

Chapter 14

The IMF, Financial Regulation, and Capital Controls

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Abstract

The debate surrounding the extent to which countries should employ capital controls and financial regulation remains a key concern for governments and international organizations. This chapter examines the International Monetary Fund (IMF)'s perspective on this matter. While new developments in economic theory play an important role in shaping the IMF's views, changes in its policies are gradual. These are often influenced by shifting global economic conditions, political differences among its members, and varying perspectives among its staff. This dynamic is illustrated through an exploration of three IMF instruments: its Institutional View on Capital Flow Liberalization and Management; its stance on macroprudential policy; and the Financial Sector Assessment Program.

Key words: IMF, capital controls; financial regulation, Global Financial Crisis; policy evolution, capital flow management, macroprudential regulation, Financial Sector Assessment Program

Introduction

THE question of how much a country should rely on capital controls is a key concern for governments and international organizations. The International Monetary Fund (IMF or Fund) has notably shifted its stance on this matter—moving from enthusiastic support to marked opposition, and then back to a more measured support. This shift was so pronounced that when the IMF once again endorsed capital controls after the 2008 Global Financial Crisis (GFC) had led to a surge of credit toward emerging markets, the *Economist* magazine quipped it was akin to the Vatican sanctioning birth control.¹ It was a clear departure from the IMF's 1990s advocacy of eliminating capital controls across the world.

This chapter explores the debates surrounding the IMF's evolving stance on capital controls and financial regulation more broadly, aiming to identify the main driving forces behind these policy shifts. It suggests that policy change is shaped by new trends in economic thought, the interests of member states, and important events—with the GFC being paramount

¹ This was attributed to the *Economist* magazine in Tooze (2018). The exact quotation (475) is “It was, the *Economist* magazine commented, ‘as if the Vatican had given its blessing to birth control.’”

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among them. While new trends in economic thought offer fresh insights into mechanisms like capital controls, important events prompt a re-evaluation of entrenched policies. Meanwhile, the unique priorities and concerns of member states exert influence on the IMF's broader policy agenda. Collectively, these elements determine both the direction and speed of policy evolution within the organization.

To support this perspective, the chapter examines three cases that illustrate the IMF's stance on capital controls and financial regulation. First, it delves into the IMF's policy framework for capital flow management, launched in 2012 and updated in 2022. This was devised to bring clarity and coherence to the IMF's position on a subject that was once so divisive within the organization that a senior official described it as a "taboo" topic of discussion. Second, it assesses the IMF's approach to macroprudential regulation, and how it underwent significant transformation after the GFC. Finally, the chapter discusses the Financial Sector Assessment Program (FSAP), highlighting its transition from a voluntary initiative to a mandatory program in 2010, underscoring the IMF's heightened emphasis on rigorous financial regulation in response to the GFC.

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The chapter finds that the IMF's stance on capital controls and financial regulation has evolved incrementally. Across the cases that were examined, there's consistent evidence of measured rather than radical policy change or rigid continuity. On the surface, the IMF's position might seem unwavering, but when viewed over an extended period, these gradual modifications accumulate into pronounced shifts in policy. The need to keep up with new developments in economic thinking and the demands of its members necessitate a flexible and adaptive approach, rather than a strict adherence to a particular doctrine. The broader implication of this finding is that the IMF is probably not wholly committed to just one school of economic thought or a fixed policy paradigm. However, this observation comes with caveats. First, the specific mechanisms behind policy and ideological changes are not fully clear. The speed at which new ideas are accepted and their integration into the organization's ethos require deeper exploration. Second, there is still much to learn about the tangible effects of IMF policies. For instance, we remain uncertain as to whether frameworks like the Institutional View (IV) have directly impacted behavior or influenced on-the-ground policy outcomes.

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This chapter first offers an historical overview and explores the relevant literature on capital controls and financial regulation. It then presents the main argument and case studies. It concludes by considering the implications of this argument and outlining possible future research to address knowledge gaps.

The IMF's Approach to Financial Regulation and Capital Controls: A Brief Overview

In 1944, when the IMF was founded, there was broad acceptance of capital controls among policymakers. The turbulent period following World War I, marked by events like the Great Depression, eroded confidence in unrestricted capital movement. Both US Treasury official Harry Dexter White and the eminent British economist John Maynard Keynes, principal architects of the Bretton Woods agreement, had no desire to return to the old gold standard monetary system, which largely permitted unregulated capital flows. Despite their differing visions for the post-war order—with White leaning toward a US-centric approach and Keynes advocating for greater autonomy—they shared a belief: any new international stabilization fund should possess the authority to curb capital

