

Title: “Analyzing the IMF’s ‘New’ Institutional View for Regulating International Capital Flows Using Minsky and Kregel: Do They Finally Get It?”

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Abstract: In the wake of the North Atlantic Financial Crisis, the IMF’s Institutional View noticeably shifted towards a much greater acceptance of capital flow management measures to regulate international capital flows. This raises a host of issues; most importantly, whether its new policy stance is finally consistent with the needs developing economies have for ensuring financial stability. That is the topic examined in this paper. To do so, we compare the substance and results of a Minsky-Kregel model of international financial fragility to that of the IMF’s ‘New’ Institutional View. We find that while the IMF has come a long way in its recognition of the efficacy of capital flow management measures, there still remains an even further way to go.

JEL Codes: F41, F63, G15, O11

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In a series of reports following the North Atlantic Financial Crisis (to borrow a term from Griffith-Jones and Ocampo (2014)), the IMF shifted its Institutional View towards greater acceptance of using ‘capital flow management measures’ to regulate global capital flows.¹ For an institution that has historically embraced neoliberalism, admitting the efficacy of capital flow management measures could appear to be a monumental declaration that begs the question as to what the IMF’s policy change implies for developing economies. As such, we are interested in whether the IMF’s ‘New’ Institutional View is appropriate for the needs developing economies have for ensuring financial stability. To perform this research, we took the IMF’s recent statements on these tools and on the origin and evolution of financial instability and compared it with those expressed by Minsky and Kregel- which we believe to be the correct framework for analyzing the stability and sustainability of development finance.

The presentation is structured as follows. In Section II, we delineate the familiar Minskian process by which capitalism endogenously generates financial instability and discuss Kregel’s extension of it to developing economies. In addition, we analyze whether such economies can overcome this imperfection and, if so, how. Next, in Section III, the evolution of the IMF’s Institutional View is presented. In doing so, we highlight the recent developments and shift in scholarly thinking that has occurred within its corridors on capital flow management

¹ Elsewhere, these tools have been referred to by the name capital controls, capital management techniques, and capital account regulations (Gallagher et al 2011). The IMF uses ‘capital flow management measures’, so for the sake of consistency we do too. On an unrelated note, widespread research has shown that unregulated capital flows do not improve growth, investment, or inflation performance; they have directly contributed to banking, currency, and financial crises; and they encourage procyclical financial market and policy actions which intensify growth and capital account volatility (Grabel, 2003; Griffith-Jones and Ocampo, 2014). As a result, it is prudent to regulate them.

measures. This segues to Section IV where we examine the Fund's explanation regarding the origin of financial instability and elaborate its model's core properties. Then, in Section V, we contrast our findings against Minsky and Kregel to analyze whether it is viable for developing economies to experience financial stability through the Fund's 'New' Institutional View or if the latter is still off the mark. Finally, in Section VI, concluding thoughts are offered.

Section II- Financial Instability and the Needs of Developing Economies

Minsky's most famous contribution was his Financial Instability Hypothesis in which he demonstrated how the evolutionary nature of capitalist financial relations endogenously creates financial instability. His starting point was the proposition that all heterogeneous economic entities can be reduced to and analyzed as balance sheets (Minsky 1982, 145). By doing so, Minsky obtained a homogenous unit of measurement to analyze the process by which economic entities attempt to make position; that is, emit debts to purchase real and financial assets. Thus, his immediate focus became past, current, and future conditions in financial markets: what were the past and are the present expectations of borrowers and lenders, to what degree were they and are they willing to believe their expectations relative to their uncertainty, and how has this and how does this impact each's liquidity preference- which, in turn, determines investment, profits, the present viability of the system, and future financial conditions and stability.

