



## **THE IMF'S APPROACH TO CAPITAL ACCOUNT LIBERALIZATION**

### **ISSUES PAPER/TERMS OF REFERENCE FOR AN EVALUATION BY THE INDEPENDENT EVALUATION OFFICE (IEO)**

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## I. INTRODUCTION

1. Capital account liberalization and related issues re-emerged as a topic of intense debate among policy makers and economists in the early 1990s, when there was a substantial increase in private capital flows to developing countries (Figure 1). Private flows to developing countries remained substantial through 1996, with annual flows sometimes approaching \$100 billion (or \$200 billion if direct investment flows were included). At the time, policy makers in recipient countries became concerned that large capital inflows would lead to inflation, real exchange rate appreciation, or distorted asset prices. The subsequent years, however, saw a sharp and equally substantial reversal of these capital inflows, against the background of a series of capital account crises in major emerging market economies. These crises refocused the attention of the international community on the risks of an open capital account, particularly with respect to short-term flows, and the stability and health of the financial system in emerging markets. Greater attention began to be paid to the construction of regulatory environments that would maximize the benefits of access to international savings while also minimizing the likelihood and costs of crises.

2. The International Monetary Fund (IMF) has been at the center of this controversy. Within the broader debate over the increasing importance of international capital flows in the world economy,<sup>1</sup> some have argued that the IMF, in concert with some major shareholder governments, had encouraged member countries to liberalize the capital account—prematurely as alleged—and thereby subjected them to the volatility of international capital flows without ensuring that adequate safeguards were in place.<sup>2</sup> Others argue that rapid liberalization, with insufficient attention to sequencing and establishing the appropriate preconditions, has been responsible for much of the financial instability and economic distress experienced by many emerging market countries.<sup>3</sup> In response, IMF officials, while denying that they forced capital account liberalization indiscriminately upon developing countries, have acknowledged that the Fund had not sufficiently warned the countries of the risks of moving too quickly toward liberalization in the absence of supporting regulatory frameworks. Since the East Asian crisis, some IMF officials have stated that the Fund's approach to capital account liberalization has become much more pragmatic and that there is

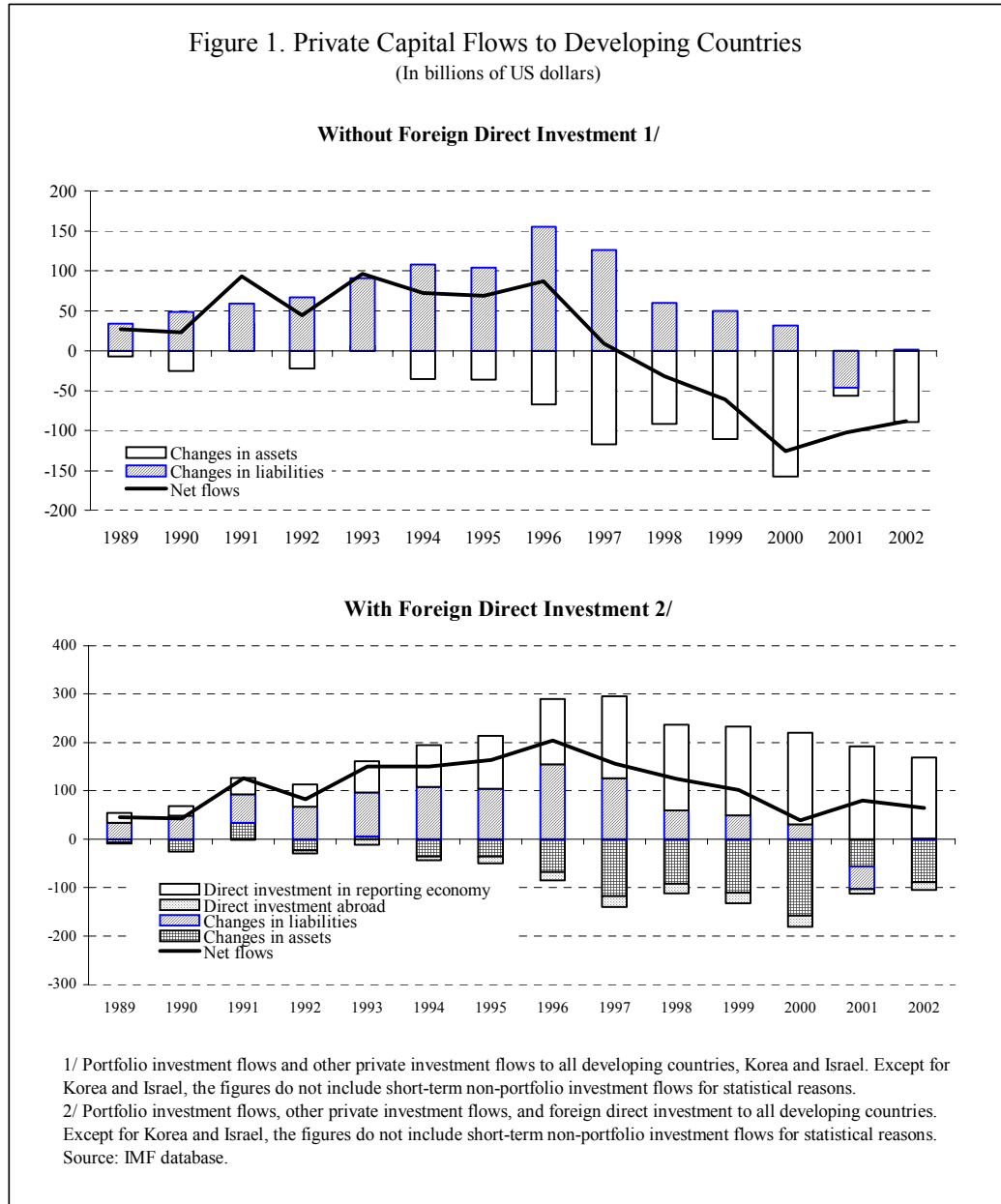
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<sup>1</sup> The broad international interest in capital account issues that existed during the 1990s can be seen, for example, in the coverage given by successive issues of the UNCTAD's *Trade and Development Report* (see, in particular, Chapter 5 of the 1999 report).