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flows if they threatened economic stability.² This consensus became foundational in the IMF's Articles of Agreement. Member countries "may exercise such controls as are necessary to regulate international capital movements" (Article VI, Section 3). Furthermore, member countries are prohibited from leveraging the Fund's resources "to meet a large or sustained outflow of capital" (Article VI, Section 1), and the IMF is granted the right to "request a member to exercise controls to prevent such use" (Article VI, Section 1). Non-adherence could render a member ineligible to draw on the Fund's resources. Broadly, the Articles affirmed

² The historical record suggests that both plans contained capital controls, though the White plan envisioned them primarily as a temporary measure. With vast gold reserves and being a creditor nation at that time, the US generally favored a system that would allow capital to move more freely across borders. Nonetheless, White was willing to compromise on this issue to secure British support. The differences between the Keynes and the White plans are still the subject of considerable debate. For informed commentary, see Skidelsky (2000); Boughton (2021); and Ghosh, Chapter 1 of this volume.

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countries' rights to impose capital controls, so long as these did not hinder payments for current account transactions.³

Post-Bretton Woods to the Asian Financial Crisis

For much of its 80-year history, the IMF took a hands-off approach to capital controls, neither urging their removal nor pressuring members to adopt them. Nonetheless, Abdelal (2007) notes that as early as the 1950s, some Fund publications began to imply that the organization's goal should be the removal of both current and capital account restrictions. However, from the 1970s to the early 1980s, there was a notable shift as the United States, along with other affluent nations, eased restrictions on capital flows.⁴ This move not only boosted the volume and importance of these flows but also transformed global finance. In this context, the IMF began championing liberalization, despite lacking a formal legal mandate or authority to do so (Abdelal 2007, 128). In practice, the IMF began to exert

³ For an informed discussion of this aspect of the Articles of Agreement, see Boughton's prologue (2012, li–lii) and Ghosh, Chapter 1 of this volume.

⁴ The move to ease controls began with the United States in the 1970s. Japan and leading European states were less enthusiastic about liberalization until the early 1980s.

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pressure on countries to liberalize, both during its regular Article IV consultations and when those countries sought its financial support. In 1997, for instance, it pressured Russia to remove restrictions in order to receive financial support. The Central Bank of Russia raised concerns, viewing capital controls as a necessary tool to maintain a pegged ruble, especially given high levels of government borrowing. However, during the negotiations with the IMF, the Bank's concerns were overruled not just by IMF pressure, but also by internal divisions among the Russian authorities (Stone 2002, 147–8). The financial crash that followed in 1998 confirmed the Bank's initial apprehensions.

Rather than merely urging governments to liberalize, the IMF sought to reshape the very bedrock of global economic governance by amending its Articles of Agreement. The proposed change would have established capital account liberalization as a universal goal for its members. Had it been adopted, the amendment would have endowed the Fund with significant authority over capital flows, pushing toward the elimination of all restrictions (Abdelal 2007; Joyce 2012, 83; Korinek, Loungani, and Ostry 2022). Former IMF Managing Director Michel Camdessus (1987–2000) described the pivotal change in thinking as follows:

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The idea first emerged at the end of the 1980s and the beginning of the 1990s with the sea changes of that time. It was a moment of the ascendance of some important ideas: globalization, democracy, and the market economy. It was time for us—without rushing—to accompany countries to full liberalization of capital. We would monitor the health of the bank systems and the stability of financial movements along the way. It was time to define the goal, even if it were to take us fifteen or twenty years. The IMF's role would be to help countries adapt to a new world. The natural consequence of this thinking was to change the Articles.⁵

In 1997, Camdessus believed there was sufficient support on the Executive Board to advance the amendment. However, this growing consensus was not unanimous. While the Group of Seven (G-7) signaled backing, the US exhibited ambivalence, and several Executive Board members were openly opposed (Abdelal 2007; Joyce 2012). The amendment's momentum was dealt a heavy blow following the Asian

⁵ This quotation is taken from Abdelal (2007, 129).

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Financial Crisis (AFC), which began in the summer of 1997 and was deeply connected to capital flows. Notably, countries with capital controls in place generally weathered the crisis better. In the wake of the turmoil, the US authorities rescinded their support, leading eventually to the withdrawal of the proposed amendment. Subsequently, the IMF's enthusiasm for capital mobility diminished (Boughton 2012, prologue, lxii). Disheartened by the proposed amendment's failure and the modest gains from financial globalization, the subject became a touchy issue within the organization.

The Global Financial Crisis: Confronting the Elephant in the Room

The GFC served as a stark wake-up call for complacent high-income economies, many of which had not weathered a severe financial crisis in decades. Some of these economies, perhaps under the illusion of immunity, had expected such crises to be the sole preserve of emerging markets, not something they themselves would face. Consequently, the focus of policy debates within the IMF and the broader international community pivoted from regulating capital flows in developing and emerging economies to strengthening financial regulation in high-income economies.

