Article

The IMF's "New" Institutional View: An Unwitting Trojan Horse for International Financial Fragility

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In the aftermath of the Great Financial Crisis (GFC), it became widely accepted that loosely regulated international capital flows were responsible for transmitting the crisis from the developed to the developing world. As a result, using capital controls to manage them came into vogue with many groups. The International Monetary Fund (IMF) was one such actor, and its revamped policy proposals became encapsulated as its "New" Institutional View. It was here the Fund officially recognized the efficacy of controls for countering international financial fragility and stated the exact conditions under which they were acceptable. However, it also designated that authorities should retain a heavy preference for using "market-based" adjustment measures to correct capital flow-induced macroeconomic imbalances, even going as far as to mandate specific correctional paths and sequences for common individual scenarios, which indirectly relegated capital controls to secondary importance. This article argues these proposed adjustment measures are procyclical and hence the "New" Institutional View increases international financial fragility and impedes economic development. To do so, we combine Albert Hirschman's vision of a development process with Hyman Minsky's take on international financial instability to demonstrate this "View" is discordant with the challenges developing economies face.

Introduction

Broadly speaking, in the history of financial globalization there have been three distinct eras. The first occurred from roughly the early 1970s until the Mexican Debt Crisis of 1982, which later expanded and turned into the Latin American Debt Crisis, whose effects endured until the introduction of Brady Bonds in 1989. This wave involved a large increase of internationally-based syndicated lending in dollars by American banks to the state-owned enterprises of Latin America, who themselves were pursuing the late stages of import substitution industrialization—which was producing extremely high rates of real per capita economic growth. This structure lasted until the Paul Volcker-led U.S. Federal Reserve abruptly raised interest rates in late 1979, forcing virtually all major Latin American governments to become insolvent overnight since their debts were denominated in a foreign currency with flexible interest rates.

The second wave of financial globalization took place in the 1990s up until the East Asian Financial Crisis of 1997. This time around it was the deregulation of many South- and Northeast Asian capital accounts that allowed, once again, predominantly American multinational banks to heavily invest in these "emerging" financial markets, with the stability of the whole system being predicated upon relatively constant exchange rates among all East Asian currencies *and* against the dollar. However, once the Thailand-based Finance One Corporation was declared insolvent, investors rapidly pulled

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out of Thai markets, which caused the Thai baht currency to plummet and sparked a contagion domino effect across the region—with equity, bond, and currency markets plunging in value. Later on, the International Monetary Fund's (IMF) proposal to raise interest rates as a solution to this only served to increase the size of the outstanding debt of the region, which significantly set back recovery prospects.

In both waves, the common denominator that led to the respective crises was a push toward deregulatory approaches in domestic financial markets and capital account liberalization that allowed increasingly globalized American banks to take on highly leveraged investment positions denominated in dollars, which made it extremely difficult for debtors to repay since their liability obligations were denominated in a foreign currency (dollars). Interestingly enough, this is also what happened in the third wave of financial globalization, which started roughly in 2003, was temporarily suspended following the chaos of the Great Financial Crisis (GFC) and the subsequent bursting of the Commodities Bubble in 2009, and then which resumed to present day.

However, one of the more prominent characteristics of this third wave that distinguishes it from the previous two has been the increasing volatility of traditionally longer-term capital flows, such as FDI and certain types of portfolio debt, to the point that now virtually all forms of international capital are easily transferred between national economies (Ocampo, Kregel, and Griffith-Jones 2007; Ocampo 2016). As a consequence, in developing nations subject to balance of payments dominance—which is a situation where trade and external financing shocks predominantly influence macroeconomic conditions—the potential for financial fragility has become accentuated, with a contemporaneous impact on development (Ocampo 2016). Indeed, this structural evolution has made it much easier for developing nations to involuntarily slip into what are called "vulnerability zones"—basically when an economy is prone to a rapid reversal of financial activity because certain events during a boom endogenously increase the risk of financial instability. For example, some of the more obvious of these vulnerabilities could include having, "high external liabilities, with a large short term share; significant current account deficits; appreciated exchange rates and currency mismatches; high prices of domestic financial assets and real estate; [and] sizeable increases in money supply as counterpart of the accumulation of international reserves" (Ffrench-Davis 2005; Ffrench-Davis and Griffith-Jones 2011).