<sup>2</sup> While such a policy was often referred to as the "Washington consensus," full capital account liberalization was in fact not one of the 10 policy reforms that Williamson (1990) considered as forming the Washington consensus. The presumed consensus was not on liberalization of capital flows in general, but rather more specifically on that of foreign direct investment.

<sup>3</sup> Academic proponents of these views are Stiglitz (2000, 2002, 2004), Wade (1998–99), and Wade and Veneroso (1998).

now a clear recognition of the need to build strong financial systems as a precondition for capital account liberalization.<sup>4</sup>



<sup>4</sup> See the statement of the Managing Director to the Executive Board, “Draft Report by the Managing Director on Strengthening Financial Systems and Orderly Capital Account Liberalization,” SM/98/223, September 21, 1998. More recently, Rogoff (2002) argued that the IMF in the future would be guided by a more “eclectic approach” than the one that reigned during the early 1990s.

3. Although current account liberalization is among the Fund's official purposes outlined in its Articles of Agreement, it has no clear mandate to promote capital account liberalization.<sup>5</sup> Indeed, the Articles give the Fund only limited jurisdiction over the capital account.<sup>6</sup> Nevertheless, given the increasing importance of international capital flows for macroeconomic and exchange rate management in many countries, the IMF has given greater attention to capital account issues over the past few decades. On a number of occasions, moreover, the IMF has been called upon to deal with a crisis whose origin lay at least in part in the volatility of capital flows associated with a more open capital account. In view of the importance that capital account issues have assumed in the work of the IMF, an independent assessment of how the IMF has addressed these issues, particularly those related to capital account liberalization, seems to be warranted.

4. The evaluation seeks to (i) contribute to transparency by documenting the IMF's approach to capital account issues and capital account liberalization in particular; and (ii) identify areas, if any, where the IMF's instruments and procedures might be improved, in order to better deal with capital account issues.<sup>7</sup>

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<sup>5</sup> The Fund in the 1990s sought to include capital account liberalization explicitly in the Articles of Agreement in a manner analogous to current account liberalization. The analogy, however, breaks down in one important respect. In the case of current account transactions, the Fund's jurisdiction applies only to the making of payments, and not to the underlying transactions. In the case of capital account transactions, it became apparent during the course of discussion on the proposed amendment of the Articles that it was not always possible to make a clear distinction between transactions and the making of payments for those transactions. For this reason, we do not attempt in this note to distinguish transactions from payments when discussing capital account liberalization or capital controls.

<sup>6</sup> For example, Article VI states that when a member experiences "a large or sustained outflow of capital," the "Fund may request a member to exercise controls"; Article XXX explicitly mentions restrictions on "normal short-term banking and credit facilities," "payments due as interest on loans and as net income from other investments," and "payments of moderate amount for amortization of loans or for depreciation of direct investments" as restrictions subject to Fund jurisdiction. Since 1977, moreover, the Executive Board has included "the introduction or substantial modification, for balance of payments purposes, of restrictions on, or incentives for, the inflow or outflow of capital" as an issue for discussion with a member. See the 1977 Surveillance Decision, as amended on April 10, 1995. The 1995 amendment added "unsustainable flows of private capital" as an event triggering such discussion.

<sup>7</sup> The IMF's instruments and procedures might, for example, include surveillance, technical assistance, internal organization, the decision making process, and tools of analysis.

## II. BACKGROUND

5. Issues related to the capital account constitute a subject upon which divergent views have existed and professional consensus is yet to emerge. Reflecting the considerable interest that resulted from the expansion in the volume of cross-border capital flows in the 1990s, however, a rich scholarly literature on capital account issues has emerged in recent years. The literature covers a wide range of areas, but those of particular relevance to the Fund and to this evaluation would include: (a) benefits and risks of liberalization, including the impact of liberalization on economic growth; (b) sequencing and speed of liberalization; and (c) policy responses to a surge in inflows or a sudden outflow of capital. The IMF's own analytical work has also addressed issues in these areas. While the purpose of the evaluation is not to contribute to the ongoing academic debate, some understanding of the existing knowledge of these issues as it evolved over time is important in assessing the IMF's approach to capital account issues.