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The Group of Twenty (G-20), the premier intergovernmental forum for addressing global economic issues, prioritized enhanced regulation. At the 2009 Pittsburgh Summit, the G-20 conducted a thorough overhaul of the regulatory and supervisory framework. This revamp underscored the need for adequate capital buffers, increased regulation and oversight of systemic financial institutions, and closer examination of banks' governance and compensation practices, among other measures (G-20 2009). The IMF was given the responsibility of championing this agenda using all the tools in its arsenal, including regular multilateral and bilateral surveillance exercises and the Global Financial Stability Report (IMF 2018, 59). The FSAP—a joint initiative with the World Bank—was strengthened, becoming obligatory for all member nations with significant financial sectors. The IMF also expanded its focus to the regulation of non-bank financial institutions like shadow banks, evaluating their contribution to the financial system (IMF 2018, 73). In addition, it championed the cause of macroprudential regulation, emphasizing system-level risks and offering technical aid to nations implementing macroprudential regulation. Broadly, the reforms implemented by the G-20 and the IMF captured a shifting mood in the international community. Put simply, policymakers in high-income

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economies had lost faith that markets, left to their own devices, would self-regulate, and naturally curb excessive risk-taking.

In this era of reform, the IMF finally addressed the long-ignored elephant in the room: its position on capital controls. Over a decade had passed since the failed amendment to the IMF's Articles of Agreement, which would have given it considerable authority over global capital flows. Although it had previously routinely pressed emerging economies to remove capital flow restrictions, the landscape shifted dramatically following the GFC, which triggered a surge of capital away from high-income economies. In this new context, how would the Fund advise emerging economies? Would it recommend allowing in potentially destabilizing foreign capital, or advocate for stricter controls? Olivier Blanchard, the former IMF chief economist (2008–15), provides an inside perspective on how the conversation evolved within the organization:

When I went to the Fund in 2008, capital controls, as they were called then, were taboo. And then the financial crisis happened and there were these very large flows and it became clear that that position had to be reassessed. And it was a fairly fascinating discussion within the IMF . . . It went from taboo to ‘when everything else has been tried

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just do it.’ Then it became *primus inter pares*—you can use it but there are many other things you should do like macro-prudential tools, and then slowly it became something that was more acceptable, and that was the view which was integrated into the Institutional View in 2012.⁶

The IMF’s IV, launched in 2012 and updated in 2022, provides a comprehensive policy framework for managing capital flows. This framework acknowledges the notion that liberalization is not a one-size-fits-all solution. Suitability might hinge on various factors, such as a country’s developmental stage, the maturity of its financial sector, and its specific economic and policy frameworks. While some economists believe the latest iteration might not fully address issues like capital outflows (Stiglitz and Ostry 2022) or assist countries in achieving social objectives (Korinek, Loungani, and Ostry 2022), the IV has facilitated a conversation on a subject once taboo within the IMF. Notably, even high-income nations like Iceland have received the Fund’s endorsement for capital

⁶ This quotation is an extract from an opening address to a virtual event hosted by the Peterson Institute for International Economics (PIIE) in 2022. See PIIE (2022).

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controls as an emergency measure, particularly in the aftermath of the GFC.

In summary, the IMF's stance on capital controls has seen pronounced shifts, transitioning from support to opposition and then returning to a more balanced viewpoint. Similarly, its approach to financial regulation has undergone a change, moving from a somewhat *laissez-faire* attitude in the 1990s to firmer oversight across developing, emerging, and high-income nations.

What Explains the IMF's Perspective on Capital Controls and Financial Regulations?

The Economic Case for Financial Liberalization

Many economists believe that economic liberalization is desirable for the simple reason that markets know better than bureaucrats. This belief naturally extends to financial markets: if domestic markets allocate resources efficiently, there is no reason in principle why financial markets should not similarly excel. This reasoning explains much of the allure of financial liberalization for economists and policymakers. However, it would be a mistake to assume that there is a consensus that financial liberalization is integral to economic growth or stability. For one, it is not

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necessarily appropriate to equate domestic markets to financial markets, and assume that if one is efficient, so is the other. This comparison may oversimplify the nuances and complexities of different market types. Financial markets, with their speculative elements and potential for bubbles, might not always behave as efficiently as other markets.

