The Design of a Country Insurance Facility: Discussion

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The views expressed in this discussion are those of the author and should not be attributed to the IMF, its Executive Board or its management.
A Global Liquidity Facility

- EMs suffer from liquidity shocks

- The authors draw lessons from:
  - Domestic LLRs
  - Bilateral swaps from the US Fed
  - and propose a global liquidity facility to benefit a broad range of countries

- For an effective ILLR, the authors suggest a liquidity facility with automaticity (of ex ante qualification and ex post trigger) and plentiful liquidity

- In practice, there may be a trade-off between these two desirable features
Automaticity: Rules vs. Discretion

- Pre-qualification has several advantages:
  - Increased predictability
  - Incentive for sound policies
  - De-stigmatizing request for external financial assistance

- Automatic pre-qualification places a burden on forecasting ability:
  - Severity of shock (US unemployment)
  - Transmission mechanisms (Irish banking crisis)
  - Shocks to “collateral” (Euro-zone developments)

- This narrows the scope for pre-qualification and argues for some discretion
Objective triggers
- Complications: Risk-sharing vs. contagion, cyclical vs. structural shocks, the need for adjustment

Informational imperfections
- Market sensitivity of labeling members needs to be taken into account
- Take-up of FCL
- Secrecy of domestic LLR facilities
Flexibility May Be A Substitute

- IMF packages during the crisis:
  - Reduction in EM spreads may have been due to expansion of aggregate Fund resources
As trade linkages grow within regions, pooling arrangements become more attractive (Basu et al. 2010)

- Intra-regional exports as % of total exports: Europe (73%), Asia (50%), South and Central America (26%) (data from R. Bebczuk)
- Transfers of reserves to regional pools or co-financing to leverage off IMF lending and/or Fed swaps

Cross-border financial linkages: May improve risk-diversification but may also make the global network more prone to systemic risks

Susceptible to region-wide shocks so global pool still needed
A very stimulating proposal!