### A. Benefits and Risks of Liberalization

6. An important aspect of the background in which capital transactions expanded in the 1990s was the increasing real integration of the world economy. With greater real integration, any existing restrictions on capital transactions tend to lose effectiveness, as greater integration creates more channels for evasion. Yet, capital controls involve an administrative cost. They are also costly in other ways—they give rise to distortions as substitution takes place from controlled to exempted transactions; they are discriminatory as controls are necessarily more binding on some sectors of the economy than on others; and they may also breed corruption and rent-seeking activity.

7. The theoretical rationale for capital account liberalization is based primarily on the argument that free capital mobility promotes an efficient global allocation of savings and a better diversification of risk, hence greater economic growth and welfare (Fischer 1998). An opposing view has held that information asymmetry is considerable in international financial markets, so that free capital mobility—especially when significant domestic distortions exist—does not necessarily lead to an optimal allocation of resources (Stiglitz 2000, 2004).<sup>8</sup> While the idea that free capital mobility enhances economic welfare is an appealing concept to many economists, there has been surprisingly little empirical evidence to date to either support or refute such a view conclusively. Eichengreen (2001) has noted that the consensus among academic economists favoring liberalization emerged with a surprising degree of certitude in advance of (and in the absence of) evidence.

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<sup>8</sup> Between these two opposing positions is the view that, while there are benefits to be gained from liberalization, the magnitude of the gains is relatively small. For example, Gourinchas and Jeanne (2004) use a calibrated neoclassical model to show that, for a typical developing country, the welfare gains from switching from financial autarky to perfect capital mobility is about one percent permanent increase in domestic consumption.

8. Recent empirical work has addressed this issue from the standpoint of the effect of capital liberalization on economic growth (see Edison et al. 2002 for a survey). Unfortunately, the debate remains inconclusive because such empirical studies inherently involve a joint test of the effect of liberalization on growth and the particular method of quantifying the degree of liberalization or effectiveness of capital controls.<sup>9</sup> As it turns out, empirical results are sensitive not only to the quantitative measure of capital controls but also to the choice of sample and methodology. For example, while Quinn (1997) finds a positive association between capital account liberalization and economic growth, Grilli and Milesi-Ferretti (1995) and Rodrik (1998) fail to find any such relationship. This ambiguity may reflect the role of institutions (e.g., rule of law), macroeconomic stability, and other factors in determining the effect of liberalization on growth (Arteta et al. 2001; Eichengreen and Leblang 2002).<sup>10</sup>

9. Whatever the potential benefits of capital account liberalization may be, policy makers must weigh them against its associated risks and costs, including the diminished ability to pursue monetary policy autonomy and exchange rate stability simultaneously, the possibility that excessive capital inflows may make macroeconomic management more difficult, and the greater vulnerability to contagion from financial crises elsewhere. Recent experience also shows that, with a weak regulatory framework, large capital inflows can exceed the absorptive capacity of the banking system, leading to inappropriate lending decisions and a subsequent buildup of financial system fragility. The critical issue thus seems to be how best to manage the process of liberalization so as to make sure that the benefits outweigh the risks. Recognition of the centrality of process has led to a policy-oriented literature on the sequencing and speed of liberalization.

### **B. Sequencing and Speed of Liberalization**

10. The speed with which a tightly controlled regime can (or should) be liberalized depends on various factors, including institutional capacity.<sup>11</sup> Developing appropriate

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<sup>9</sup> This problem is common to all empirical studies in this area. Another common problem is the endogeneity of capital controls, which makes it difficult to disentangle the effect of capital controls per se from that of the macroeconomic and international environments within which they are introduced.

<sup>10</sup> Prasad et al. (2003) also consider the effects of financial integration on consumption smoothing and find little evidence to indicate the benefits of liberalization. See Stiglitz (2004) for commentaries on this work. On the other hand, studies that have more narrowly focused on stock market liberalization have found a positive impact on growth (for example, Henry 2003).

<sup>11</sup> Lack of administrative capacity may argue either for or against faster reform, because there is no presumption that the resource requirements of implementing a quick reform are either  
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regulatory frameworks takes time, but a lengthy process may create inappropriate incentives and distortions. There are also political considerations. The big-bang approach may be appropriate if a prolonged transition is likely to create resistance from vested interests or if different elements of the existing system are so dependent upon each other that a piecemeal reform is not possible without creating significant distortions. The gradualist approach, on the other hand, may be more appropriate if building political consensus takes time or if a slower process is more conducive to minimizing the adjustment costs.