While many economists advocate for the benefits of increased capital mobility, the path to achieving an optimal level of capital flow remains contested (Rodrik 1998; Eichengreen 2004). Some argue that economic growth and stability are prerequisites for effectively harnessing the benefits of capital mobility. In contrast, others believe that periods of “creative destruction,” brought about by certain degrees of economic instability, can lead to innovation and foster growth. Amidst this myriad of economic perspectives, institutions like the IMF have the challenging task of crafting practicable policies. In doing so, it’s important to remember that the IMF operates within a specific financial stability mandate. This mandate, determined by its membership, has largely remained consistent in legal terms over the years. However, it has proven flexible enough to accommodate reinterpretation as new challenges emerge (Georgieva and Weeks-Brown 2023).

The Political Economy of International Organizations

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While the debate among economists and policymakers primarily revolves around the optimality and best methods of liberalization and regulation, scholars in International Political Economy (IPE) adopt a different lens. They probe the motivations behind the pursuit of such policies, explore why major international organizations endorse them, and analyze the dynamics of shifting positions. At a more profound level, IPE research aims to identify the beneficiaries of these policies and to discern what policy evolution or continuity signifies about global political structures and power dynamics. In examining the IMF's stance on capital controls and financial regulation within this IPE tradition, the literature suggests three primary approaches.

The first focuses on how external shocks can create opportunities for changes in deeply held beliefs and policies, including those related to capital controls (Moschella 2010 2012, 2015; Chwiero 2014, 2015). In this case, the AFC of the late 1990s and the GFC of 2008 led to the realization that capital controls could address specific economic challenges, such as large inflows causing bubbles or sudden outflows causing instability. Major financial crises undoubtedly present a window of opportunity to embrace new or different ideas and bring forth needed reforms.

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A second strand of the literature focuses on the interaction of ideas and external factors, such as national interests and the wider policymaking environment (Moschella 2009, 2010; Grabel 2015). According to Grabel (2015), the evolution of economic thought isn't the only driver of new policy shifts on capital controls. The rise of developing states that are becoming more autonomous, coupled with confident and assertive economic policymakers, also plays a significant role. Indeed, several studies have examined such countries' experiences of capital controls (Chwierothe 2015; Gallagher 2015b), as well as the experiences of high-income economies in the wake of the GFC (Sigurgeirsdottir and Wade 2015). In relation to national interests, Gallagher (2014) finds that some emerging markets, particularly Brazil, Russia, India, China, and South Africa (the so-called BRICS coalition), maintained or expanded their sovereignty to regulate cross-border finance in the years following the GFCs.

A third strand of the literature traces the sociological and organizational processes by which norms and rules around capital controls and financial regulation have changed. Research in this strand has examined informal processes such as international norm entrepreneurship within the IMF (Chwierothe 2015; Gallagher 2015a), the layering of new

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policies over old ones (Chwieroth 2014), and the role of leadership in instigating policy change (Abdelal 2007). In relation to fiscal policy, Clift (2018, 7) argues that the IMF is engaged in reflexive and pragmatic processes of bricolage, where institutional solutions are crafted by recombining elements in their existing repertoire and layering new ideas over old.

The three approaches described here do not represent monolithic schools of thought on the motivations and actions of international organizations. In fact, there is much overlap in these approaches; most studies acknowledge that IMF policy decisions are influenced by a variety of factors such as the economic state-of-the-art, political, and bureaucratic considerations, as well as the organization's mandate. However, most of the IPE research reviewed in this chapter relates to capital controls; significant gaps remain in our understanding of other areas of financial regulation.

Case Studies

If we consider the quote by Olivier Blanchard describing his experience of policy and ideational change, it suggests a gradual rather than rapid process, and while most research supports this view, the exact mechanisms of change are contested. Some authors attribute greater

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importance to ideas, while others focus on some combination of member state interests, staff behavior, and exogenous shocks. This section considers the case for incrementalism in three instruments related to capital flows and financial regulation, namely the IMF's policy framework for capital flow management, its approach to macroprudential regulation, and its approach to financial sector surveillance. The first of these cases has been studied extensively, while considerable gaps remain in our understanding of the latter two cases. In each of the cases examined, exogenous shocks have played a role in hastening the development of the instrument. However, new trends in economic thought, staff behavior, and member state interests have also precipitated change in different ways.

The Institutional View on the Liberalization and Management of Capital Flows

In 2012, the IMF adopted an “Institutional View” on the liberalization and management of capital flows. This policy framework granted legitimacy to a “when everything else has been tried just do it” perspective. Gallagher (2015a, 186) reports that the new framework—which shifted the organization from a lenient approach toward capital controls to advocating for them under specific circumstances—was the outcome of a political process that involved the organization's staff and a coalition of emerging

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markets and developing nations, particularly the BRICS. This coalition was pitted against high-income economies, who were initially not supportive of the project. Some were concerned that the process might get out of hand, while others saw it as a case of institutional overreach (Stiglitz and Ostry 2022). The BRICS managed to overcome opposition through negotiation; industrialized country fears were eased when it became clear that the IV would not require any changes to the Articles of Agreement, and therefore would not impose strict legal obligations.