Such risks associated with occupying vulnerability zones became highly visible during the GFC, particularly after the collapse of Lehman Brothers, when North Atlantic investment bank insolvencies, liquidity constraints, and declining risk appetites quickly transmitted the meltdown to emerging markets in developing regions, which led to large increases in their sovereign and corporate spreads, limited their enterprises' abilities to make position, and intensified interest and exchange rate volatility (Agosin and Diaz-Maureira 2016). This is reflected in figure 1.

In turn, this meant that it became that much more difficult for developing economies to maintain developmental macroeconomic frameworks by controlling "macro prices", such as the exchange rate and the level and term structure of interest rates, and ensuring safe "risk profiles"—which strictly refer to the financial characteristics of individual economic entities, but is used to show how the changing composition of such profiles can translate

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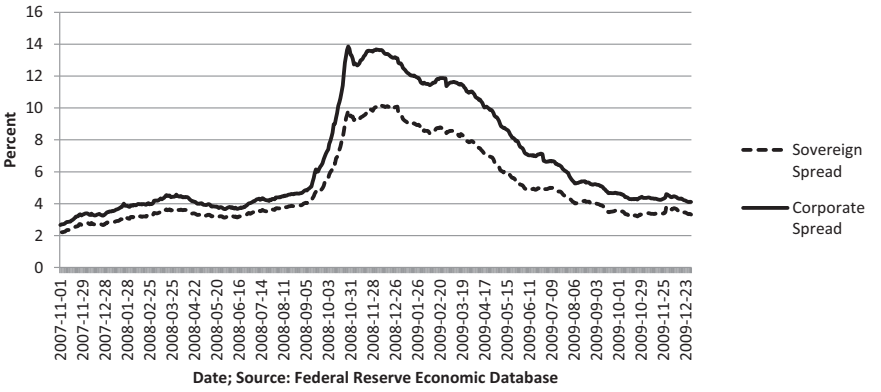

Figure 1. Emerging market sovereign and corporate spreads November 2007–January 2010.

into increasing sectoral and macroeconomic financial fragility dangers (Minsky 1982; Ffrench-Davis 2005). To be sure, since a development process is simply the combination of short-term demand targeting with long-term structural change, it became evident that the prospects for successfully navigating such a process over a forty- to fifty-year time period were increasingly unlikely.[1]

Hence, as the dust settled, many observers noted that the developing economies least impacted by the GFC displayed (at least) two distinct structural characteristics. First, in the run-up, authorities had used capital controls to influence the magnitude, composition, and maturities of inflows (Ostry et al. 2010; Qureshi et al. 2011). Second, in the GFC's wake, these nations had rapidly implemented aggressive countercyclical policies, especially fiscal, which had direct implications about the efficacy of Keynesian macroeconomic policies. Thus, to all but the staunchest capital account liberalization supporters, it became clear that general support for loosely regulated international capital flows was waning and, conversely, capital controls, at least in certain instances, gained widespread acceptability (Korinek 2011; Jeanne 2012).

The IMF was no exception to this trend, which used a 2012 publication to announce its "New" Institutional View that laid out the conditions for when, where, why, and how capital controls would be deemed appropriate. To note how significant this shift seemingly was, in statements that would seem incredulous to observers before the East Asian Financial Crisis (EAFC), former Managing Director Dominique Strauss-Kahn stated in 2010,

[1]*A development process should be seen as the combination of short-term demand targeting with long-term structural change for the following reason. The need for long-term structural change should be self-evident: since many developing economies lack the labor and capital markets of developed economies; suffer from heavy concentration of exports in only a few goods and/or clients; and have very unequal land, wealth, and income distributions, it is clear that to ameliorate this situation the nation's economic structure must fundamentally be changed. By definition, that will involve long-term structural change. On the other hand, short-term demand targeting is necessary for two reasons. First, it is needed to initiate a development process and give the impetus for a more productive use of resources. Second, throughout a process of long-term structural change, certain 'on the fly' adjustments will need to be made. To do so and sustain the development process, short-term demand targeting will be required to realign the short-term macroeconomic movements with the longer-term structural goals.*

