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International Cooperation in Times of Global Crisis: Views from G20 Countries

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Needed: Integrated System of International LLR (ready to lend sovereign when nobody is)

- Domestic model
  - Liquidity: Lend liberally against good marketable collateral to bridge temporary credit supply disfunction
  - Solvency: Lend senior in bankruptcy reorganization
- Required International adaptations
  - Minimum preconditions and conditionality (contingent on shock) as financial safeguard and to factor in spillovers
  - Some version of the Sovereign Debt Restructuring Mechanism
- Liquidity or solvency? Monitor liquidity treatment to shift to adjustment and debt restructuring modes seamlessly, adding needed conditionality according to countries' capacities
- See "International LLR and Sovereign Debt Restructuring" in Sovereign Debt and the Financial Crisis (WB)

Example:
ILLR for Systemic Liquidity Crises

- Success of G20 London Summit shows that institutions of ILLR were and are inadequate to sustain financial globalization responsibly. Emerging Economies need institutions, not ad-hoc support by Advanced Economies.
- Blueprint with Eduardo Levy-Yeyati "Global Financial Safety Nets" *International Finance* 15
- To achieve broad-based prevention and protection (power, speed and certainty):
  - Automatic trigger based on overall EMBI jump
  - Country prequalification based on fair Art. IV
  - Lending on demand by issuers of last resort

A network of ILLRs?

- Systemic crises call for centralization.
  - Liquidity provided by issuers of last resort through IMF (or multilateral CB network, not ad-hoc, unreliable bilateral support)
  - Regional pools and MDBs facilitate, but cannot provide
- In idiosyncratic crises, MDBs and regional ILLRs add value:
  - EU has financial muscle and institutions to call the shots
  - Asia (Chiang Mai) has Japan and China, but still needed IMF link to enforce adjustment impedes regional autonomy
  - LAC does not have comparable heavy weights; small country game
- Should IMF be advisor to all (knowledge and independence) but ILLR only to weaker regions w/o financial muscle?

The specter of moral hazard

- Don’t be paralyzed by moral hazard: if ILLR is repaid, country bears the cost and little room for country opportunism.
- But if ILLR runs credit risk (inadequate financial safeguards), then the door opens for abuse and Moral Hazard:
  - Do not let unsuccessful liquidity support to drift unchecked; place ILLR in a clear resolution strategy
  - Beware of ILLR overlending; assess potential private debt relief
  - Beware of unprecedented ILLR pari-passu lending
- EU has powerful tools for regional cooperation to perform ILLR better than IMF, but use with care
- See “Coping with Financial Crises: Latin American Answers to European Questions” with Eduardo Cavallo in VOX EU