In 2011, this process culminated in a formal statement by the G-20 finance ministers and Central Bank governors. This statement articulated a long-term goal for G-20 nations “should be to put in place, domestically and internationally, through enhanced cooperation, the conditions that allow members to reap the benefits from free capital movements, while preventing and managing risks that could undermine financial stability and sustainable growth, and avoiding financial protectionism” (G-20 2011, 2). While this long-term goal acknowledges that nations can benefit from free capital movements, it also mentions the need to prevent and manage risks. In addition, the statement emphasized that there is no one-size-fits-all approach for the use of capital flow management measures and no obligation for governments to undertake capital account

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liberalization. In general, this is a more cautious stance on capital controls compared to the IMF's 1997 proposal.

The IMF is not mentioned in this statement, except to emphasize that no member is obligated to liberalize under the IMF's legal framework. Nonetheless, the G-20 statement paved the way for the IMF to articulate its own IV, without specifically requesting it to do so.

Meanwhile, an additional reform process was underway within the IMF. According to Gallagher (2015a, 189), key individuals acted as norm entrepreneurs, driving change by demonstrating that some capital flow regulations were consistent with conventional economic thought. These key individuals mediated divisions within the organization, reconciling the Monetary and Capital Markets Department, which was most committed to capital account liberalization, with the Research Department, which was most committed to establishing a new role for capital account regulations. Ultimately, the IV that emerged from these processes ended a decade-long stagnation in discussions on managing global capital flows.

In 2022, the IMF updated the IV, following the recommendations of its Independent Evaluation Office and informed by its staff experiences (IMF 2022a). From the position of advocating for capital controls when everything else had been tried, the revised framework endorsed the pre-

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emptive use of capital controls in some circumstances (IMF 2022b).

According to Stiglitz and Ostry (2022), the revised framework wisely allows for pre-emptive measures against capital inflows but does little to address the outflow side of the equation. In a global context of rising interest rates, capital outflows may become a significant threat to developing and emerging markets, and the current framework may leave them ill-equipped to deal with this threat.

The adoption and subsequent reforms to the IV suggest that policy has evolved incrementally rather than rapidly. From 1997, it took over a decade for the Fund to substantively engage with the topic of capital flow management, and since then it has gradually rather than radically altered its position. While this supports the case for incrementalism, it must be recognized that political processes among member states, staff input, and exogenous shocks were essential in bringing forth policy change.

Nevertheless, important questions remain. First, we do not know if the IMF systematically follows its own policy framework. Korinek, Loungani, and Ostry (2022) have documented many instances of conflict between the IMF and its member states regarding capital controls. Several countries, including Korea, Canada, Australia, and New Zealand, have faced accusations of imposing such controls in order to pursue social

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objectives such as, for example, Australia's attempt to stabilize its housing market by limiting certain types of investment. We do not know whether the IMF selectively follows its policy framework in these cases, nor whether its policy advice convinces its members to reverse or not implement some decisions. Second, we know little about the wider effects of this policy framework. Research suggests that capital controls, state reputation, and policy autonomy are connected (Lia and McDowell 2022), yet little is known about the impact of the IV on such outcomes.

The IMF's Approach to Macroprudential Regulation

Macroprudential regulation, once viewed as a hindrance to market efficiency, is now widely accepted as an effective approach to reducing the likelihood and severity of financial crises. Its aim is to mitigate systemic or system-wide risk. Its scope of analysis is the financial system as a whole and its interactions with the real economy (IMF 2011). Some of the macroprudential policy tools that are currently available include countercyclical capital requirements, loan-to-value ratios designed to curb excessive credit growth, and capital and liquidity surcharges that correspond to institutions' roles in contributing to systemic risk (Viñals 2011). The IMF defines these tools as those:

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either specifically tailored to mitigating systemic risk, or not originally developed with systemic risk in mind but modified to become part of the macroprudential toolkit, provided that they fulfill two conditions. Firstly, they should target explicitly and specifically systemic risk. Secondly, the chosen institutional framework is underpinned by the necessary governance arrangements to ensure that there is no slippage in their use. (IMF 2011)

What do some of these tools look like in practice, and how do they affect ordinary people? To take one example, the Central Bank of Ireland has a macroprudential regulatory framework that focuses on mortgage measures. This framework limits first-time house buyers to borrowing 3.5 to four times their income (Central Bank of Ireland 2023). Before the introduction of this framework, Ireland experienced one of the largest credit-fueled housing busts in history. During this time, commercial banks had significant autonomy to lend, and did so recklessly, in some cases offering 100 percent loans at many times a borrowers' income. Macroprudential regulations now constrain some of these excesses, but do not say anything about the basic financial practices underpinning them, some of which may be socially or ethically questionable.