During an era of capitalist expansion, relatively stable and tranquil economic conditions encourage the formation of bullish expectations, the attaching of increasing degrees of confidence to the accuracy of those expectations, and, accordingly, make individuals increasingly willing to become illiquid (Minsky 1982a, 94). It is this combination that conspires during an expansion to raise the prices of capital assets relative to their current output prices (Minsky 1982a, 111). This raises the level of investment which, from the Kalecki Profit Identity,

we know will increase gross profits and provide businesses with the cash to fulfill their payment commitments. In the first instance, this ensures the current cash flows of businesses from current investment exceeds current cash commitments by healthy margins of safety; in the second, it confirms the veracity of the expectations and the weighting attached to them (Minsky 1982b, 65-6). It is with the latter that the seeds of financial instability are sown.

A recent experience with successfully financing positions in real and financial assets informs borrowers and lenders of two interrelated points. First, it shows that those willing to take on large leverage ratios thrived; second, for entities with lower leverage ratios, it implies existing margins of safety were excessive relative to those which were necessary (Minsky 1982b, 65). As a result, those entities functioning with large leverage ratios will continue to do so (and likely grow them) while ‘underlevered’ units will emit increased quantities of liabilities as they come to believe operating with higher payment to income ratios is financially sustainable (Minsky 1982c, 81). The systemic consequences of this are that what are deemed to be acceptable margins of safety decline as expectations governing future financial activity come to be such that future cash flows will be sufficient to meet future cash commitments with a concurrent increase in each’s confidence of the accuracy of these expectations (Minsky 1982c, 74). Thus, as Kregel (1997) highlights, it is perfectly rational over time for borrowers and lenders to engage in financial activity with declining margins of safety since past repayment profiles indicate past margins were exorbitant.

The eventual outcome of this process is an increased interconnectedness of payment chains in which an otherwise small and meaningless event can trigger a major financial crisis in which the bullish expectations, confidence weights attached to them, and the desire for illiquidity are easily reversed. In the event that this happens, the prices of capital assets fall below their

current output prices and current investment is therefore not large enough to generate the profits necessary to fulfill all currently contracted cash commitments (Minsky 1982a, 111). In turn, this provokes another subsequent increase in liquidity preference, which only additionally depresses the prices of capital assets, further reduces current investment and profits, and ensures even greater cash shortfalls relative to commitments. Hence, the evolution of a capitalist financial process is such that it endogenously initiates shockwaves that reverberate throughout the real economy by depressing output and employment.

This led Minsky to conclude that the capitalist system itself is imperfect. However, on this basis, Minsky was quick to acknowledge, “That capitalism is flawed does not necessarily mean that one rejects capitalism” (Minsky 1982a, 112). Instead, one of the major themes he emphasized throughout his career was that ‘IT’ - ‘IT’ being a severe depression- had not happened in the post-War era because the institutional structure of the U.S. economy had changed to the point where large lender of last resort operations and fiscal deficits were able to sustain asset prices and profits to stabilize the economy and avert the possibility a financial crisis could turn into a depression. In this regard, he believed institutions and associated institutional innovation were capable of mitigating financial instability by altering relative incentive and price structures to subsequently influence economic behavior in a certain direction. Thus, for Minsky, there was no single ‘capitalism’; in its place was an infinite variety of capitalisms whose structure and dynamics were a reflection of existing institutions and their evolution. However, he was cautious to warn that there is no ‘final solution’ to the instability posed by capitalism. Instead, by recognizing that the nature of financial relations is evolutionary he was able to see that,

“...there is no economic organization or magic formula which, once achieved and set in motion, solves the problem of economic policy for all times. Economies evolve, and with the internal evolution of the economic mechanism the apt structure of legislated institutions and policy operations change...(Minsky 1982a, 113-4)”.

Importantly, in a series of papers over the years, Kregel has extended Minsky’s basic concepts to developing economies in an analysis of the major issues they face when attempting to ensure sustainable development finance; namely, the implications international capital flows have for domestic and international financial stability, what is an appropriate structuring of regulations to mitigate the negative aspects of such flows, whether the global monetary system is capable of creating the conditions by which developing economies are net recipients of financial resources, and how to overcome these asymmetric financial relations.²

The starting point for this extension is the recognition that with capital account liberalization, foreign capital flows frequently enter developing economies when they are in the relatively early stages of an expansion and exhibiting financial stability. It is at this point they are labelled ‘emerging markets’- signaling to developed economy investors they represent a new asset class and thus an opportunity for diversification- which quickens the pace of capital inflows and requires these economies to adhere to a set of ‘conventional wisdom’ credibility criteria if the inflows are to continue, such as inflation targeting and fiscal austerity, (Kregel 2009; Ocampo et al 2007).

