Discussion: Capital Flows Volatility and Financial Safety Nets

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Global Cooperation for Sustainable Growth and Development
Outline

1 Capital Controls

2 Global Safety Nets
Outline

1. Capital Controls
2. Global Safety Nets
Comment 1: Use of the De Jure Measure

- The extent to which *de jure* controls impact the actual quantum of flows depend on the degree of enforcement.

- According to the Chinn-Ito measure India has been at the low end of the spectrum in terms of capital account openness.

- However, *de facto* measure indicate significant increase in the extent of financial integration despite *de jure* measure showing no change.

- Chinn Ito index is based on AREAER which continues to classify a market as closed even if it retains some minimal controls in cases of flows which have been significantly liberalized.

- Consequently, the measure is not sensitive to the imposition of controls that the paper alludes to.

- Can a more sensitive country specific measure be created?
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Discussion of Capital Controls Paper: Key Highlights

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Comment 2: Impact of Capital Controls

- The path towards capital account liberalization was driven by shift towards non-debt creating flows, dissuade volatile inflows and gradual liberalisation of outflows.

- Longer term evidence suggests that Indian capital control regime was successful in altering the composition of flows.

- India’s ranking in terms of non-debt creating flows is also better than its overall ranking.

- A global comparison of the impact of recent capital flows do suggest that they helped in moderating the growth of asset price bubble and mitigate currency appreciation pressures.

- A plausible reason for weak impact of capital controls in recent years could be increased level of financial development.
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Countries also resort to capital controls to negotiate the trilemma, in absence of which they can be forced into a corner solution. Following the methodology outlined in Aizenman et al (2010) one can trace the path India has traversed in dealing with the trilemma. Over the last two decades India has juggled the various policy objectives under the trilemma. Reliance on the various policy objectives in recent years have shifted depending on the demands of the macroeconomic situation.
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Comment: Global Financial Safety Nets

- Despite the recent surge, GFSNs continue to cover a small part of external assets and liabilities.

- With bulk of the GFSNs dependent on central bank reserves global imbalances are likely to persist in the near future.

- While the additional swap lines and enhanced IMF toolkit are encouraging, their impact on markets will have to be seen.
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An effective GFSN needs to clearly outline the extent and conditions under which the issuer of last resort would be willing to provide liquidity to the rest of the world?

The various IMF proposals need to iron out wrinkles related to automatic access on ground and clarity in definition.

Calculation of the potential costs in the analytical framework?
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Calculation of the potential costs in the analytical framework?
THANK YOU !!
Appendix Outline

- De Jure Measures of Openness
- Change in Composition of Capital Flows
- Evolution of Non Debt Creating Flows
- Capital Controls
- Trilemma Diamond Plots
- Financial Openness and GFSNs
- Change in Spreads
- Inclusion in Fed Swap Arrangements
Cross Country Comparison of De Jure Openness

(a) 1970s

(b) 1980s

(c) 1990s

(d) 2000s

Median Openness

De Jure Measure
De Facto & De Jure Measures of Openness

Sen Gupta (ADB)
Appendix

Change in Composition of Capital Flows

(a) India

(b) Chile

Composition
Appendix

Evolution of Non Debt Creating Flows

FIGURE 6. Ratio of FDI and Portfolio Liabilities in Gross External Liabilities
Source: Lane and Milesi-Ferretti (2006) dataset and author's calculations.

(a) 1996

(b) 2006
These tables exhibit exchange rates and stock market indices indexed to 100 on January 1, 2008. In South Korea the index continues to rise after each measure but the total...
Impact on Financial Development

Graphs by d_fin1

High Financial Development

Low Financial Development

Chinn Ito Dejure Measure

Lane Milesi Ferreti De facto Openness

Fitted values
Monetary independence is measured as the inverse of the annual correlation of the monthly interest rates between India and the United States.

\[ MI = 1 - \frac{\text{corr}(i, i^*) - (-1)}{1 - (-1)} \]  

The index for Exchange Rate Stability is calculated using the annual standard deviations of the monthly exchange rate between India and the United States.

