIs, including money market funds and open-ended funds, that play a key role in core financial markets and market-based intermediation of capital flows across the Fund's membership. The paper will also discuss arrangements to strengthen liquidity provision in these markets. The paper will support the ongoing participation of Fund staff at senior and technical working groups at the FSB and Standard Setting Bodies (SSB).

RESOURCE IMPLICATIONS

7. The new initiatives outlined above would have manageable resource implications in the near term. Staff has already begun responding to the IEO recommendations and as a result several actions proposed in the MIP are already being incorporated into departmental work plans and the budget for FY2021. Therefore, beyond the 1.5 FTE to support the AREAER work, additional costs resulting from the MIP are expected to be limited in the near term. Budget implications of this MIP for the medium term will be discussed in the context of FY2022–24 budget proposals as work progresses.

Annex I. IEO Evaluation of IMF Advice on Capital Flows: Recommendations, Board Responses, and Proposed Follow-up

| IEO Recommendation | Executive Directors' Response | Follow-up Plan and Timeline | Accountability |
|---|---|---|---|
| <i>1. Revisit the IMF's Institutional View in the light of experience and recent research.</i> | Directors broadly agreed on the need to revisit the IV in the light of recent experience and research, while underlining that its core principles remained valid, emphasizing the need to establish adequate safeguards against possible misuse of CFMs, and calling for its continued evenhanded application across countries. | <ul style="list-style-type: none"> Staff will undertake a review of the IV on the basis of research and experience (including from the COVID crisis) and make an informal presentation to the Executive Board to discuss preliminary proposals in 2021Q3. Staff intends to complete the review in the second half of 2021. | LEG, MCM, RES, SPR |
| <i>2. Build up the monitoring and research of capital account issues as part of a sustained Fund-wide medium-term agenda.</i> | Directors broadly supported strengthening monitoring, analysis, and research of capital account issues as part of a Fund-wide medium-term agenda to help maintain the Fund as a thought leader and increase traction of Fund policy advice. | <ul style="list-style-type: none"> Staff will brief the Executive Board on progress on operationalization and analytical work related to the IPF (Informal presentation in 2021Q2). Staff will brief the Executive Board on analytical work being undertaken on the interplay between capital flows, CFMs and crises (Informal presentation planned for 2021Q4). MCM will hire 1.5 additional staff to work on the AREAER (By 2021Q2). Staff will publish on the IMF external website indices of capital account openness using the AREAER database (binary and change indices by 2021Q4 and indices also accounting for type of CFMs by 2023Q4). | RES, MCM, SPR MCM, RES MCM MCM |

| IEO Recommendation | Executive Directors' Response | Follow-up Plan and Timeline | Accountability |
|--|---|--|---|
| | | <ul style="list-style-type: none"> Staff will publish an update of the IMF Taxonomy of CFMs on the IMF external website (By end 2021). Staff will explore refinements to capital account-related aspects in the EBA models (Informal presentation to the Executive Board in 2022Q1). | MCM, SPR RES, SPR |
| <p>3. <i>Strengthen multilateral cooperation on policy issues affecting capital flows.</i></p> | <p>Directors agreed with the need to strengthen multilateral cooperation on policy issues affecting capital flows, calling for close collaboration with other multilateral organizations, with due regard to their different mandates, purposes, and memberships.</p> | <ul style="list-style-type: none"> Staff will brief the OECD as the review of the IV takes place and once it is completed. Following the completion of the review, staff will brief the Executive Board on the IV and the OECD Codes of Liberalization. Staff will also invite OECD staff to present their revised Codes of Liberalization at the IMF's Capital Flows Group forum (2021Q2) and hold jointly with the OECD a workshop on capital flow-related research (by 2022Q4). Staff will present a proposal to consider the use of the assessment letter framework to respond to OECD requests for information (Board paper by 2022Q1). Staff will address inadvertent and unintended tensions between the IV and the Basel III framework as part of the review of the IV. Staff will prepare a paper on "NBFIs and Market-Based Intermediation", to support the participation of Fund staff in discussions at international working groups at the FSB and SSB. (Departmental Paper by 2021Q2). | LEG, MCM, SPR LEG, MCM, SPR MCM, SPR MCM |