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IMF Reverses Position on Capital Controls

By IAN TALLEY And SUDEEP REDDY

WASHINGTON—The International Monetary Fund, which for decades has been unwavering in its support of the free flow of **capital**, reversed itself and said developing countries can under some circumstances put up barriers to protect their economies.

The International Monetary Fund says for some developing countries, **capital controls** are a suitable way to protect the economy. WSJ's Jake Lee and Peter Stein discuss what this means for Asian economies.

The move on Tuesday comes as countries ranging from Brazil to South Korea to Turkey are limiting **capital** flows in an effort to control inflation, limit the rise in their own currencies or prevent bubbles in their stock and real-estate markets.

The **IMF** traditionally has advocated open markets for investment flows, as have banks, hedge funds and portfolio managers who want free movement of clients' money. However, ultralow interest rates in developed countries and high rates of return in developing nations have helped drive huge volumes of **capital** into some emerging economies.

IMF Managing Director Dominique Strauss-Kahn said the fund is taking a "very pragmatic" view of **capital controls**, the use of taxes, interest rates or other policy tools to curb flows of cash in and out of countries.

"It cannot be a substitute for the right economic policies, but when the right economic policies are in place, then it can be necessary, on a temporary basis, to use this kind of tool," he said.

Some members of the board opposed the **IMF** plan, fearing it will result in more restrictions rather than assistance.

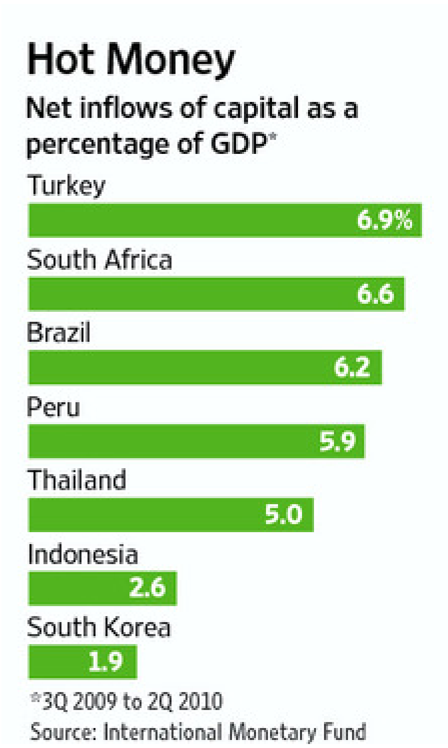
"The treatment of **capital**-flow issues in this report is biased in its approach and deficient in its analysis," said Paulo Nogueira Batista, the executive director at the **IMF** representing Brazil and other eight countries in Latin America and the Caribbean. "We see the current discussion as an attempt to prepare the terrain for more interference by the fund in the policies of emerging-market countries," he told the board.

The fund outlined a policy framework for advising economies on the best use of **controls** to stem surges in **capital** investments. The framework also lays the foundations for the Group of 20 industrial and developing nations as they devise a "code of conduct" on **capital controls**, a priority set by France, which leads the organization this year.

Some developing economies want the IMF's endorsement of their **capital controls** so they aren't penalized politically in the markets for adopting them.

"Many of the emerging markets feel they should be allowed to institute **capital controls** without being stigmatized for it," said Eswar Prasad, a senior fellow at the Brookings Institution and former head of the IMF's Financial Studies Division

The **IMF** doesn't levy penalties against countries with policies contrary to **IMF** guidance, but the stigma can be



politically painful both domestically and internationally.

The **IMF** move could stoke debate about the causes of "hot money," or short-term, flows that can destabilize emerging economies. Some developing countries blame loose U.S. monetary policy for pumping excessive **capital** into global markets. U.S. officials, including Federal Reserve Chairman Ben Bernanke, have rejected that criticism.

The new framework outlines circumstances in which the **IMF** can endorse **capital controls**. The **IMF** said authorities should try to deepen their **capital** markets to help absorb cash inflows and prevent surges from causing damaging distortions in their economies. Since that takes time, however, governments should adjust monetary or fiscal policies as the first line of defense, such as by boosting the value of their currencies, buying foreign-exchange reserves, adjusting interest rates and tightening budget, the **IMF** said.

If a country's currency is undervalued, **IMF** officials said **capital controls** likely won't be endorsed. Also, if **controls** become necessary, the fund said it prefers that **controls** don't discriminate against foreign **capital**.

Bloomberg News

Dominique Strauss-Kahn, managing director of the **IMF**, said the fund is takinga "very pragmatic" view of **capital controls**.

Some central bankers and finance officials believe markets will be the ultimate arbiters of their policies.

"They don't want the **IMF** becoming intrusive in how they manage their **capital** accounts and other policies," said Mr. Prasad, the Brookings fellow. They are worried "this will become a tool for the **IMF** to heighten surveillance of emerging markets" rather than the developed economies supplying the **capital**.

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