11. Much of the literature advocated the big-bang approach in the context of transition economies in the early 1990s, arguing that the lack of credibility in the reform made it more appropriate to act quickly (Funke 1993). Accordingly, a substantial liberalization of the capital account in many cases took place early in the reform process (see Bakker and Chapple 2003). In extending the big-bang approach to non-transition contexts, many experts, including some at the IMF, even argued that the best route to an efficient financial sector was to liberalize the capital account quickly, as it would allow market discipline to operate on the banking system (Gutián 1996).<sup>12</sup> Current thinking, however, seems to take a position more favorable to the gradualist approach, emphasizing the need for sequencing and for establishing the preconditions.<sup>13</sup>

12. The literature that has emerged since the East Asian crisis, with significant inputs from IMF staff, stresses the importance of an “integrated” approach, which considers capital account liberalization as part of a more comprehensive program of economic reform and coordinates it with appropriate macroeconomic and exchange rate policies as well as policies to strength the financial system (Johnston et al. 1999). In this approach, emphasis is placed on the sequence by which the necessary preconditions—including the system of prudential

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smaller or larger than those of managing a long transition process or administering capital controls.

<sup>12</sup> In a broader context, the “discipline effect” of international markets has been argued by some to operate on macroeconomic policy making more generally. See, for example, Tytell and Wei (2004), who suggest that “financial globalization” may have encouraged low-inflation monetary policies but not necessarily low budget deficits.

<sup>13</sup> “Sequencing” is an operational concept, involving specific measures of institutional building, distinct from “order” as used in the literature on economic reform. The early contributions in this literature were based on the “Southern Cone” experience of Argentina, Uruguay and Chile in the late 1970s, and emphasized the importance of achieving macroeconomic stabilization, financial liberalization, and trade liberalization before opening the capital account (McKinnon 1982 and Edwards 1984). The broad consensus now is that the process must be country-specific, based on consideration of such factors as initial conditions, institutional and regulatory developments, and potential consequences for macroeconomic stability.

supervision—are to be established and the various components of the capital account are to be liberalized (e.g., long-term vs. short-term flows; debt vs. equities). IMF staff has developed an operational framework, based on several sets of country experience, to sequence capital account liberalization in coordination with other closely related policies (Ishii et al. 2002).

### **C. Policy Responses to a Surge in Inflows or a Sudden Outflow of Capital**

13. Responding to the surge in private capital flows to developing countries in the early 1990s, academic research began to focus attention on policy options available to countries desiring to manage excessive capital inflows (e.g., Schadler et al. 1993; Goldstein 1995; Calvo et al. 1996; and Corbo and Hernandez 1996). Depending on the nature of the inflows, the options often considered included sterilization through open market sales of domestic securities, increases in reserve requirements, fiscal tightening (mainly through a reduction in public expenditure) and greater nominal exchange rate flexibility. Further trade liberalization, the removal of restrictions on capital outflows, and tightening of controls on capital inflows were also considered. The consensus, however, seems to be that none of these policies is a panacea, as each may involve significant costs or otherwise bring about other policy challenges.<sup>14</sup> There is thus a difficult tradeoff between the potential short-term costs of large capital inflows and the side-effects of the policies to deal with them.

14. The case of Chile is of particular interest in this regard because it tried to get around this dilemma by introducing price-based controls on capital inflows in the form of unremunerated reserve requirements (URR) in 1991. URR required that an amount equal to a certain percentage of the inflow be deposited at the central bank for a specified period of time.<sup>15</sup> Thus, the effective tax rate on capital inflows declined as the maturity was lengthened. The effectiveness of URR in limiting the volume of inflows is difficult to assess, because its introduction coincided with an acceleration of global flows to emerging market economies in the early 1990s. The evidence is inconclusive, but this may be due to the possibility that any impact of URR was offset by the surge in inflows induced by global factors. There is a broad agreement across different studies, however, that URR was successful in changing the composition of inflows towards longer-term maturities and hence reducing a country's potential vulnerability to a sudden shift in market sentiment, though

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<sup>14</sup> For example, sterilization has quasi-fiscal costs (as higher-yielding domestic securities are typically exchanged for lower-yielding industrial country securities) and may lose effectiveness as substitutability of assets increases; high reserve requirements affect the allocation of credit adversely by reducing financial intermediation; exchange rate flexibility may lead to a large real exchange rate appreciation; elimination of restrictions on capital outflows can send a positive signal to the markets, thus encouraging further capital inflows; and fiscal policy lacks short-run flexibility.

<sup>15</sup> Alternatively, the amount could be paid upfront.



probably at the expense of increasing the cost of capital to smaller domestic firms (Forbes 2003; Gallego and Hernandez 2003).<sup>16</sup>

15. Malaysia is an example of a country that used capital controls to deal with a sudden outflow of capital. In 1998, in the aftermath of the financial crises that swept East Asia and amid great political uncertainty within the country, the authorities introduced capital controls aimed at restricting portfolio capital outflows by subjecting the repatriation of the proceeds from sale of Malaysian securities by nonresidents to a 12-month holding period. It is often claimed that controls on outflows are generally less effective than controls on inflows—particularly when introduced during a crisis—because they tend to go against significant economic incentives to circumvent them (Dooley 1996; Edwards 1999). But the Malaysian experience has received some positive (as well as negative) academic assessment (e.g., Kaplan and Rodrik 2001; Johnson and Mitton 2003). If the capital controls indeed worked in Malaysia as intended,<sup>17</sup> it may be due to the controls' strictly temporary nature, the supporting policies (including measures to strengthen the banking and corporate sectors), Malaysia's institutional capacity, and a generally favorable external environment (see Abdelal and Alfaro 2003).