Once this ‘push’ occurs, it is typically a credit-driven consumption-led expansion (though private investment-led can and has occurred, notably in East Asia) that initiates and/or accelerates an increase of financial asset and real estate prices as well as raises the prices of

² Asymmetric financial relations refers to the current structural feature of the international financial system in which developing economies are frequently unable to issue domestic currency denominated and/or long term liabilities while they have relatively small financial systems compared to the potential size of speculative interests. As a result, any interaction between developing economies and developed economy capital is inherently on uneven terms (Ocampo, 2008; Frenkel, 2008).

capital assets used to produce booming consumption goods above their corresponding current output prices. Thus, the entities in these economies begin to undergo the Minskyian process above concerning bullish expectations, attaching increasing weight to those expectations, and a willingness to become illiquid. It is then the aforementioned endogenous process of declining margins of safety begins to occur while interest and exchange rates appreciate. This latter feature involving the interest and exchange rate has two effects. First they make the carry trade increasingly attractive to developed economy investors (and hence stimulating further net inflows). Second, they also cause a structural trade deficit to emerge (Kregel and Burlamaqui 2006). Meanwhile, as a result of this entire process, developing economy policymakers are typically forced to adopt procyclical fiscal and monetary policies, thus allowing international capital to dictate sovereign policy and narrow the realm of available policy space.

As this process unfolds, the payments chain becomes so complex the market passes some maximum leverage saturation point it can accommodate. It is here the financial system becomes increasingly prone to allowing a small disturbance, such as a change in relative interest or exchange rates or a cash receipt shortfall, to initiate a financial, balance of payments, or currency crisis (could also be a combination). In the event such a disturbance occurs, the increase in developed economy investors' liquidity preference will initiate a reversal of net capital flows from developing to developed economies while the former's capital and financial asset prices and exchange rate collapse (Kregel 1998, 1998a, 1999, 2003, 2004, 2004a; Kregel and Burlamaqui 2006; Ocampo et al 2007). In this regard, Kregel was able to demonstrate how international capital flows incite a process by which they transform financial stability into instability.

This is not all. In a seminal piece that indicts the global monetary system, Kregel identifies how the geographical dispersion of production across national boundaries has caused a proliferation of international investments that ultimately has destabilizing implications for the factor services portion of the current account balance and thus the net flow of financial resources to developing economies. The general idea is that the construction of the current and capital accounts occurred at a time when production was largely confined to national boundaries and trade mostly represented the movement of finished goods and services. However, with the transnational spread of intermediate stages of production, there is now a large proportion of international capital flows that represent investments made by developed economy enterprises towards subsidiaries located in developing economies. The net effect of this over time is that while the investment in a developing economy subsidiary is a one-off capital flow towards that economy, the subsidiaries themselves subsequently continually repatriate interest and income payments to the developed economy parent enterprise- thus representing a deficit in the factor services portion of the current account and an eventual and persistent net transfer of financial resources from developing to developed economies (Kregel 2004). Hence, the current structure of international production inherently causes permanent international imbalances *and* does so in a system in which there is no automatic adjustment mechanism to rectify these imbalances. Indeed, within this framework, the burden of adjustment is placed on the debtor- which represents an inherently deflationary and depressive international monetary governance mechanism (Kregel 2004, 2015).