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"short term capital controls may be necessary in some cases" while recently the Fund's former Director of Research Olivier Blanchard noted, "... there is a clear swing of the pendulum away from markets towards government intervention, be it macroprudential tools, capital controls ...." (Grabel 2011, 819; IMF 2015, 3). However, while this might seem to be a positive step, the IMF quickly about-faced and designated that all capital flow-induced macroeconomic imbalances should first be dealt with by "market-based" adjustment mechanisms—essentially policies that explicitly avoid direct government intervention into financial markets by instead attempting to indirectly influence market participant behavior via a series of incentives. In fact, the Fund even went as far as to mandate specific correctional paths and sequences for common individual scenarios, which thereby relegated capital controls—an instrument that uses direct intervention—to secondary importance. We argue that these adjustment paths and sequences are procyclical and hence the Fund's "New" Institutional View will only serve to increase international financial fragility and impede economic development. As a result, this framework will have the exact opposite of its intended effects.

The structure of our argument is as follows. In Part II, we trace the "New" Institutional View's evolution from the EAFC to the present. This moves to Part III where we examine each individual path the Fund recommends for correcting capital flow-induced imbalances and show how they lead to procyclical policy action. Next, in Part IV, we analyze the effects this will have on international financial fragility and development. Using insights from Hirschman and Minsky, we show that rather than stabilize these processes, the "New" View forms destabilizing tendencies and thus unwittingly imposes itself as a barrier to global development. We finish with concluding remarks in Part V.

Part II- What is the "New" Institutional View?

Despite its most notable changes being made after the GFC, it was in the post-EAFC environment where the IMF began subtly altering its policy recommendations on capital controls. Starting with the publication of research by Prasad et al. (2003), the Fund acknowledged controls should be seen as permissible elements of a macroeconomic toolkit, given that they were temporary, "market-conforming", only on capital inflows, and used solely after capital account liberalization made the economy's "fundamentals" "sound." For our purposes, the specifics of the Fund's past policies are not what is noteworthy; to be sure, such conditions have changed. However, what was significant then and now was the IMF's general shift on the acceptability of the policy itself; whereas prior to this capital controls were an anathema, they were now being outright endorsed, albeit for rare circumstances (Grabel 2011). When the GFC struck, the Fund leveraged this broad transition by rapidly amending its above list of stipulations to produce the "New" Institutional View.

This next step involved an analysis of the GFC's causes and fallout. Of note, as mentioned above, a February 2010 policy brief by Ostry et al. (2010) demonstrated that inflow controls enable policymakers to promote longer-term liability maturity structures, thereby lessening the economy's susceptibility to an international financial crisis. Accordingly, the authors concluded it was this that was responsible for why certain economies escaped the GFC

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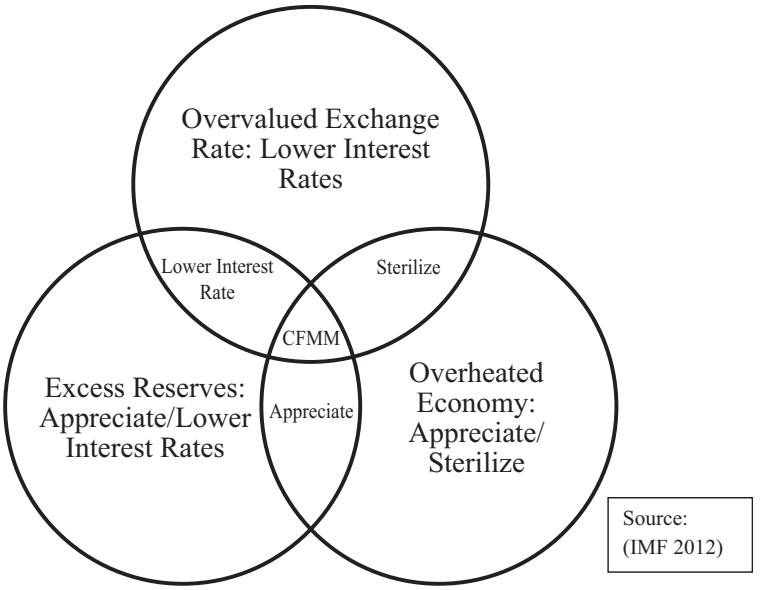

