April 10, 2020 – Ramin Toloui – Stanford University

Outline of Proposal

IMF Systemic Liquidity Facility (SLF)

Goal: Provide expedited, no-conditionality access to emergency liquidity in a systemic shock for countries running high-quality policies prior to the crisis.

Concept: Use market-based indicators to identify eligible countries and calibrate access levels.

Outline:
1) The Executive Board would approve activation of the facility. Correlation/co-movements in credit spreads could be used to support the determination of a systemic event.
2) A country's average credit spread in the 6 months prior to the systemic event (either 5yr CDS or spread on cash bonds of designated maturity range) would be used to determine eligibility.
3) The set of countries eligible to draw from the facility would be based on prior average credit spreads – e.g., all countries with prior spreads less than +250 basis points would be eligible.
4) Access levels would be calibrated in proportion to credit spreads on a sliding scale – i.e., access would phase out, rather than there being a "bright line" for eligible versus non-eligible. For example, countries with prior average spreads of +100 basis points or less would be eligible to draw 250 percent of quota, which would decrease linearly such that countries at +250 basis points would be eligible for 0 percent of quota.
5) Repayment term would be very short (maximum 12 months), reflecting the expectation that the shock would be temporary. If additional support is needed at a later time, a fuller program with conditionality may be warranted.
6) Financing terms would be at a penalty rate (e.g., surcharge of 300 basis points) to discourage excessive use of IMF resources (rather than their own) and encourage countries to tap capital markets as soon as possible.

Discussion: The idea is to provide an objective basis for measuring policy quality, as well as identifying systemic shock episodes. A single country experiencing a large increase in credit spreads (such as due to policy deterioration) would thus not be eligible to draw on this facility, since the facility would not even be open during non-systemic shock periods.

Making these judgements using market-based measures has several advantages:
(1) mitigates potential that judgments are clouded by political or bureaucratic considerations
(2) obviates the need to rely on subjective or arbitrary thresholds on macro-financial variables
(3) avoids risk that most recent IMF analysis (e.g., Article IV consultation) may be out of date and no longer representative (e.g., if a new government changed the policy framework)
(4) the phase-out feature means that countries won't "just miss" qualifying or not qualifying
(5) enables the facility to be executed rapidly yet equitably at scale, which is exactly what is needed during systemic shock.

None of this to suggest that market-based measures are foolproof (markets misjudge risks frequently) or that credit fundamentals may not deteriorate differentially among eligible countries due to the shock (they can). But, on average, the advantages just enumerated outweigh the drawbacks in comparison to other potential approaches, providing a framework for rapid deployment of meaningful levels of support while safeguarding IMF resources.