### III. ISSUES FOR EVALUATION

16. The evaluation, roughly covering the 1990s and early 2000s, poses the following two overarching questions for the approach of the IMF towards capital account issues and capital account liberalization in particular:

- What was the IMF's advice on capital account liberalization and other capital account issues, and how did it change over time?
- Did the IMF's advice on capital account issues in specific instances sufficiently take into account the tradeoffs involved in various alternatives in the light of the then existing state of knowledge?

These overarching questions may be addressed by asking more specific questions about aspects of the IMF's two related areas of activity, namely, (i) its specific advice on capital account liberalization and (ii) its analysis and surveillance of broader capital account issues.

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<sup>16</sup> For empirical studies on the effectiveness of URR in Chile, see Valdes-Prieto and Soto (1998), De Gregorio et al. (2000), and Le Fort and Lehmann (2004). See Cardenas and Barrera (1997), and Ocampo and Tovar (1999) for the effectiveness of a similar system introduced in Colombia in 1993.

<sup>17</sup> Some argue that the controls were introduced only after significant outflows had already taken place.

17. Specific questions about the role of the IMF in capital account liberalization would include:

- Is there evidence that, in the early 1990s, the IMF encouraged member countries to liberalize the capital account? If so, to what extent did the IMF's advice include consideration of the reforms needed in the financial and other sectors and the institutional and regulatory capacity of the governments?
- Is there evidence that, in more recent years, the IMF has changed its approach towards encouraging member countries to liberalize the capital account? If so, how is this reflected in its advice to countries that have not undertaken significant liberalization of their capital account?
- In countries that opened the capital account during this period, what was the role of the IMF in terms of policy advice and technical assistance, and what was the extent of country ownership? In more recent years, how useful did the countries find the IMF's "integrated approach" as a practical guide to capital account liberalization?
- Did the IMF's approach differ across countries? If so, was the difference systematically related to the initial conditions and the context within which liberalization was being considered?
- For a given set of conditions, was the IMF's policy towards capital account liberalization consistent between program and non-program contexts,<sup>18</sup> as well as across departments or between staff, management and the Executive Board within the IMF? If not, what was the reason for the inconsistency?

18. Specific questions about the IMF's analysis of international capital movements and its policy advice to deal with volatile capital flows would include:

- What was the IMF's position on policy choices available to member countries facing a sudden—and presumably temporary—surge of capital inflows? How was this policy applied in practice?

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<sup>18</sup> Whether or not capital account measures can be included as part of Fund conditionality involves a complex set of issues. However, the standard interpretation of the Articles of Agreement seems to be that, "on balance," "the incorporation of capital account convertibility...would be an illegal circumvention of the right of members to control capital movements." See "Capital Movements – Legal Aspects of Fund Jurisdiction Under the Articles," SM/97/32, Supplement 3, February 21, 1997.

- How did the IMF take into account the context within which a country seeking advice was placed? For example, did the IMF view differently capital controls existing in a highly regulated system and those being reintroduced in a more liberalized regime?
- In this context, did the IMF take a consistent position on the role of temporary capital controls as part of crisis response and prevention? Did the IMF objectively assess the usefulness and effectiveness of these controls, and provide useful advice, in situations where they were introduced?
- Did the IMF give sufficient attention to the consistency of policy towards the capital account with macroeconomic and exchange rate policies?
- Did multilateral surveillance give sufficient attention to potential volatility on the supply side of capital flows, within the context of macroeconomic developments in major industrial countries or contagion from emerging market crises? How was such analysis incorporated into the policy advice given to member countries on capital account issues?

#### **IV. THE SCOPE AND METHODOLOGY OF EVALUATION**

19. As indicated by the brief literature review offered at the outset of this note, issues related to the capital account are wide-ranging even when they are limited to those of particular relevance to the IMF. The work of the Fund in this area has also expanded in more recent years. The Fund, for example, has provided advice and, in some cases, technical assistance to several low-income countries that are opening the capital account in an attempt to attract inflows of foreign capital, including foreign direct investment (FDI). To cover all issues in the context of all countries, however, is not possible in a single evaluation. To keep the evaluation manageable and focused on the objectives for which it is designed, the scope of the evaluation must be clearly defined.

20. The evaluation is designed to assess the IMF's approach to capital account liberalization, as it relates to the broader question of how to manage capital flows. The focus of the evaluation therefore will be primarily on emerging market economies, for which private capital flows have been important. Particular attention will be paid to country experiences with liberalization (in terms of speed, sequencing and preconditions) and policy responses to capital flows, including temporary use of capital controls, and the IMF's role and advice in these areas. In discussing controls on capital outflows introduced in the context of a capital account crisis, it must be stressed that the focus will remain on issues specific to the capital account, and we will not consider broader crisis management issues (including, for example, private sector involvement and debt restructuring). Likewise, no attempt will be made to establish, in the context of a specific country, causality between capital account liberalization and a subsequent capital account crisis, although vulnerabilities to crisis created by a particular policy towards capital account liberalization may be noted.