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After the GFC, macroprudential regulations such as these began to be viewed not as obstacles to market efficiency but as necessary tools for systemic stability. In the aftermath of the crisis, policymakers in high-income economies lost faith in the idea that markets could self-regulate and naturally restrain excessive risk-taking. As a result, international organizations such as the IMF became empowered to develop new tools to manage risk. Although it took several years to develop new tools and instruments, the broader macroprudential approach to risk management was far from new. It had strong foundations in institutional economics, a field with intellectual traditions dating back over a century (Baker and Widmaier 2014). Furthermore, despite a general lack of enthusiasm for the approach among economists and policymakers before the global crisis, Baker (2013a) contends that macroprudential regulation had maintained at least some institutional presence since the 1970s.

While the intellectual embrace of macroprudential tools was swift, the introduction of regulation was an incremental process, mediated by multiple factors. First, it depended critically on the G-20, who granted their approval for a significant international regulatory overhaul at their Pittsburgh 2009 Summit. Top-level political approval was essential for the emergence of a new macroprudential regime. Once secured, various

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organizations, including the IMF, the Bank for International Settlements (BIS), and the Financial Stability Board (FSB) (IMF, FSB, and BIS 2009), took the lead in developing and implementing this new policy framework. National regulatory authorities also played a significant role (Lombardi and Moschella 2017; Cecchetti, Chapter 12 in this volume). Moreover, new agencies for the evaluation of systemic risk were created, including the Financial Stability Oversight Council in the US, the European Systemic Risk Board in Europe, and the Bank of England's Financial Policy Committee in the United Kingdom.

Most studies agree that while macroprudential regulation was embraced rapidly in principle, it has evolved incrementally after the GFC (Baker 2013b; Westermeier 2018). For example, in the initial years after the crisis an influential IMF paper, "Macroprudential Policy: An Organizing Framework" noted that:

it is too early at this stage to cast these as a set of principles of good practices that could support internationally consistent implementation of macroprudential policies.

However, the preliminary views offered on key aspects of macroprudential policy making . . . could form the basis for

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ensuring broad consistency in Fund advice on
macroprudential policies . . . (IMF 2011, 3)

Critics who advocate for a focus on systemic or structural transformation have been disappointed by the IMF's risk-management-centric approach to macroprudential regulation. Many had hoped that adopting a structural or system-level approach would enable the IMF to realign the global economy in a more progressive direction, base its actions on ethical principles, and imbue its policies with a greater sense of social purpose (Baker 2018). Despite disappointment over the implementation of macroprudential regulation, there is consensus that the approach has evolved incrementally. However, significant gaps remain in our understanding of its causes and consequences. Research indicates that macroprudential policies are predominantly implemented in emerging economies, particularly in the context of foreign exchange (Cerutti, Claessens, and Laeven 2017). The effects of these policies on economic stability and growth, as well as the extent to which they have been adopted due to IMF guidance remain unclear. Likewise, the degree to which these policies are shaped by political agendas has yet to be fully understood. In general, IPE scholars have devoted more attention to other policy domains, such as capital flow management and fiscal policy.

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The Financial Sector Assessment Program

The IMF and the World Bank, shaken by the AFC of the late 1990s, introduced the FSAP in 1999. If not for the AFC, these organizations might have continued to endorse free capital flows while neglecting financial regulation. The FSAP marked a decisive shift toward a more structured approach to regulation, focusing on risk management and rigorous monitoring and data collection.

Though the IMF and the World Bank maintain that the FSAP wasn't explicitly designed to prevent financial crises, its main goal seems to lean toward crisis prevention. Supporting this notion, Breen and Kranke (2018) reference an early staff paper, highlighting its emphasis on the ambition to "identify near-term vulnerabilities and prevent crises" (IMF 1999, 2). This purpose sets the FSAP distinctly apart from Article IV consultations, the routine health checks most IMF member states undergo. While the FSAP dives deep into the financial sector, Article IV consultations offer a broader overview of a country's economic situation. Notably, FSAPs are episodic, conducted once every few years, whereas Article IV consultations are annual or biennial (Edwards, Chapter 4 in this volume).

