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# IMF Report on Capital Controls Opposed by Nations Seeking More Flexibility

By Sandrine Rastello - Apr 5, 2011

An International Monetary Fund staff proposal to endorse capital controls in limited circumstances aroused opposition from Brazil and other nations seeking greater freedom to stem inflows of money from overseas.

“We strongly oppose any such guidelines or ‘codes of conduct’ that establish, standardize, prioritize or restrict the range of policy responses of the member countries that are facing large surges in volatile capital inflows,” Paulo Nogueira Batista, Brazil’s executive director at the IMF who also represents eight other countries, said in an e-mail.

Countries from Indonesia to South Africa are striving to manage inflows of overseas capital that put upward pressure on their currencies, making exports less competitive, and threaten to inflate asset-price bubbles. Nations including China and South Korea have argued that U.S. monetary easing has added to cross-border money flows in pursuit of higher returns.

“A majority” of the IMF board meeting on March 21 backed the IMF staff guidelines, the Washington-based agency said in an e-mail statement today. At the same time, a “significant minority” was “concerned” that such recommendations “would restrict the range of policy responses.”

The IMF proposal, reported last week by Bloomberg News and made public today, backs the use of capital controls as a last resort after countries strengthen banking systems and adopt economic measures such as building up reserves, tightening fiscal policies and lowering central bank interest rates.

## Advice to Members

“This framework will be used by the fund as a basis to providing policy advice to all member countries,” Aasim Husain, an adviser in the IMF’s Strategy Policy and Review Department, said on a conference call with reporters. “Over time, it will be refined and adjusted based on experience.”

The endorsement of capital controls, even as a last resort, marks a shift for the IMF, which has insisted on maintaining unrestricted flows of money across borders as it led bailouts during crises in Latin America and Asia in the 1990s.

Resistance from emerging economies makes it less likely that the agency will be able to use the guidelines in its annual assessments of the economies and policies of its members, known as Article IV consultations, said Eswar Prasad, a senior fellow at the Brookings Institution in Washington.

“The IMF appears to have been blindsided by the lack of support from key emerging markets,” said Prasad, who headed the fund’s Financial Studies Division in 2005 and 2006. “These countries’ governments remain dubious about the IMF’s intentions and are wary of giving the institution a greater say in these matters.”

## ‘Generally Beneficial’

Directors “emphasized that capital inflows are generally beneficial for recipient countries, promoting investment and growth,” the IMF said. “At the same time, they recognized that a sudden surge in inflows can pose challenges, including currency appreciation pressures, overheating, the buildup of financial fragilities, and the risk of a sudden reversal of inflows.”

Directors “agreed that the recent surge of capital inflows has been driven by a combination of improved fundamentals and growth prospects in capital-receiving economies and accommodative monetary policy in capital-originating economies,” the IMF said.

Brazil’s Nogueira Batista said that there was a “lack of even-handedness” in the report, which “downplays the supply side factors driving” the increase in inflows.

Asked whether the IMF would put more emphasis on these “push factors,” the IMF’s Husain told reporters that upcoming reports will study the impact of policies by the U.S. and other major economies onto the rest of the world, including monetary policy.

Today’s report focuses on seven nations, including Brazil, South Korea and Turkey, and warns that some may be tempted to use capital controls “to avoid appreciation of undervalued currencies.”

## Overheating Economies

The guidelines suggest that measures should only be used if a currency isn’t undervalued, reserves are above precautionary levels and the economy is overheating, making lower interest rates impossible.

The report says “prudential” steps that strengthen the ability of economies to absorb overseas capital, such as measures to develop local bond markets, can be used at “any time.” Such steps also include reserve requirements for local- currency deposits adopted by Turkey and Brazil.

Capital-management measures that do not discriminate based on residency can come as a “second line of defense,” according to the report, which cites South Korea’s levy on banks’ non- deposit foreign liabilities as an example.

Measures “that discriminate based on residency could be considered when other options have already been deployed or are infeasible,” staff wrote.

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