21. In discussing capital account openness in specific countries, the evaluation will focus on de jure (as opposed to de facto) controls<sup>19</sup> on capital transactions as defined by the IMF's *Annual Report on Exchange Arrangements and Exchange Restrictions*.<sup>20</sup> Clearly, when one is to investigate an economic impact of capital account liberalization, one must define capital account openness in a way that has an operational content. Edison and Warnock (2003), for example, suggest such an operational measure that takes account not only of the existence but also of the *intensity* of capital controls.<sup>21</sup> Such attempts to define openness in terms of de facto controls, however, are based on the notion of effectiveness and therefore are not suitable for our purpose. Rather than defining capital controls as those measures that are effective in affecting capital flows, we are instead asking such questions as: "What is the right sequence of removing different types of control measures?" "Of the types of control measures often employed by countries, which ones are more effective than others?" "What determines the effectiveness of a particular control measure?" These are all about de jure controls.

22. Treatment of FDI in the evaluation requires clarification. FDI is an important component of private capital flows, and is sometimes so integrated with equity and other portfolio flows as to make separate treatment irrelevant. At the same time, to the extent that these two types of flows are separable, there is a greater consensus on the benefits of liberalizing FDI. In practice, moreover, FDI is frequently liberalized in a broader framework of trade regime reform and whatever restrictions that may exist on FDI, including in a number of industrial countries, are often related not to economic but to political and strategic factors. For these reasons, while recognizing that portfolio and FDI flows are both integral to discussion of capital account issues, we will place somewhat more emphasis on portfolio and other financial flows, which have figured more prominently in the ongoing debate on capital account liberalization.<sup>22</sup>

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<sup>19</sup> The term "control" is less restrictive than outright prohibition. For example, a tax on a particular transaction is a control measure, because the transaction itself is allowed.

<sup>20</sup> A methodology of summarizing legal measures in different categories of capital transactions is offered in IMF (1999), pp. 83-96. Such a measure may be created for the sample countries, in order to see how countries compare with each other or how countries changed over time, in terms of legal control measures.

<sup>21</sup> See also Prasad et al. (2003), pp. 6-8, for a discussion of the difference between "the existence of de jure restrictions on capital flows" and "de facto financial integration in terms of realized capital flows."

<sup>22</sup> It is interesting to note that FDI was excluded in the proposed capital account amendment of the IMF Articles of Agreement.

23. When a particular decision needs to be evaluated, the evaluation will duly consider (i) what information was available to the decision maker (in terms of the then existing best practice and country conditions) and (ii) if all available information relevant for the decision making was taken into account. When a lesson is to be drawn, the evaluation will also consider what has subsequently become known. This is not to establish accountability, but to identify areas, if any, where the IMF's instruments and procedures might be improved.

24. The evaluation will utilize three layers of analysis:

- Analysis of cross-sectional issues, including multilateral surveillance.
- A desk study of internal documents for about 15 countries.
- A more detailed case study of five or six countries.

How each of these layers might be designed will be explained below.

25. The **first layer** will use Executive Board papers and minutes of discussions on systemic themes, including World Economic Outlook (WEO) and Global Financial Stability exercises,<sup>23</sup> and consider how the IMF viewed capital account issues, including its own mandate in this area.<sup>24</sup> As noted in the previous section, the evidence gathered from this analysis will be used to assess whether the Fund had a consistent approach to capital account issues and how effectively it adapted this approach over time in light of experience. In this layer of analysis, we will also examine how the IMF communicated its views to the international community through its (official and unofficial) public communications, including the *Annual Report*, Occasional Papers, Working Papers, the *Finance and Development*, and the *IMF Survey*.

26. The **second layer** will use internal documents, including staff reports for Article IV consultations and program reviews, briefing papers and back-to-office reports for staff missions, the minutes of relevant Board discussions, and technical assistance reports, for a sample of about 15 countries. On the basis of the size of portfolio capital flows during 1991-2003, our own qualitative judgment of the degree of capital account openness in 1990/91, and the changes introduced during the 1990s, we have selected a preliminary list of 32 countries for this purpose (Table 1).<sup>25</sup> The list includes: (i) countries that significantly

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<sup>23</sup> The *Global Financial Stability Report* has replaced the previous *International Capital Markets Report* and *Emerging Market Financing*.

<sup>24</sup> The proposed amendment of the Articles of Agreement, which was discussed from the mid to late 1990s, constitutes part of the evolution of the IMF's thinking during this period.