The above indicates that a primary issue is what types of institutions, if any, developing economies should use to provide themselves with (additional) policy space for financial stability. Following Minsky and Kregel, it is evident doing so requires implementing policies that allow

economic entities to better match the variations of cash receipts with those of cash commitments. In this regard, capital flow management measures are one such appropriate choice since they have the ability to influence the magnitude, type, price, maturity, duration, composition, and ownership of the stock of financial assets and liabilities. As a result, they enable policymakers to engineer a financial structure conducive to stability. However, given the evolutionary nature of the capitalist financial system and its relationships, it is clear no single package of these measures will be sufficient for any and all time; instead, they must be constantly evaluated and modified accordingly to ensure they have the intended effects.

Section III- The Evolution of the IMF's 'New' Institutional View

Over the last twenty years, the IMF's Institutional View has undergone significant revisions with regard to capital flow management measures, moving from an outright dismissal towards now a much greater acceptance.³ Thus, as noted in the Introduction, this begs the question as to whether the IMF finally 'gets it'; that is, is its official policy stance sufficient for financial stability? To answer this, we start by examining the progression of its views.

Importantly, Grabel (2011) notes that the IMF did not suddenly decide to alter its policy stance on capital flow management measures immediately following the North Atlantic Financial Crisis. Instead, its reorientation began in the aftermath of the East Asian Financial Crisis when IMF research publications deemed such operations to be an 'acceptable' component of the macroeconomic toolkit- reserving the qualification that they should only be temporary, be 'market-conforming', levied on capital inflows, and warranted only after liberalization made the economy's 'fundamentals' 'sound' (Prasad et al 2003). Since prior to this anything other than a

³ To recognize this progression, one only need remember that in the run up to the East Asian Financial Crisis the IMF was preparing to alter its Articles of Agreement to specifically mandate capital account liberalization while, as we shall see below, its 'New' Institutional View states capital flow management measures are permissible contingent to certain conditions (Grabel 2011).

completely liberalized capital account was an anathema, this marked an important turning point in the IMF's thinking on the regulation of capital flows despite only endorsing them as actions for exceptionally rare circumstances (Gabel 2011).

Nonetheless, these changes became much more pronounced after the North Atlantic Financial Crisis. In February 2010, the IMF published a policy brief noting the economies least affected by the Crisis were also the ones that had used capital flow management measures to influence inflows over the previous fifteen years (Ostry et al 2010). It is hard to overstate the magnitude of this reversal from the pre-East Asian Financial Crisis position; whereas these tools were once thought to *cause* macroeconomic inefficiency, they were now endorsed as being capable of creating the conditions by which a nation could *avoid* macroeconomic inefficiency. That is not all. In the same document, Ostry et al (2010) stated management measures designed to impact inflows reduce the chance the latter will directly induce financial crises by lengthening external liability maturity structures. Subsequently, the IMF's own 2010 Global Financial Stability Report corroborated these positions, arguing such controls can be effective in certain situations- though it is most sensible if used as a last resort (Gabel 2011).

These changes were reflective of a larger movement within other institutions and the mainstream academic literature. Indeed, in the post-Crisis environment, NBER research staff published findings that managing capital inflows improved the performance of monetary policy, stabilized exchange rates, lengthened external liability term structures (as above), and that outflow restrictions could be beneficial (Magud et al 2011; Gallagher et al 2011). At the same time, the neoclassical academic literature began recognizing the faculties of such measures. Here, a single agent, basic welfare economics model is employed in which a borrower failing to take into account their own actions produce externalities and imperfect information. As such,

once an exogenous shock disrupts what are believed to be otherwise perfectly functioning financial markets, the results are non-Pareto optimal outcomes. Consequently, in this rudimentary model, capital flow management measures are to serve as a second best policy for reducing instability (Gabel 2013).