Figure 2. The "New" institutional view's mandated adjustment mechanisms for capital inflow-induced imbalances.

relatively unscathed. Next, both propositions were concretized later that year in a Global Financial Stability Report, which, disappointingly, also added that controls, while potentially effective, are most efficiently utilized as a last resort (Grabel 2011).

The final step in the IMF's progression entailed its actual release of the "New" Institutional View, which was disseminated in a 2012 Executive Board report entitled *The Liberalization and Management of Capital Flows: An Institutional View* and was followed up by a 2013 *Guidance Note for the Liberalization and Management of Capital Flows*. Echoing past reports, the Fund upheld that capital flows can present a threat to financial stability; that in instances where capital account liberalization is either premature or improperly "sequenced" this is more likely to happen; and that inflow and/or outflow measures can be used to counteract it (IMF 2012, 2013; Grabel 2011). However, the IMF also maintained controls should be temporary, used once the economy accumulated sizeable reserves, only after "the market" has equilibrated interest and exchange rates, that they should not discriminate against the geographical location of the investor/depositor, and that price-based measures should be favored over quantity-based ones. In addition, following the earlier 2010 Global Financial Stability Report, its ultimate position was that controls should be a final recourse, and they were thus categorized as a second best policy (Gallagher, Griffith-Jones and Antonio Ocampo 2011; Grabel 2011). Instead, the Fund continued to support capital account liberalization as a first best policy and, to promote this, declared a heavy preference for using "market-based" adjustment measures to eliminate capital flow-induced macroeconomic imbalances, rather than through capital controls.

The IMF next provided a schematic representation of the thinking it used to construct these parameters, where it highlighted the specific correctional paths and sequences it believed would most efficiently and effectively address capital inflow-induced imbalances, which we reproduced in figure 2.

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As we can see, the Fund identifies three common imbalances caused by capital inflows: currency overvaluation, overheating (price inflation from excessive absorption relative to productive capacity), and excess reserves. Following each imbalance is the Fund's recommended reaction, such as lowering interest rates if the exchange rate is overvalued. Next, should two of the three imbalances occur simultaneously, the overlapping circles in the Venn diagram list the Fund's proposed solution, such as allowing the currency to appreciate if the economy is overheated and has excess reserves. Finally, if all three imbalances were to occur at the same time, implying the necessary policy space to use "market-based" adjustment measures might be constrained, the center of the diagram (where all three Venn circles overlap) states it is then permissible to implement capital controls—what the IMF calls "capital flow management measures (CFMMs)"—as long as it is a last resort, the Fund's above guidelines are followed, and other, more fundamental reforms are taken in conjunction to permanently close the imbalances.

At the same time, it is important to note that while figure 2 shows the suggested adjustment actions for capital inflow-induced imbalances, the relevant prescriptions for outflow-induced imbalances can be obtained by reversing the adjustment direction of a particular variable. For instance, instead of lowering interest rates to "correct" an overvalued exchange rate, one would raise rates to "correct" an undervalued exchange rate. Nonetheless, in keeping with the "New" Institutional View's own discussion of adjustment mechanisms, and consistent with Hyman Minsky's view that the endogenous accumulation of risk occurs during a boom, in what follows we focus on capital inflow adjustment since it is here that the IMF encourages procyclical actions that drive a medium term boom and, we argue, eventually lead to even larger busts.

Why the IMF's "New" Institutional View is Procyclical

The above scheme, which is the backbone of the "New" Institutional View, is procyclical. As we show below, its proposed "market-based" adjustment mechanisms ultimately create and amplify financial instability rather than ensure stable financing for development arrangements. As a result, this entire perspective is hazardous to sustainable economic development. To make our case, we take each recommended correctional path and demonstrate how its transmission mechanism reinforces the direction and effects of capital flows rather than counterbalance them.