<sup>25</sup> Argentina and Singapore are among the countries that are excluded from the table because we viewed their capital accounts as virtually free of relevant restrictions in 1990/91 and no major issues related to the capital account rose in the context of these countries (Argentina's

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liberalized the capital account during the 1990s; (ii) countries that still maintain significant controls on capital account transactions; and (iii) countries that introduced measures to restrict capital account transactions during the 1990s. The sample covers all geographical areas and, as it has turned out, all except one received financial support, technical assistance in relevant areas, or both from the IMF over the period. The list will be eventually narrowed to about 15 countries during the course of the evaluation, based on our own judgment of the learning potential.<sup>26</sup>

27. Finally, the **third layer** will be a more detailed case study of five or six countries with varied experiences with, and at different stages of, capital account liberalization. The purpose of this exercise is to have a better understanding of the role of the Fund in countries that substantially eased restrictions on capital transactions during the early 1990s, the nature of Fund advice for countries that have only recently begun to open their capital account, and specific country experiences with capital controls and capital account liberalization. The selection of case studies will be made on the basis of diversity of experience and availability of information. The countries will be selected from among those included in the second layer of analysis, and may include Chile or Colombia (as a country that introduced market-based controls on inflows),<sup>27</sup> Malaysia or Thailand (as a country that introduced controls on outflows in a crisis situation), Tunisia (as a country that recently began the process of liberalizing the capital account with IMF technical assistance), and one or two transition economies.

28. The work of the evaluation will be based primarily on a desk study of internal documents, supplemented by interviews with IMF staff members and a review of the academic literature. In addition, brief field visits will be made to some of the countries selected for the evaluation, including all the case study countries.

Comments on this paper and inputs relating to the substance of the issues raised therein are welcome and should be submitted through the IEO's website ([www.imf.org/ieo](http://www.imf.org/ieo)) or by email ([ieo@imf.org](mailto:ieo@imf.org)). It is expected that the evaluation report will be drafted toward the end of the year and will be released to the public, following discussion by the IMF Executive Board, sometime in early 2005.

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debt default in late 2001 is an entirely different issue). The list would not change materially even if FDI were included, although the relative standing of countries within the list would change.

<sup>26</sup> Important criteria determining this judgment are diversity of experience and outcome and the relevant time period of the experience (e.g., before or after the East Asian crisis).

<sup>27</sup> An IEO mission visited these countries in late April and early May in order to hold consultations with current and former authorities on capital account issues.

Table 1. Cross-border Capital Transactions and Capital Account Openness in Selected Countries

