Discussion at G-20 Conference

Capital Controls, Liquidity Provision, and Foreign Investors

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Ghosh

- Outlines that there are significant links between countries, raising the likelihood of "innocent bystander" problems and increasing the severity of systemic crises.
- Suggests that precautionary credit lines can be beneficial to economies, and help prevent spillover effects.
- Explains that a Global Financial Safety Net may be the most efficient way to accomplish this, rather than individual credit lines.
  - Relies on connectedness in GDP across countries, a very reasonable assumption.

- Q: Should we think about unanticipated consequences/equilibrium effects? (Discussion below).

Pickford

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  - Allowing the IMF to borrow from capital markets.
  - Creating a global network of swap arrangements.
  - Formalising links between the IMF and RFAs; making it clear ex-ante what scale of resources might be available.
- Q1: Even for Eurobond issuance, it comes down to a fiscal policy question. The lesson seems to be that you can't raise capital unless you have the ability to create fiscal policy/raise taxes as well.

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- Q1: Even for Eurobond issuance, it comes down to a fiscal policy question. The lesson seems to be that you can't raise capital unless you have the ability to create fiscal policy/raise taxes as well.
- Q2: Is strategic ambiguity useful when thinking about disclosure on the scale of resources available?

Patnaik and Shah

- Consider whether capital control tightening in India during the crisis was effective in controlling capital flows.
- Present several useful examples that it did not.
- One example: maximum permitted interest rate for foreign borrowing dropped by 50-100 bp.
  - Attempt to control capital inflows.
  - But capital inflows from all *other* sources increased to compensate.
- Q: Doesn't this raise a broader issue about re-optimization by financial agents in response to policy changes?

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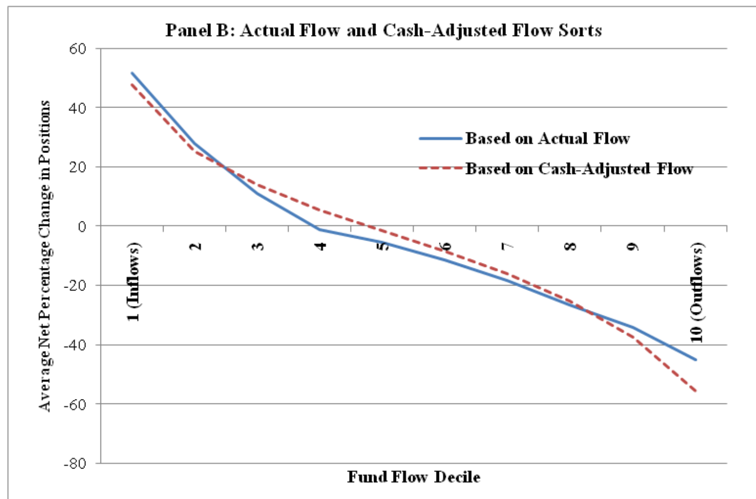
- View: New institutions generate (both positive and negative) unintended consequences.

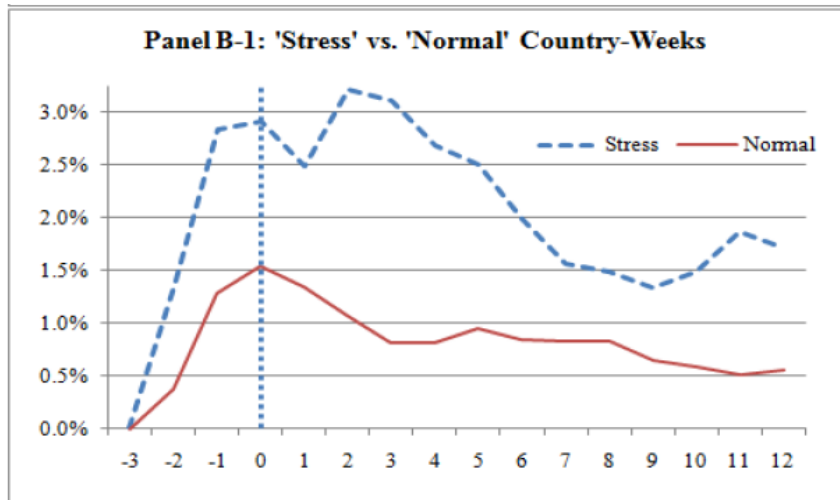
Lessons from Asset Fire Sales

Global funds cut positions in emerging markets in response to domicile-induced funding shocks



Lessons from Asset Fire Sales

Large price impacts especially during crisis periods



Lessons from Asset Fire Sales

Funds reallocate to more liquid markets

Decile	Flow (%)	Countries Expanded	Countries Reduced or Eliminated
1 (Inflows)	12.75	54.11	58.76
2	3.73	53.77	55.74
3	1.38	53.86	54.79
4	0.24	55.21	55.95
5	-0.07	55.27	55.45
6	-0.67	54.98	54.15
7	-1.58	54.60	52.80
8	-2.82	55.59	53.47
9	-4.71	55.48	52.85
10 (Outflows)	-10.85	57.08	52.92
1-10	23.60	-2.96	5.83
t-statistic	--	(-3.28)	(6.56)

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- The two are connected: when firms are connected to each other (say through trade credit links), financing spillovers automatically take place.
- Liquidity provision could thus also have beneficial asset pricing impacts, since trade links generate stock return correlations.

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  - Conversely, sometimes solving one problem (real liquidity provision to firms in one country) solves many simultaneously.
- These re-optimization effects and institutional externalities need to be thought through when re-designing institutions.
- Also important to build enhanced levels of reporting and disclosure, in addition to liquidity provision facilities.