These developments are the intellectual precursors of what ultimately came together over 2011-2012 to form what we labelled as the IMF's 'New' Institutional View, which was enumerated in its 2012 Executive Board report. In keeping with the aforementioned research, the report reiterated that capital flows can indeed create financial instability; that premature, improperly 'sequenced' capital account liberalization can be detrimental; and that in particular instances it may be necessary to implement inflow and/or outflow measures (IMF 2012; Gabel 2013).⁴ However, the report concludes they should only be used as a final recourse after macroeconomic adjustment has been attempted, should be temporary, only employed as a second best policy (with the first best being capital account liberalization), only once the economy has accumulated significant reserves, after the nation has allowed 'the market' to adjust interest and exchange rates, that policymakers should favor price-based over quantity-based methods, and that they should not normally discriminate against the geographical location of the investor/depositor (Gallagher et al 2011; Gabel 2013).

Given the IMF's past reputation, the entirety of this policy change should be viewed as a gargantuan shift in another direction. Indeed, it was none other than former IMF Managing Director Dominique Strauss-Kahn who stated in 2010, "short term capital controls may be necessary in some cases" while former IMF Director of Research Olivier Blanchard stated,

⁴ It was during this time that the IMF finally noted the term 'capital controls' had been given a negative connotation and thus impacts how international investors view a developing economy. Accordingly, it relabelled them as capital flow management measures- which is the term used here (Gallagher et al 2011; Gallagher 2012).

“...there is a clear swing of the pendulum away from markets towards government intervention, be it macroprudential tools, capital controls...” (Gabel 2011, 819; IMF Survey 2015, 3).

Section IV- The Origin of Financial Instability in the ‘New’ Institutional View

Despite explicitly altering its policy recommendations, the IMF does not devote a lengthy discussion to what it believes to be the origin of financial instability. Indeed, in all of the documentation the Fund has produced on its ‘New’ Institutional View, there is no section labelled ‘Causes of Instability’, or something to that tune. This is rather shocking given that the entire point of the Fund’s transition is to bring to the forefront tools for addressing instability itself.⁵ To be sure, since it changed its policy recommendations on the matter, for consistency the Fund *should* have a new explanation for the origin of it. Fortunately, in certain passages of both the 2012 Executive Board report and a 2013 Guidance Note for Staff on the Liberalization and Management of Capital Flows, the Fund, albeit *very* briefly, mentions how it believes instability occurs.

In short, instability comes from exogenous shocks to the system due to spillovers arising from ineffective policy coordination and/or policy mismanagement between the source and recipient(s) economies (IMF 2012, IMF 2013).⁶ Using their words, “cross-border policy coordination among recipient countries, and between source and recipient countries, would help to mitigate undesired spillover effects of policies and *achieve globally efficient outcomes*” (IMF 2012, 28, Italics Added). Similarly, “Policymakers in all countries, including countries that generate large capital flows, should take into account how their policies may affect global

⁵ Save for the excerpts in the main text that will follow, this situation appears similar to Fine’s (2006) analysis of the IMF’s Financial Programming model in that there has historically been a very limited discussion involving the theoretical rationale underlying the policies themselves.

⁶ It is not clear in the documents if the IMF would support the notion that investors can temporarily become irrational and create asset bubbles, such as with irrational exuberance models.

economic and financial stability. Cross border coordination of policies would help to mitigate the riskiness of capital flows” (IMF Survey 2012).

These statements can be used to obtain the IMF’s origin of financial instability. First, it notes that if coordination is properly undertaken, financial markets will produce efficient outcomes. Conversely, a lack of coordination and/or inappropriate coordination increases the risks of capital flows- which implies the potential for inefficient outcomes. Thus, in this view, endogenous financial market operations can never be the direct source of inefficient financial outcomes; indeed, remember, if coordination is properly undertaken, financial markets, “achieve globally efficient outcomes”. Instead, it is exogenous shocks from ineffective policy coordination that is used to explain how the magnitude and direction of capital flows can change over time which, in turn, lead to financial instability if sufficient macroeconomic adjustment is not previously taken in an appropriate time frame and ever-changing policy differentials continue to exist between nations (IMF 2012, IMF 2013).