Case #1: An Overvalued Exchange Rate

The first imbalance considered is an overvalued exchange rate which, as noted above, the Fund suggests eliminating by lowering interest rates so as to drop international investors' real return and force a portfolio reallocation. As in a standard neoclassical growth model, the rationale seems to be that lowering rates will reduce capital costs and increase financial asset prices, which in turn will spur investment, particularly in increased exports, from a lowered exchange rate. However, this line of thinking suffers from (at least) three fallacies.

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First, we know from Keynes' *General Theory* that the most important determinant behind real capital formation is profit expectations, not the prevailing interest rate (Keynes 1997). To be sure, businessmen will borrow sums of money at 40 percent rates of interest if profit expectations are such that they expect the future return to be 50 percent. Unfortunately, in developing economies, in which low levels of real income produce low levels of domestic demand *and* low levels of technological sophistication combine with inexperienced national systems of innovation to produce uncompetitive international industries, there are not many robust a priori reasons to expect domestic and export profit expectations to be bullish (Nurkse 2009).

Second, it takes significant amounts of *time* to invest in and expand production in tradeables, especially when most of those economies have typically only exported a few products to a few markets over the past few hundred years, meaning there is no guarantee that the exchange rate would fall and improve the trade balance as interest rates fell since this has not historically happened (Bulmer-Thomas 1995).

Third, the thinking behind this transmission mechanism is outdated in that it views the current account as predominantly dictating the movement of the exchange rate. This is no longer the case; movements in the capital account dwarf movements in the current account (D'Arista and Erturk 2013). Hence, to think that falls in interest rates will lead to increased investment in exports owing to a depreciated exchange rate ignores the fact that financial concerns have far more contemporary influence over the exchange rate than industrial and/or agricultural concerns. And it is for precisely this reason that instead of slowing inflows and depreciating the currency, lowering interest rates is likely to have the opposite effect. To be sure, lowering rates will decrease financing costs, make it easier to rollover existing liabilities, and raise the prices of capital and financial assets, especially in the bond market. Such a combination encourages additional domestic and international financial investment, the realization of higher financial profits, gives a justification for past liability structures and lower future margins of safety, and encourages additional rounds of increased financial investment. Thus, with asset prices continually rising over the short and medium terms, this would only serve to attract further international capital and appreciate the exchange rate—regardless of what industrial and/or agricultural concerns were doing on the current account. There is significant empirical backing for this argument; after all, these are the same general mechanics that were behind the run-up to the East Asian Financial Crisis (Kregel 1998). Thus, rather than discourage capital inflows and depreciate the currency, lowering rates would draw it in with greater force and strengthen the currency—a procyclical scenario.

Part III.B- Case #2: An Overheated Economy

The second imbalance the Fund analyzes involves overheating, or when capital inflows cause price inflation from total demand expenditure being greater than available supply. For this, its recommended fix is either appreciating the currency or using a sterilized intervention. Neither would be likely to succeed and both would be procyclical. However, we should initially view why the IMF believes these to be relevant solutions.

It seems that the reasoning for the first strategy, that of letting the currency appreciate, is the Fund feels appreciation will make exports more

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expensive and imports cheaper, with the net result being that fewer foreigners will buy domestically produced goods. In turn, this would decrease total demand expenditure relative to available supply and thus lessen inflationary pressures. Unfortunately, this is not an appropriate strategy for this situation. First, the goal of a development process, particularly when total demand expenditure exceeds available supply, should not be to reduce aggregate demand relative to available supply but rather to use that excess demand as an incentive to expand the nation's available supply through additional net capital formation (Ffrench-Davis 2005). Indeed, the whole of the problem facing developing economies is to acquire, "productive capacity capable of providing income and employment for the population" since development is nothing more than, "finding economically productive activity for an expanding supply of labor" (Kregel 2016, 505). To sacrifice this in the name of price stability, rather than preserve it while achieving the latter primarily via capital controls, is incredibly negligent. And, further, it would not work.

