Inter-American Development Bank
Office of the Chief Economist

VIII Meeting of the Latin American Network of Central Banks and Finance Ministries
Washington, D.C.

April 14 -15, 1998

AGENDA

8:00-9:00am	*Registration*
9:00-9:15am	*Welcoming Remarks: Nancy Birdsall, Executive Vice President*
9:15-9:30am	*Introduction: Ricardo Hausmann, Chief Economist*

Tuesday, April 14 ***Session I***

9:30-12:30pm Making sense of emerging market debt prices

Session topic: Emerging market debt (EMD) issues are now a firmly established and increasingly important part of international capital markets. A background paper will discuss issues related to spread determination, rating agency effects and related subjects. In the discussion we expect to cover four issues:

- What drives emerging market debt prices? Why are they so volatile? Why are they correlated between sovereign issuers?
- Do debt prices have direct effects on the economy or are they merely reflecting other factors? Does volatility of debt prices have macroeconomic effects?
- What is the role of rating agencies?
- What are the policy implications of debt price volatility?

12:30-12:45pm Photograph of the Group

12:45-2:15pm ***Lunch hosted by Enrique V. Iglesias, President IDB***

Keynote Speaker: Mr. Edwin M. Truman, Staff Director
International Finance Deivison
Board of Governors, Federal Reserve System
(by invitation only)

Session II

2:30-5:30pm What is the appropriate regulatory structure for international financial transactions?

What is the logical basis for the regulation of international financial transactions? Two main rationales have been offered: to provide authorities with greater scope for macroeconomic policy management, and to minimize the risks of an international financial crisis. In this session we will explore the implications of these considerations for the appropriate regulatory structure for international financial transactions. We expect the discussion to center around the following issues.

- While not completely unrelated, the ‘macro-management’ and the ‘prudential’ rationales for regulation of international financial transactions may have different implications for the appropriate regulatory structure. Are both rationales valid? Is one more important than the other?
- International financial markets are supposed to: (i) permit higher levels of domestic investment, (ii) facilitate consumption smoothing in the face of national economic shocks, (iii) increase welfare and economic stability by allowing for greater portfolio diversification, and (iv) provide market discipline over public and private borrowers. Are they accomplishing these tasks? At what cost?
- It is well accepted that domestic financial transactions must be conducted within an appropriate regulatory framework, and that the regulations governing some institutions and types of transaction must be more restrictive than those governing others. Are international financial transactions any different? If so, how? What are the underlying problems - as reflected in inadequate incentives, information, or behavior patterns of international investors, domestic financial institutions, non-financial borrowers, and policymakers - that regulation must address? What are the main risks - maturity, credit, currency or other - created by volatile international capital flows, and what sectors of the domestic economy are most affected by these risks? What are the tradeoffs involved in regulating international financial transactions, and what are the implications for the appropriate regulatory structure?
- Until recently discussion about policies toward capital flows emphasized policies to manage excessive capital inflows. But the recent Mexican and Asian experience illustrates that the absence of arrangements for managing an international liquidity crisis tends to protect short-term debt holders, thus forcing providers of equity and longer-term debt finance to bear a larger share of the costs. Looking ahead, this may have the perverse effect of discouraging longer-term capital flows, and may create demands for official emergency finance that cannot be satisfied. Should there be more explicit ‘stand-still’ arrangements constructed to reduce this problem? If so, how should this be done? If not, would alternative regulatory structures, such as taxing short-term inflows, help?

Wednesday, April 15 *Session III*

9:30-12:00pm **What is being done? Is it working?**

Session Topic: According to the IMF Annual report on Exchange Arrangements and Exchange Restrictions, as of end-1996 over 91% of the 184 reporting countries impose some restrictions on financial transactions between residents and non-residents. These restrictions take several forms and affect a diverse set of transactions. In this session our purpose is to discuss current practices, their advantages and disadvantages and the degree to which they are effective in achieving stated goals. The background paper will discuss issues of regulation and will describe current practice. We ask participants to express remarks on the following issues:

- Does the type of regulation usually implemented adequately address the type of problems that emerge from the existence of volatile capital flows?
- What are the fundamental mismatches between what one would want to address with regulation and the regulation that we actually have?
- A common objection to regulation or controls over capital account transactions is the issue of effectiveness. It is said that capital controls “erode” over time as market participants design alternative transaction strategies. How relevant is erosion in practice? Does the accelerated development of markets for derivative financial instruments provide new sources of erosion? How can regulation best address the issue of erosion?
- It is claimed that countries that impose capital controls find it difficult to remove them later. One reason is that authorities might want to consider capital controls a permanent feature of policy. Another, that they want to avoid overreactions by financial markets to the news generated by abandoning this policy. Is the point relevant: do capital controls tend to perpetuate themselves due to high exit costs?
- Erosion and perpetuation are two practical issues that might imply, as has been claimed, a possible “endogeneity” of capital controls. A specific set controls cannot be expected to be relevant to all financial instruments created after its implementation. The set of new financial instruments, in turn, might be partly a consequence of the specific control regime. The argument is that authorities might, themselves, respond to these new financial instruments with new controls. Is this a relevant problem? How can regulation best address the issue of endogeneity?
- In 1995, financial turbulence in Latin America was observed mainly in countries with relatively few capital controls. In 1997-98 turbulence was observed mainly in countries with relatively high capital controls. Does this say anything about the relationship between controls and vulnerability, or is this spurious correlation in both cases? If this is spurious correlation, what factors do explain this asymmetry in adjustment?

12:15-2:00pm *Network Working Lunch*: Discussion of topics for future meetings.
(by invitation only)
Executive Dining Room - 7th floor East