Switching gears from the origin of instability to the nature of financial markets, it is clear from these statements that in the ‘New’ Institutional View, financial markets remain thought of as normally calm and efficient mechanisms for allocating scarce resources to the highest risk-adjusted return- meaning the IMF’s base finance theory is still extremely neoliberal.⁷ Supporting this is the IMF’s own unwavering dedication to capital account liberalization as an ultimate end

⁷ One may point to the Fund’s recent publication “Neoliberalism: Oversold?” as evidence of an objection to our argument. However, a critical reading of that document shows that the IMF neither recants its past positions nor offers any alternative(s). Moreover, the authors only rebuke against the most extreme of deficit hawks and the shortest term of capital flows while still supporting capital account liberalization after an appropriate sequencing and the limiting of capital flow management measures to the period after economies attempt macroeconomic adjustments, letting the market determine interest and exchange rates, and only as a last recourse- the very conditions of the ‘New’ Institutional View discussed here! In addition, the authors defend privatization and balanced budgets on the grounds of increased efficiency- central tenets of neoliberalism. Thus, that research should be taken more as the IMF performing an internal reflection and admonition of its past failures rather than any ideological transformation. Indeed, the only novelty of the essay is that the IMF argues austerity and capital account liberalization can increase income inequality which can decrease income growth and make development processes unsustainable- something well known in the heterodox literature.

after an appropriate ‘sequencing’ occurs. To be sure, such a policy implies the Fund believes free, unfettered, and deregulated financial markets are typically stable and incapable of creating instability. If one held this view, it could only be argued that disruptions result from exogenous sources- or else one would never endorse outright capital account liberalization to begin with. Viewed from this angle, it makes sense that the Fund only promotes capital flow management measures as a temporary tool of last recourse (as they do) and that they “should not substitute for warranted macroeconomic adjustment” because if the former were to prove equally, if not more, valuable at stabilizing financial flows relative to certain macroeconomic adjustments, this would imply that a market impediment could produce a Pareto superior outcome to a decentralized free market self-adjustment mechanism- something that cannot occur within the parameters of a neoliberal model (IMF 2013, 13). This recognition implies the IMF’s underlying theory of financial markets is still very much aligned with the Efficient Markets Hypothesis, firmly grounded in a neoclassical world, and incapable of analyzing the endogenous creation of international financial fragility resulting from rational circumstances nor the evolutionary nature of capitalism and how institutional factors can affect its stability.

Section V- Comparing the IMF's ‘New’ Institutional View with the Needs Developing Economies Have for Financial Stability

In the Introduction, we stated that this paper set out to analyze whether the IMF's ‘New’ Institutional View is consistent with a policy strategy developing economies can use for financial stability. To reach our conclusion, we compare the Fund’s beliefs surrounding financial fragility and capital flow management measures with the Minsky-Kregel perspective. A summary of our analysis is given in Table 1.

****INSERT TABLE 1 HERE****

The most glaring difference between the two perspectives is the explanation given for the origin of financial instability. In a Minsky-Kregel world, declining margins of safety are the rational outcome of international financial processes, which means the latter are an evolutionary affair that lead to instability if unrestrained. On the other hand, if such processes are constrained, the methods actually used for constraining them will influence financial relations in such a way that the constraining methods will set in motion an entirely new set of actions and incentives that can lead to instability unless they themselves are subsequently restrained, *ad infinitum*. In this view, financial instability is the normal course of affairs and management measures must be used *proactively* as a *first option* on a *permanent basis*.

On the other hand, the economic model underlying the IMF's 'New' Institutional View is that international financial processes are normally efficient and 'harmonious' which are then subjected to eras of instability due to exogenous policy shocks. Here, financial stability is thought to be normal and instability is seen as the exception to the rule. In this world, capital flow management measures should be used sporadically only when absolutely needed and are thought to be appropriate solely as *defensive* actions taken as a *last recourse* whose duration will be *temporary*- 'just enough to let the seas calm'.

Though not the only major difference between the two perspectives, the above is nonetheless the most significant because it sets the institutional parameters for what is and is not 'acceptable' within any given context. To be sure, this is what determines the range of feasible policy options and thus the potential for ensuring financial stability through time.