The reason why attempting to appreciate the currency to slow total demand expenditure relative to available supply would not work is because, as above, it suffers from the aforementioned view that movements on the current account, rather than the capital account, dictate the exchange rate. However, we know this is not the case; movements in the capital account matter far more for the exchange rate than the current account (D'Arista and Erturk 2013). In turn, this implies that appreciation is more likely to encourage additional inflows and thus accelerate price inflation because it promotes the carry trade by enabling investors to subsequently repatriate capital gains and interest income at more favorable exchange rates. Hence, it would serve as red meat for international financial interests to expand their inflow operations, the net effect of which would be continued excess total demand expenditure relative to available supply and price inflation, just as occurred in Brazil from 2003 to 2007 (Kregel 2009).

On the other hand, a sterilized intervention would involve the government selling some of its debt on the open market while simultaneously purchasing some of the capital inflows in an effort to taper the increased size of the money supply caused by those inflows, with the idea being that restricting the size of the money supply will limit the expansion of total demand expenditure relative to available supply—thereby attaining a degree of price stability. However, Brazil attempted to do this in the late 1990s with little success (Kregel 1999). The reason for this is because developing economy governments pay a country-risk premium above the international risk free rate. In turn, this means that the rate the developing economy government would have to pay on its bonds would be greater than the rate it would earn on the international capital holdings it acquired during the sterilization. As a result, this would simply create a structural fiscal deficit and, counterproductively, procyclically increase total demand expenditure relative to available supply, with additional consequent inflation.

To summarize, the IMF's "New" Institutional View recommends either appreciating the exchange rate or undertaking a sterilized intervention in the event that capital inflows cause total demand expenditure to be greater than available supply, resulting in price inflation. However, as shown above, appreciating the exchange rate will only encourage additional private inflows while a sterilized intervention will create a fiscal deficit. In either case, the net result would be a further increase of total demand

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expenditure relative to available supply, making the Fund's proposed solution procyclical in nature and counterproductive to its intentions.

Part III.C- Case #3: An Accumulation of Excess Reserves

The third imbalance and adjustment mechanism the IMF considers is when capital inflows generate foreign exchange reserves in excess of the economy's needs, which can constitute a substantial social cost. In fact, Gallagher and Shrestha (2012) have attempted to estimate the current cost of this (at the time) since it has become common for developing economies to stockpile foreign exchange reserves as insurance against future global volatility and as a way of avoiding IMF standby arrangement conditionality. Using a widely accepted methodology, the authors found that the cost to developing economies of stockpiling foreign exchange reserves in excess of their needs is approximately 1.8 percent of GDP for the developing world as a whole, and potentially as large as 3 percent of GDP for China. Hence, this is clearly a situation to avoid since such funds could be recouped and used for other, more vital developmental purposes.

To avoid such a dilemma, the "New" View prescribes either appreciating the exchange rate or lowering interest rates. However, we already demonstrated above that both of these solutions are procyclical; hence, for brevity, they shall only be summarized. If policymakers appreciate the currency, this will promote the carry trade since capital gains and interest income can be repatriated at better exchanges rates. In turn, this will induce further inflows which, if left unchecked, would create additional foreign exchange reserve accumulation—clearly a procyclical outcome.

On the other hand, lowering the interest rate would decrease financing costs, make it easier to rollover existing liabilities, and raise the prices of capital and financial assets. Accordingly, this would spur additional domestic and international financial investment, the realization of higher financial profits, provide a validation for past liability structures and lower future margins of safety, and spark extra rounds of international capital inflows which would increase reserve stocks. Thus, regardless of whether a nation chose to appreciate the exchange rate or lower its interest rate, rather than slow excess foreign exchange buildup the IMF's suggested adjustments would procyclically accelerate their accumulation and exacerbate the initial imbalance.