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Recent FSAPs offer detailed stability assessments and key policy recommendations. These encompass areas such as systemic risk analysis, macroprudential policies, regulation and supervision, liquidity and crisis management, cybersecurity supervision and oversight, as well as strategies for anti-money laundering and countering the financing of terrorism. To illustrate, following Iceland's 2023 FSAP, one notable recommendation from the IMF suggested that its Central Bank do more to monitor non-bank financial entities, which include pension funds and foreign investors (IMF 2023a). While these reports primarily cater to specialists, their findings occasionally capture media attention.

Following the GFC, the FSAP underwent notable changes. The episode revealed how a crisis in a systemically important country could spread to others. It also highlighted a *laissez-faire* attitude toward financial regulation in many countries, particularly in relation to banking regulations. After the crisis, all G-20 members, including China and the United States, pledged to undertake an FSAP evaluation. Previously, both superpowers had delayed and obfuscated their evaluations, setting a poor example globally. Their resistance to undertaking an FSAP wasn't unique; many nations either delayed assessments to coincide with favorable conditions or, upon participation, chose not to publicize their results.

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However, in the aftermath of the crisis and under directives from the G-20, the IMF made FSAP assessments mandatory for 25 countries, chosen based on the magnitude and interconnectivity of their financial sectors (IMF 2023b). In 2013, the IMF's Executive Board tweaked the assessment criteria, expanding the list to include 29 countries. Between 1999 and 2021, the IMF and the World Bank conducted 373 assessments across 157 member countries, with 112 of these nations accounting for 98.8 percent of the world's financial system (IMF 2021). Despite these reforms, scholars like Kranke and Yarrow (2019, 824) argue the FSAP remains rooted in traditional paradigms, focusing on national rather than systemic risks.⁷

The effectiveness of the FSAP has often been debated. While some proponents believe it may have deterred potential financial crises, proving something did not happen is always challenging. Preventative measures such as the FSAP often go unnoticed for their success, yet their failures are glaringly evident. Iceland's 2006 FSAP commended its resilience to "withstand extreme, but plausible, shocks," a judgment that was later shown to be deeply flawed. When Iceland's economy subsequently

⁷ They also note that while IMF staff suggested a three-year assessment cycle, most executive directors rejected this proposal as too costly.

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collapsed amidst a severe financial crisis, IMF officials lamented the absence of expert market skills within FSAP teams, as noted by Seabrooke and Nilsson (2015). Ireland's 2006 FSAP concluded that Irish banks had adequate capital buffers to withstand serious shocks (IMF 2006), yet, in a short span, Ireland faced one of the most severe banking crises in history on a per capita basis (Breen 2012). Despite these shortcomings, the prevailing academic view is not that the FSAP should be abandoned. Instead, such missteps have amplified calls for enhanced and more nuanced surveillance methods (Momani and Hibben 2017; Edwards 2019; Breen and Doak 2021).

Conclusion

Implications of Findings

In the cases examined in this chapter—from the IMF's policy framework for managing capital flows to the embrace of macroprudential regulation—the evidence reveals a pattern of steady, incremental policy updating by the IMF. This evolution has been shaped by several factors: exogenous shocks, shifts in economic thought, and changing member state interests. The case for incrementalism is most evident in the study of the IV. Here, policy evolution took a gradual path, marked by shifts in member state demands, evolving beliefs on the necessity of capital

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controls, and pivotal events like the AFC, the GFC, and the failure of the 1997 amendment to the IMF's Articles of Agreement. Similarly, the FSAP's development and the IMF's approach to macroprudential policy reveal an incremental progression, especially in the aftermath of major financial crises and under the guidance of the G-20 leadership. While macroprudential regulation was quickly embraced intellectually, its operational development took longer.

These findings suggest the IMF is not rigidly committed to a single economic doctrine. Yet, the continuity or evolution of the IMF's overarching policy vision remains a point of contention among IPE scholars. Some assert policy consistency, even amidst the transformative shifts in the global economy over recent decades. Kentikelenis, Stubbs, and King (2016), for instance, believe that IMF conditionality has seen minimal change, even as its public declarations about the need for conditionality have lessened in the post-GFC period. While their focus is on conditionality and this chapter examines capital controls and financial regulation, their research paints the IMF as an entity masking its true intentions behind softened rhetoric.

Another school of thought in IPE emphasizes change over continuity. Kaya and Reay (2019), for example, find significant variation

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in the extent to which IMF policy documents adhere to the Washington Consensus agenda.⁸ Lütz and Kranke (2013), find that IMF staff did not rigidly adhere to the Washington Consensus agenda during the euro crisis, in contrast to the European Union, which pursued this agenda more faithfully. Güven (2018), argues for a post-Washington Consensus agenda, which he describes as an upgrade of orthodox neoliberalism to include good governance, regulatory reforms, and social sustainability. He suggests that the IMF has partially retreated from this agenda in recent years, demonstrating flexibility and discretion in policy practice.