A second major contrast involves capital account liberalization, which stems from the above views on instability. In the Minsky-Kregel world, international financial processes are envisioned as evolutionary affairs that inherently lead to instability. Therefore, capital account

liberalization is not generally encouraged because the removal of any institutions that might otherwise serve to constrain financial fragility will only exacerbate it.

On the other hand, the ‘New’ Institutional View argues that capital flow management measures are permissible only *after* ‘sequenced’ capital account liberalization has been ‘successfully’ undertaken and a shock occurs *or* if premature liberalization threatens to instigate a crisis because financial development is not yet ‘deep’ enough (and if in both cases no other policy recourse exists). Naturally, this acceptance of capital account liberalization follows from the belief that financial markets are efficient. Clearly these are very different perspectives: the former sees financial instability as a pervasive, constant threat and therefore capital account liberalization is to be avoided while the latter sees instability as constrained and transitory and thus capital account liberalization is to be encouraged.

A third major divergence between Minsky-Kregel and the ‘New’ Institutional View surrounds how each incorporates capital flow management measures into the relationship between a strategy of economic development and the determinants of the interest and exchange rates. In the first perspective, management measures should be actively used to enhance developmental prospects by adjusting the interest and exchange rates to levels that will increase policy space and encourage structural transformations to increase productivity.⁸ In this regard, management measures are seen as a vital component of the macroeconomics-for-development toolkit.

By contrast, the ‘New’ Institutional View advocates using management measures only *after* market forces have determined the interest and exchange rates. The Fund notes, “using CFMs [capital flow management measures] to influence exchange rates in order to

⁸ Achieving an industrial equilibrium would be one such example of this. For more on an industrial equilibrium, see Bresser-Pereira (2008, 2011, 2014).

gain...competitive advantage would not be appropriate” (IMF 2013, 16). Thus, the IMF’s ‘New’ perspective continues to adhere to its prior tradition of allowing ‘the market’, relative prices, and ‘latent’ or ‘revealed’ comparative advantage to determine specialization patterns and development prospects.⁹

Fourth, both sides differ on the appropriate type of capital flow management measures that should be used. In the Minsky-Kregel paradigm, while there is a distinction made between price- and quantity-based management measures, the general concern is with their effectiveness; that is, whether they constrain instability or encourage it. The ‘New’ Institutional View, however, explicitly prefers price- over quantity-based management measures which stems from the role relative price signals play in creating theoretically stable financial markets within this paradigm. As a result, they argue policymakers should privilege the efficiency of the price system over effectiveness.

A similar dispute arises over the position each takes on whether it is permissible to regulate investors/depositors by geographical origin, such as by forbidding residents to hold foreign currency deposits or if foreigners should be allowed to make short term portfolio investment. As noted above, the Minsky-Kregel view centers on taking management measures if they are effective at mitigating instability. As such, this approach would find it perfectly acceptable to discriminate amongst investors/depositors based upon their geographical location as long as it creates stability. By contrast, the ‘New’ Institutional View is normally against discriminating amongst investors/depositors based upon their geographical location because this introduces yet another market distortion into relative price determination, which, by definition, further reduces market efficiency.

⁹ By preventing the state from utilizing management measures to increase developmental policy space, the Fund’s macroeconomic development theory is not only at odds with the vast majority of successful development experiences but also eliminates developing economies’ ability to replicate them (Reinert 2007; Chang 2003).

Finally, because each paradigm has a distinctly different model underlying it, it is only natural there would be a wide discrepancy between each's long term prognosis on how capital flow management measures affect the fragility of a financial process. In the Minsky-Kregel view, since the analysis is evolutionary, so too is the long term outlook: because financial processes are constantly changing, the structure of financial relations that will create stability are as well. Thus, there is no 'final solution' to the endogenous instability posed by capitalism that can be applied for all time and space. This means any capital flow management measures designed to mitigate fragility will have to be constantly evaluated, monitored, and adjusted over time- and this may still be insufficient to constrain it as capitalism's institutional structure and dynamics morph into Minsky's different 'varieties'.