Part III.D- Cases #4, 5, and 6

There are three other cases the IMF puts forward, each of which involves considering two imbalances occurring at the same time. The recommended solutions for each are in the overlapping circles of the Venn diagram in figure 2. For example, in the case of an overvalued exchange rate and an overheated economy, the IMF recommends sterilizing; for an overheated economy with excess reserves, it suggests appreciation; and for an overvalued exchange rate with excess reserves it advises lowering rates. Each of these solutions is procyclical. However, we need not devote space below to demonstrating why. Instead, we would reference the reader to our presentation above where we showed how each individual imbalance's mandated resolution is procyclical. Since each of the solutions for the individual

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imbalances are procyclical and remain unchanged, it follows that any combination of them for addressing multiple imbalances is also procyclical.

Part IV- Implications for International Financial Stability and Development

A development process is a productive sector transformation that creates diversified, high-value added, technologically-dynamic domestic and external sectors that are well-integrated with one another. As mentioned above, this means that the primary task of development policy is utilizing short-term demand targeting to mobilize domestic resources toward those higher productivity trajectories, which will subsequently give rise to accompanying long-term alterations in demand and market structures. Throughout this process, it is essential that the economy possesses stable financial arrangements to allow investment inducements to emerge by reducing uncertainty and liquidity preference in environments typically lacking such accommodative traits (Hirschman 1958). To be sure, it is only with the creation of such financing conditions that the driving mechanisms of a development process would be enabled to come to the fore in which inherently present real macroeconomic imbalances generate backward and forward linkages that, in turn, enlarge domestic investment and production, just as Hirschman envisioned (Hirschman 1958).

At the same time, capitalism is an economic system that combines a market economy with an advanced financial system, the latter of which makes it inherently susceptible to cumulative destabilizing tendencies (Minsky 2013). To be sure, in developing economies with open capital accounts, positive risk-adjusted return differentials between developing and advanced economies promote international capital flowing toward fast-growing, middle-income economies. Once this occurs, a process is set off in which financial markets, macro prices, risk profiles, and (frequently) real estate undergo consistent medium term appreciation—giving actors the impression gains are guaranteed. As this sequence generates sufficient profits to justify past liability structures, both borrowers' and lenders' past decisions become vindicated, informing them prior liquidity preference and margin of safety decisions were excessive. Thus, those units operating with high leverage ratios continue to do so (or increase them) while underlevered units similarly take on higher liability to income ratios. The result is a series of financial risk profiles increasingly operating with lower margins of safety and a macroeconomic payments chain that becomes more and more dense (Minsky 1982; Kregel 1997; Kregel 2004; Kregel and Burlamaqui 2006; Damill, Kampel and Rozerwurcel 2016). Once asset prices reach values well above historical trend and clearly go into outlier territory—what we referred to earlier as "vulnerability zones"—an incredibly small (and otherwise meaningless) event can and often does trigger an investor panic (Ffrench-Davis 2005; Ffrench-Davis and Griffith-Jones 2011). In the ensuing crisis, each individual's attempt to sell highly leveraged positions collectively creates significant capital outflows and a self-fulfilling financial macroeconomic collapse (Kregel 2004; Ocampo, Kregel, and Griffith-Jones 2007). Importantly, this means that deregulated domestic and international financial systems will lurch from periods of stability to periods of instability and crisis because of their inherent tendencies to endogenously generate increasing levels of

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systemic risk—implying that they will act as barriers to development rather than assisting it.

To further complicate matters, structural changes made within the international financial system since the Latin American Debt Crisis, such as an emphasis on bulk origination and distribution of loans and the need for a rapid realization of capital gains, has created a culture where financial agents are characterized by short-term horizons (and thus preoccupied with factors determining short-term returns); frequently confine themselves to dealing in liquid, short-term debts; and operate under conditions of pervasive fundamental uncertainty (since finance deals with an inherently unknown future) (Ocampo, Kregel, and Griffith-Jones 2007; Ffrench-Davis 2010; Ffrench-Davis and Griffith-Jones 2011). This culture, along with a governing ideology that accommodates it, created a system in which waves of international investor optimism rapidly shift to pessimism (and vice versa), causing international capital flows to heavily fluctuate and explaining why global financial agents exhibit herd behavior—which makes the effects of international financial cycles on developing economies more acute (Ffrench-Davis 2005; Ocampo, Kregel, and Griffith-Jones 2007; Ocampo 2008). In a very real sense, these conditions make development prospects that much more bleak.