	Private capital flows 1/ (annual averages)												Capital account openness 2/				Memoranda:	
	As a percent of GDP						In billions of U.S. dollars						Openness index		Global ranking in 2002	Change	IMF-supported programs (1990-2003)	Technical assistance in banking and external sectors (1990-2003)
	1989-1993		1994-1997		1998-2002		1989-1993		1994-1997		1998-2002		1995	2002				
Liab.	Asset	Liab.	Asset	Liab.	Asset	Liab.	Asset	Liab.	Asset	Liab.	Asset	1995	2002	Change				
<b>Average</b>	<b>2.5</b>	<b>-0.2</b>	<b>4.8</b>	<b>-0.7</b>	<b>4.8</b>	<b>-1.5</b>	<b>2.3</b>	<b>-0.5</b>	<b>6.5</b>	<b>-2.1</b>	<b>5.7</b>	<b>-2.8</b>	<b>81</b>	<b>0.7</b>	<b>0.6</b>	<b>-0.1</b>		
Brazil	1.5	-0.2	2.8	-0.1	5.3	-0.5	6.3	-0.7	20.8	-0.8	31.2	-3.0	79	0.7	0.6	-0.1	Yes	Yes
Bulgaria	4.8	0.8	4.1	-1.8	8.1	1.0	1.0	0.1	0.4	-0.2	1.0	0.2	97	0.9	0.8	-0.1	Yes	Yes
Chile	3.3	0.2	6.4	-0.8	7.0	-5.0	1.4	0.0	4.6	-0.6	5.1	-3.7	58	1.0	0.4	-0.6	Yes	Yes
China	2.4	-1.2	6.2	-1.5	3.8	-3.0	12.1	-5.8	45.0	-12.5	41.0	-31.7	132	0.9	1.0	0.1	No	Yes
Colombia	1.1	-0.6	3.7	-1.6	2.6	-1.7	0.6	-0.3	3.6	-1.5	2.4	-1.5	114	0.9	0.9	0.0	Yes	Yes
Croatia	0.7	-0.9	6.7	2.3	9.8	-0.3	-0.1	-0.1	1.3	0.4	2.0	0.0	114	0.9	0.9	0.1	Yes	Yes
Czech Republic	1.7	0.8	4.9	-3.8	7.3	0.7	0.7	0.2	2.5	-2.1	4.3	0.5	44	0.6	0.3	-0.4	Yes	Yes
Estonia	4.9	0.0	14.8	-6.7	12.9	-5.4	0.1	0.0	0.6	-0.3	0.7	-0.3	44	...	0.3	...	Yes	Yes
Hungary	5.2	-0.3	4.5	-1.1	8.6	-1.1	1.9	-0.1	2.0	-0.5	4.3	-0.5	1	0.8	0.0	-0.8	Yes	Yes
India	1.4	0.5	2.1	0.0	2.3	-0.1	4.0	1.4	7.3	-0.1	10.5	-0.6	132	1.0	1.0	0.0	Yes	Yes
Indonesia	2.2	0.0	3.5	0.0	3.0	-3.6	3.0	0.0	7.3	0.0	4.9	-5.6	97	0.8	0.8	0.0	Yes	Yes
Israel	2.5	-1.5	5.0	-0.7	5.5	-3.9	1.4	-0.9	4.7	-0.5	6.0	-4.2	1	0.8	0.0	-0.8	No	No
Jordan	13.8	-0.1	7.2	0.0	8.3	-3.5	0.7	0.0	0.5	0.0	0.7	-0.3	31	1.0	0.2	-0.8	Yes	Yes
Korea	2.8	-1.3	5.6	-3.6	1.3	-0.9	8.9	-4.1	28.5	-18.2	7.4	-4.6	114	0.8	0.9	0.1	Yes	Yes
Latvia	5.2	0.0	15.0	-5.8	12.6	-3.8	0.2	0.0	0.7	-0.3	0.9	-0.3	31	0.2	0.2	0.0	Yes	Yes
Lebanon	1.2	4.8	2.0	21.5	1.9	9.9	0.0	0.4	0.2	2.5	0.3	1.6	83	0.3	0.7	0.5	Yes	No
Lithuania	1.5	0.0	9.0	-1.3	8.6	-0.9	0.0	0.0	0.7	-0.1	1.0	-0.1	31	0.4	0.2	-0.2	Yes	Yes
Malaysia	6.9	-0.6	7.7	-2.6	3.1	-1.5	4.0	-0.5	7.1	-2.4	2.6	-1.3	114	0.8	0.9	0.1	No	Yes
Mexico	6.9	-1.2	4.6	-0.9	3.6	0.3	22.4	-3.2	16.8	-2.8	19.6	1.8	83	0.9	0.7	-0.2	Yes	Yes
Peru	3.2	0.1	6.9	0.0	0.6	0.0	1.0	0.0	3.6	0.0	0.3	0.0	1	0.2	0.0	-0.2	Yes	Yes
Philippines	4.9	0.6	6.9	1.8	6.0	-2.5	2.4	0.3	5.4	1.5	4.4	-1.8	114	0.9	0.9	0.0	Yes	Yes
Poland	-2.8	-1.9	-2.0	0.4	6.2	-1.1	-2.5	-1.2	-1.4	0.9	10.6	-1.9	83	0.9	0.7	-0.2	Yes	Yes
Romania	-0.2	-0.3	2.4	-0.5	5.0	0.1	-0.3	-0.1	0.8	-0.2	2.0	0.0	73	0.8	0.6	-0.2	Yes	Yes
Russia	0.6	0.5	6.4	-5.5	2.2	-6.3	0.2	1.0	22.7	-19.9	5.4	-16.3	97	0.8	0.8	0.0	Yes	Yes
Slovak Republic	1.7	0.6	5.2	-2.7	11.3	-1.1	0.3	0.1	1.0	-0.6	2.5	-0.2	132	0.7	1.0	0.3	Yes	Yes
Slovenia	-0.7	-0.7	3.8	-1.0	6.6	-2.8	0.0	-0.1	0.7	-0.2	1.4	-0.6	73	0.8	0.6	-0.3	Yes	Yes
South Africa	0.1	-0.7	4.7	-3.0	5.1	-3.5	0.2	-0.8	6.9	-4.5	6.6	-4.5	114	0.9	0.9	0.0	No	Yes
Thailand	5.3	0.0	4.4	0.2	3.3	-0.9	4.9	0.1	7.4	0.3	3.8	-1.0	97	0.6	0.8	0.2	Yes	Yes
Tunisia	-4.2	1.3	-4.5	1.8	-7.1	2.4	-0.6	0.2	-0.8	0.3	-1.4	0.5	114	0.9	0.9	0.0	No	Yes
Turkey	0.1	-0.2	2.3	-0.3	-0.8	-1.4	0.1	-0.4	3.9	-0.5	-1.0	-2.8	83	0.6	0.7	0.2	Yes	Yes
Ukraine	3.7	0.0	-0.9	0.1	-1.2	-2.1	0.9	0.0	-0.6	0.1	-0.5	-0.8	114	1.0	0.9	-0.1	Yes	Yes
Venezuela	-0.6	-3.5	2.5	-4.1	1.5	-6.3	-0.3	-1.8	2.6	-3.0	1.7	-6.8	83	0.3	0.7	0.4	Yes	Yes

1/ Except for Korea and Israel, the figures do not include short-term non-portfolio investment flows for statistical reasons.

2/ Taken from the IMF, Annual Report on Exchange Arrangements and Exchange Restrictions, various issues. The index indicates the number of restricted categories divided by the total number of capital control categories. A smaller number means a smaller number of existing restrictions on capital account transactions.

Source: WEO and other IMF database.

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