Conversely, the 'New' Institutional View's perspective on this matter is essentially non-existent. Because the IMF upholds the idea that financial markets are stable mediums for distributing scarce resources that only experience instability through exogenous policy shocks, it is incapable of discussing the evolution of endogenous financial instability. As a result, it cannot begin to address how capital flow management measures affect the fragility of a financial process over time since their implementation is thought to allow financial markets to revert back to efficient operations until another, subsequent exogenous policy shock occurs.

Section VI- Conclusions on the IMF's 'New' Institutional View and Financial Stability in Developing Economies

In concluding, it is our contention that the IMF's new stance still falls short of the mark; that is, the 'New' Institutional View remains insufficient for developing economies to experience financial stability. The primary reason for this is that despite the Fund's evolution on capital flow management measures, it nevertheless fails to incorporate any of the substantive insights

Minsky and Kregel provided on financial fragility. Indeed, the Fund instead continues to assert that instability solely results from exogenous policy shocks, and, as a result, cannot explain the actual root causes of fragility. In turn, the policy recommendations that are derived from this model for addressing and eliminating instability are inherently incapable of actually doing so. Furthermore, this indicates that any overlap between an individual nation exhibiting financial stability and the IMF's own recommendations for that nation are coincidental and spurious at best.

Though the IMF has come a long way from its pre-East Asian Financial Crisis position, it still has an even further way to go. Just because one endorses capital flow management measures does not mean that one correctly understands why, where, when, how, and by whom financial instability is caused or avoided. This is unfortunate because such an understanding goes a long way towards preventing fragility, stabilizing crises, and proactively creating developmental policy space. Hopefully the IMF recognizes this shortcoming sooner rather than later so that it can take much more significant steps towards encouraging global financial stability by adopting the views of Minsky and Kregel rather than by amending the most blatant flaws of its pre-existing neoliberal model.

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Table 1	Minsky-Kregel Perspective	IMF's 'New' Institutional View
Explanation for Origin of Financial Instability and Why Capital Flow Management Measures are Necessary	Recognizes Domestic and International Capitalist Financial Processes are an Evolutionary Affair That Leads to Instability; Instability is Normal and Therefore Management Measures are Needed Permanently; First Best Policy	Believes Domestic and International Capitalist Financial Processes are Normally Stable and Harmonious Affairs; Believes Stability is Normal, Instability is Exception to the Rule and Therefore Management Measures Should be Used Only When Sporadically Needed; Second Best Policy
Temporal Orientation on Capital Flow Management Measures	Proactive	Defensive
Temporal Preference Option on Capital Flow Management Measures	First Option	Last Recourse
Duration of Capital Flow Management Measure	Most Likely Permanent	Temporary
Temporal Implementation of Capital Flow Management Measures Relative to Capital Account Liberalization	Consistently Anti-Liberalization; Liberalization Would Exacerbate Instability	Only After Liberalization is Successful or if Premature Liberalization Threatens Crisis
Relation between Capital Flow Management Measures, The Interest Rate, the Exchange Rate, and Developmental Space	Management Measures Used to Determine Interest Rate and Exchange Rate for Developmental Purposes to Elevate Development Prospects	Management Measures Only Used After Market Determines Interest Rate and Exchange Rate; Market Guides Development Prospects
Position on Price vs. Quantity Capital Flow Management Measures	Distinction Between Price vs Quantity Measures Made on Basis of Effectiveness rather than Efficiency	Price Measures Preferred to Quantity Measures; Matter of Market Efficiency Privileged over Effectiveness
Position on Geographical Origin of Investor/Depositor	Geographical Discrimination Acceptable if it Creates Stability	Geographical Discrimination Not Acceptable
Long Term Outlook on How Capital Flow Management Measures Affect the Fragility of a Financial Process	No Final Solution; Need Constant Evaluation, Monitoring, and Adjustment- And That May Be Insufficient	Non-Existent Because of Lack of Evolutionary Perspective