IMF accepts temporary capital controls

By Alan Beattie
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The International Monetary Fund has cemented a substantial ideological shift by accepting the use of direct controls to calm volatile cross-border capital flows, though continuing to warn that such measures should be "transparent, targeted and generally temporary".

The policy, announced in a staff paper released on Monday, is in sharp contrast to the fund's enthusiasm for liberalizing capital accounts during the 1990s, and comes amid a growing willingness among governments to experiment with measures to restrain short-term financial flows.

Yet some officials and economists continue to argue that the IMF, which has gradually shifted its position on capital controls in recent years, has not gone far enough, and places too little blame on super-loose monetary policy in rich countries for encouraging volatile flows into emerging markets.

The fund paper said that while the free movement of capital was generally beneficial, it could destabilize economies whose financial systems are insufficiently developed. "Liberalization needs to be well planned, timed, and sequenced in order to ensure that its benefits outweigh the costs," the study said. "There is . . . no presumption that full liberalization is an appropriate goal for all countries at all times."

Along with governments such as China's, which is only slowly dismantling a longstanding system of capital controls, emerging and advanced economies including Brazil, South Korea and Taiwan have implemented taxes, banking regulations and other measures in recent years.

The IMF continues to argue that direct capital controls are not a substitute for macroeconomic responses to rapid inflows, including tightening fiscal policy, cutting interest rates and letting the exchange rate rise.

Paulo Nogueira Batista, who represents Brazil and 10 other countries on the fund's executive board, said the staff paper was still too cautious about using capital controls and underplayed the role of very loose monetary policy in rich countries. Brazil, whose finance minister, Guido Mantega, has repeatedly warned of a "currency war", has sharply criticized the U.S. Federal Reserve for driving money flows towards emerging markets by holding interest rates near zero.

In a response to the staff view, published in a personal capacity, Mr. Nogueira Batista said the IMF still retained a "pro-liberalization bias" and treated capital controls as a last resort rather than a standard part of the policy tool kit.

"Despite some progress compared to its previous work, the IMF has failed to deliver convincing results," he said. The experiences of Iceland, Spain, Ireland and central and eastern European countries showed the dangers of large and volatile capital movements. "The ongoing crisis has yet to have a full impact on the way the IMF considers capital flows," he added. "The extent of the damage that large and volatile capital flows can cause to recipient countries has not been sufficiently recognised."

During the 1990s, under pressure from the U.S. Treasury, the IMF management proposed changing the institution's rules to promote capital account liberalization. The drive was abandoned after the Asian financial crisis stiffened opposition among emerging market countries. In 1998, Malaysia imposed controls on capital outflows, a decision that the fund opposed at the time but which at least one IMF managing director, Horst Köhler, subsequently said was the right decision.