The findings presented in this chapter are largely in line with this latter school of thought. The case studies evidence gradual change, which has accumulated to the point that the IMF's current policies on capital controls and financial regulation are unrecognizable compared to those of a few decades ago. Yet, we cannot dismiss the arguments of those that emphasize continuity. There exists the possibility that frameworks like the IV, essentially codes of practice, may be neglected, adhered to only selectively, or serve more as a rhetorical facade than as a reflection of the organization's actual demands in practice. Further research is needed to

⁸ Their analysis covers a large sample of 12,000 documents from 1982 to 2011 (Kaya and Reay 2019).

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discern the impact of IMF policies on its members and to identify the interplay between exogenous shocks, shifts in macroeconomic thinking, and evolving state interests that might drive policy changes.

Possible Future Research on the Topic

The debate over the nature of the IMF's broad policy vision, and whether there has been continuity or change, tends to treat the organization as *sui generis*. What is missing, however, is an approach that treats the organization as just another policymaking system. Theories and tools from political science and public administration hold significant promise for shedding light on this debate. Cross and Greene (2020) examine the policy agenda of the European Central Bank (ECB) and find that its communications between 1999 and 2018 evolved in a proportional manner. This stands in contrast to many other policymaking systems, which exhibit punctuated equilibrium dynamics. Given that the ECB and the IMF are drawn from the same epistemic community, it is plausible to expect that IMF policymaking may follow a similar, proportional pattern. Nevertheless, we cannot rule out punctuated equilibrium dynamics: IMF policymaking is politicized in ways that the ECB is not, and vice versa. Further research using content analysis could help to resolve this question

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and illustrate the exact nature of change—whether it is proportional or occurs in spurts.

In recent years, comparative research on international organizations has yielded noteworthy results (Ban and Patenaude 2019). In his analysis of IMF and World Bank collaboration on the FSAP, Kranke (2022a, 2022b) notes that even institutionalized cooperation between international organizations can lead to dysfunction. He highlights significant boundary work between the IMF and World Bank, which helps define organizational jurisdiction, among other roles. Further research along these lines, focused on the comparative analysis of policy agendas, could yield new insights into how these programs evolve dynamically in response to changes in other international organizations. For example, the macroprudential revolution was led primarily by the BIS, and its agenda surely affected others within the regulatory regime complex.

Research exploring the IMF's role within this broader regulatory regime has produced interesting findings. Ramos et al. (2022) note that a network of central banks and supervisors formed the Network for Greening the Financial System (NGFS) to incorporate climate change considerations into their risk evaluation tools. Breen, Hodson, and Moschella (2020), find that differences in discretionary authority with the

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regime complex explain differences in organizations' treatment of their members. Further research could leverage the regime complexity approach to examine financial and macroprudential regulation.⁹

Finally, there is considerable room for further research on how the IMF and the international community might respond to new global challenges, such as the digitalization of finance, the rise of financial technology (FinTech), climate change, and inequality, among others. The IMF's financial stability mandate remains essential in this context, yet it must be continuously and creatively reinterpreted to allow the organization to respond to new global challenges as they emerge.

Take climate change as a case in point. Its impact is tangible: more frequent natural disasters are threatening economic and financial stability. Ramos et al. (2022, 371) label these dangers as "macro-critical" risks—big enough to disrupt international financial stability. The IMF has made steps by integrating climate considerations into its FSAP assessments and Article IV consultations. But with the growing nature of the climate threat, there's a need for greater ambition. Research suggests that IMF staff,

⁹ Regarding macroprudential regulation, the IMF's approach to macroprudential regulation has received less attention from IPE scholars than other areas of research, such as capital controls and fiscal policy (Ban 2015; Clift 2018).

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especially those based in climate-vulnerable regions, advocate more forcefully for climate action (Clark and Zucker 2023). And while member countries are gearing up with strategies to combat climate-related challenges, further research is necessary to understand how countries differ in their views and how best to combine financial stability with climate action.

Technology is another challenge. Digital money and new FinTechs are changing how money moves around the world. While there are benefits—digital money may allow for more efficient payments across borders—there are also risks, such as the potential exclusion of certain groups or unforeseen financial disruptions. The IMF has started considering these FinTech risks in its FSAP assessments; it will need to keep updating its approach as technology evolves (IMF 2022c). The allure of new technology can sometimes blind us to its potential pitfalls. Looking ahead at global political dynamics, as economies like China continue to grow, it is plausible that they might adopt more open financial markets as the century unfolds. This might revive and reshape earlier debates on financial liberalization and controls.

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