\[ ERS = \frac{0.01}{0.01 + \sigma(\Delta(\epsilon))} \]  


We use the ratio of net capital flows to GDP to capture Capital Account Openness.
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Trilemma Diamond Plots

(a) 1990-91 to 1994-95
(b) 1995-96 to 1999-00
(c) 2000-01 to 2004-05
(d) 2005-06 to 2009-10
Evolution of Policy Choices under the Trilemma

\[ 1 = \alpha MI + \beta ERS + \gamma \text{Cap Open} \] (3)
Appendix Figure 4). While for the largest emerging markets the ratio has quintupled from 20 percent of own ... starts in 1981, and for Russia in 1993.
Source: Updated and extended version of Lane and Milesi-Ferretti (2007) dataset

D. No Systemic Liquidity Provision Mechanism
12. Collective safety net. In the current system, the size of the collective financial safety
network increases with the size of the swap agreements  and, after 2010, their commitments to the multilateralized CMI.

Financial Openness and GFSNs

(a) Assets & Liabilities
(b) GFSN

Source: IMF (2011)
Change in Spreads

(a) Fed Swap & FCL


(b) London Summit

FED Swap
Country EMBI Spread / EMBI spread of countries with similar initial spread (+/- 100 pb) Index 10/14/2008=100

Ems with no access during the Lehman Crisis (Argentina, Georgia, Ecuador, Venezuela)

Ems with no access during the Lehman Crisis – Excluding Ecuador

Ems with access – Initial spread within 200 pb of countries with no access (Belize, Sri Lanka, Ukraine, Dominican Republic, Kazakhstan)

Figure 1: Effect of access to credit facilities on EMBI Spreads

(a) Fed Swap & FCL

Inclusion in Fed Swap Arrangements

Table 1: Mean values and tests of difference in means

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<tr>
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<tbody>
<tr>
<td>Non-Swap Recipients</td>
<td>0.007</td>
<td>56.25</td>
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<td>Swap Recipients</td>
<td>0.034</td>
<td>65.63</td>
<td>0.042</td>
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<td>(p-value)</td>
<td>0.25</td>
<td>0.08</td>
<td>0.96</td>
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Table 2: Univariate Probit Regressions for explaining inclusion in Fed Swap Arrangements

<table>
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<th></th>
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<th>(2)</th>
<th>(3)</th>
<th>(4)</th>
<th>(5)</th>
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<tbody>
<tr>
<td>USBankExpShare2007</td>
<td>116.9**</td>
<td>114.8**</td>
<td>116.2**</td>
<td>154.5</td>
<td>3969</td>
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<td>KOpen2004</td>
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<td>years_default_c1800</td>
<td>-0.001</td>
<td>-0.003</td>
<td>-0.001</td>
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<tr>
<td>ustrd_share2007</td>
<td>13.27</td>
<td>13.27</td>
<td>13.27</td>
<td>13.27</td>
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<tr>
<td>Constant</td>
<td>-2.962***</td>
<td>-2.455*</td>
<td>-0.920**</td>
<td>-1.297***</td>
<td>-214.9</td>
</tr>
</tbody>
</table>

Observations: 27 26 23 25
Pseudo R-squared: 0.64 0.06 0.00 0.11
Percent Correctly Explained: 89 85 83 84

Table 3: Multivariate Probit Regressions for explaining inclusion in Fed Swap Arrangements

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<tbody>
<tr>
<td>USBankExpShare2007</td>
<td>160.1</td>
<td>114.8**</td>
<td>116.2**</td>
<td>154.5</td>
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<td>KOpen2004</td>
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<td>ustrd_share2007</td>
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<tr>
<td>Constant</td>
<td>-6.185</td>
<td>-2.874**</td>
<td>-2.758***</td>
<td>-5.896</td>
<td></td>
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Observations: 26 23 25 25 21
Pseudo R-squared: 0.72 0.61 0.64 0.72 1.00
Percent Explained Correctly: 92 87 88 92 100

(a) Explaining Fed Swaps

(b) Mean Difference

Source: Aizenman & Pasricha (2010)