Integrated Policy Framework: An Introduction

By Tamim Bayoumi
Deputy Director, SPR Department, IMF
What is the IPF?

• The integrated policy framework is an analytic project examining policy responses to international capital flows.

• It covers monetary policy/exchange rates, foreign exchange intervention, capital flow measures, and macroprudential measures.

• It incorporates economic fundamentals and structure, including those relevant to emerging markets (depth of markets, susceptibility to sudden stops, dollar invoicing).
Why an IPF?

• Existing advice was based on models with efficient financial markets:
  • Monetary policy should be directed at achieving domestic macro balance.
  • Exchange rates were a shock absorber for international disturbances.
  • Macroprudential measures should be directed at achieving financial stability.
  • Intervention should mainly be used in the face of disorderly financial markets.
  • Capital controls should only be used in the face of near crisis conditions.

• Many members, including some major emerging markets, were skeptical of this “Institutional View”:
  • They criticized the policy and employed intervention/capital controls more liberally.
  • The economic performance of these countries was not noticeably inferior.
How was the IPF structured?

• There were three components, models, empirical analysis, and case studies.
  • Models examined normative issues—what should government do.
  • Empirical work examined the effectiveness of policies, alone and in combination.
  • Case studies were used to examine policy choices and their motivations.

• The three approaches interacted with each other.
  • Case studies elucidated policy concerns to motivate models and empirical work.
  • Models provided a structure and context for empirical work and case studies.
  • Empirical work provided a check on the effectiveness of policy choices.
Models

• Modeling work comprised of analytic and empirical approaches.

• The Research department produced the analytic model:
  • It focuses on three distortions: shallow markets, sudden stops, and dollar invoicing.
  • Fiscal policy is implicitly included through debt levels and financial risks.
  • Policies try to maximize welfare, defined as the path of consumption over time.

• The Monetary and Capital Markets department adapted traditional models:
  • Typical macromodels were augmented to take account of distortions.
  • Such models can help policy makers by parameterizing to different countries.
Empirical Work

• The empirical work encompassed a variety of approaches:
  • The objective was to augment the existing literature in various dimensions.
  • One focus was on mapping policy effectiveness in normal and abnormal times.
  • E.g., capital-flows-at-risk examined policy effectiveness by capital flow quantile.
  • Analysis of long-term consequences of policies was also examined.

• The results suggest that most policies are reasonably effective:
  • Macropudential measures appear able to limit financial crises at little cost.
  • Intervention can move exchange rates, especially when markets are shallow.
  • Capital flow measures alter the composition but not necessarily the size of flows.
Case Studies

• Case studies included detailed discussions of polices in countries:
  • These discussions covered responses to a variety of inflows and outflows.
  • They included a current or former policy maker from the country.
  • They covered both policy choices and the motivation for these choices.

• The results suggest a wide variety of policy choices and motivations:
  • Different policies were used across countries to combat the same risk.
  • The same policy was used across countries for different objectives.
  • The results showed the value of a coherent framework for policy choices.
Results

• The analysis came to several conclusions about appropriate policies.

• The standard advice of using the exchange rate to absorb shocks works:
  • When financial markets are deep, and risks of a sudden stop are small.
  • Generally in the face of real shocks that require some economic rebalancing.

• Distortions can justify preemptive capital flow measures and intervention:
  • Such policies can improve welfare by lowering risks of costly future financial crises.
  • There is no ordering of policies, whose use depends on shocks and fundamentals.
  • Dollar invoicing cuts exchange rate potency but doesn’t justify alternative policies.
Next Steps

• IPF analysis, plus a report on past policy advice by the Fund’s Internal Evaluation Office, will be inputs into a review of the Institutional View.

• This review will start early in 2021. The key issue will be ensuring that policies are used appropriately and not for competitive gain.

• This will require wide-ranging analysis of appropriate indicators of economic structure and the shocks driving the capital flows.

• The IPF has provided a framework to answer such questions.
Implications for Policy

• The immediate impact of the IPF on Fund policy advice will be limited:
  • The Institutional View is a Board decision that requires a new decision to overturn.
  • In the interim, policies such as preemptive capital flow measures are not advised.
  • However, staff can use judgement within the broad parameters of a policy.

• The longer-term impact depends on the review of the Institutional View:
  • Such reviews typically result in a Board decision to amend existing policy.
  • The review will need to create acceptable indicators of economic structure/shocks.
  • It will therefore likely take some time for such a review to be completed.
Implications for European Policy

• In Europe, the IPF’s impact will be limited by rules and the euro:
  • Capital flow measures are typically precluded by treaty.
  • Intervention only works in the presence of different currencies.

• But the change in philosophy may have an underlying impact:
  • The acknowledgement that financial imperfections can create risks.
  • The acceptance that limiting these risks can justify “unconventional” policies.

• As elsewhere, the impact is likely to be largest on emerging markets.
Useful References


Thank you