To compensate in a world such as this and promote the stable financial relationships that facilitate Hirschman's vision of a productive sector transformation, it is necessary to *primarily* use capital controls for (at least) two reasons. First, by altering the magnitude, type, price, maturity, duration, composition, and ownership of the stock of financial assets and liabilities, they act as a preventative measure for weakening the ability of international capital flows to contribute to the likelihood, frequency, and severity of financial crises. Second, they create additional policy space which, in the face of the above pressures, allow authorities to enact countercyclical measures to stabilize the economy as well as make it easier to implement the proactive developmental initiatives that form the core of a development process (Ocampo 2008).

This emphasis on the need to primarily and proactively use capital controls for developmental macroeconomic purposes is entirely incompatible with the IMF's procyclical "New" Institutional View. Indeed, by mandating governments follow these procyclical "market-based" adjustment policies to correct capital flow-induced macroeconomic imbalances while suppressing capital controls, the IMF is requiring developing economy authorities to act irresponsibly. Make no mistake, the Fund's policy prescriptions would heighten the excesses of a boom by encouraging additional capital inflows, accelerating a run-up of financial and capital asset prices, and generating additional financial profits—thereby validating past liability structures and enticing actors to increase leverage their ratios. Consequently, the eventual net effect of this would be deteriorating margins of safety and the creation of a financially fragile productive sector transformation. In turn, once these margins became sufficiently thin and the macroeconomic payments chain so complex that a small hiccup disrupted it, the prior run-up of asset prices would rapidly reverse course, inflows would quickly convert into outflows, and financing and development processes would collapse—all because the developing nation followed the IMF's "New" advice.

In addition, this is also when authorities would be needed most to step in and stabilize asset prices and profits to limit the extent of the crisis and

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begin recovery. However, the IMF's procyclical recommendations promote the opposite of Keynesian-style stabilization actions, such as by its recommending raising interest rates to slow a rapidly depreciating currency—which would only further depress asset and macro prices, risk profiles, and lending, as the case of East Asia revealed (Kregel 1998). Further, it would also ensure that the damage done to the real economy's transformation would be made more severe. Thus, rather than brokering financial stability and supporting a sustainable development process, the IMF's "New" Institutional View gives rise to and amplifies the very forces that destabilize financial arrangements and development efforts. In this regard, the IMF's "New" View is in violation of Parts ii, iii, and vi of Article 1 of its own Charter![2]

Part V- Conclusion

As the immediate dangers of the GFC subsided and global conditions transformed into a prolonged era of insufficient effective demand qua stagnation, many analysts recognized the role loosely regulated international capital flows played in transmitting the meltdown to the developing world. The IMF was one such actor, and its consideration of capital controls as a viable policy for managing international capital flows, formalized in its 2012 "New" Institutional View, was hailed by many as marking a turning point in the Fund's thinking. However, while this set of recommendations acknowledged controls could serve a positive purpose given certain conditions, they were largely ignored and reduced to a secondary role in favor of using "market-based" adjustment measures to correct capital flow-induced imbalances, with the Fund going as far as to mandate specific correctional paths and sequences for common scenarios.

In this article, we have argued that these adjustment sequences are procyclical and therefore the "New" View would increase international financial fragility and impede economic development. To be sure, we demonstrated that this is true for every single mechanism the Fund proposes—rendering the "New" Institutional View discordant with the actual challenges developing economies face. Thus, rather than recognize the principal function capital controls can serve in restraining and offsetting the destabilizing tendencies inherent to capitalist finance while also creating countercyclical and proactive developmental policy space, the "New" Institutional View unfortunately mandates policies that create and amplify international financial instability and obstruct economic development. Why this is considered to be novel by some and any different from past IMF behavior is beyond the creativity of this author.

[2]*Article 1 of the IMF's Charter lays out the purpose for the Fund's existence. Part ii states that this purpose is, "To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy." Part iii reads that it is, "To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation." Finally, Part vi declares that it is, "In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members" (IMF 2016).*

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