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Statement by Mr. Moser and Mr. Weber on Consideration of a New Liquidity Instrument for Market Access Countries
(Preliminary)
Executive Board Seminar 06/4
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1. We remain skeptical about the benefits of high access financing as a means for crisis prevention and about whether it can be made workable in practice. We also remain concerned about the idea of providing substantial up-front financing without having the assurance that the financing is matched by adequate policy adjustment if a balance of payments need arises. However, we are aware that the Fund must be relevant for those members that are particularly concerned about having to deal with capital account crises. We are thus ready to seek for compromise and build on common ground. In this sense, the RAL is an interesting proposal and a good point of departure for discussion.

2. Certain incentive issues related to information asymmetries, monitoring, signaling, and exit will remain regardless of instrument design, and many details still need to be worked out. However, the staff has done a commendable job at discerning these elements and putting forward a concrete proposal for discussion. We like the idea of combining ex ante and ex post safeguards and the fact that qualification is based on application. We also like the idea of applying SRF-type terms and that access is based on quotas.

3. We also think that the idea of a global cap on the use of RALs is a helpful suggestion, since pre-committing large amounts of Fund resources for potential need could diminish the Fund’s capacity to respond to actual need. However, consideration should be given to express the cap not as an absolute amount but as a percent of total Fund resources.

4. The fact that the RAL does not foresee an activation review needs to be balanced by (i) sufficiently strong criteria for qualification, (ii) a clear mechanism for monitoring policy, and (iii) clear rules on when a drawing under the RAL could be made.

5. As to qualification, unlike the CCL the RAL does not exclude members that face vulnerabilities. In addition to strong macroeconomic policies, sustainable debt, and transparent reporting, policies to address vulnerabilities to shocks are thus an important requirement. Moreover, we will also have to decide on the extent of vulnerability that is acceptable, not least since there is a link between the potential financing need and the extent of vulnerability. It would thus be necessary to clarify the relationship between RALs and

FSAPs. Given the scope and focus of FSAPs on financial system vulnerabilities, it would be sensible to make participation in the FSAP process a criterion for qualification.

6. Data and policy transparency would also be important building blocks, both to send the right signals to markets and to allow a thorough analysis of vulnerabilities. Data on the currency and maturity composition of public debt would be essential. Finally, debt sustainability would have to be assessed with a view of ensuring sustainability in circumstances that warrant a country to draw on funds provided under the RAL.

7. On monitoring, further discussion will be required on what the standards of upper tranche conditionality would imply for the RAL, which does not allow for conditionality. In light of the commitment of Fund resources involved, the requirements of the proposed framework for policy commitment also need to be further discussed. As pointed out by Mr. Kremers, a mechanism should be considered that would allow staff to propose at any time to the Board to suspend the RAL in case of a detrimental departure from the committed policy framework.

8. In case of a drawing, the staff proposes a post-drawing review report that would provide an opportunity to discuss the authorities' policy responses and to confirm that a balance of payments need existed at the time of drawing. The role of this report would need to be further discussed. It remains unclear what the consequences of a negative staff assessment would be.

9. We would like to point out that the paper says little on the Fund's role vis-à-vis the private sector. In order to broaden the discussion into this direction, the following more specific questions arise:

- *Is the instrument complementary or substitutive to other measures by which emerging markets manage their risks?* While giving countries an alternative to costly reserve build-up, we do not fully share staff's conviction (para 50) that private sector lenders will not also be (at least partially) covered by such an insurance scheme. In a crisis situation when private sector obligations also fall due, some degree of bail-out of the private sector is conceivable.

- *How does the instrument deal with market failures that are frequent in insurance type contracts?* In order to limit moral hazard, insurers often resort to collateral/ deductions, terms of agreement that allow for non-payment, and a strictly risk-based fee structure. We wonder whether the different types of measures at the Fund's disposal are just as powerful in this respect.

An assessment along these lines will help judge the effectiveness of a new liquidity instrument. We are looking forward to an informed debate in the coming months.