The Orderly Resolution of Financial Crises – A G20-Led Initiative

How could a Leaders' Level G20 make a difference?

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- Real interest rates in the United States are still below historical norms for this stage of the business cycle, reflecting the series of dramatic cuts undertaken by the Fed at the beginning of the present decade. Recent interest rate hikes have gone only part way toward normalization. Low interest rates in the financial centers reduce the cost of servicing variable-rate debt and make it cheaper for emerging markets to re-fund maturing obligations. A sharp rise in those rates could make the external debt situation much more difficult.[4]

  The IMF is at the forefront of crisis-prevention and resolution efforts.[5]

The Argentine crisis has prompted discussion of whether these problems might be solved through the application of market discipline. If the IMF, like the World Bank, funded its loans by borrowing on private financial markets and if it no longer enjoyed preferred creditor status, it would have a strong incentive to loan only when its operations had a high probability of success. Otherwise it would not be paid back, and it then would be unable to borrow to finance future operations.[8]

Unfortunately, this idea is fundamentally flawed. The role of the Fund is to lend precisely when the markets will not, because it perceives the existence of a divergence between the private and social costs and benefits of external finance. If this was not the case, there would be no role for the institution in the first place. Financial market participants, in contrast, take positions purely on the basis of private costs and benefits. To "discipline" IMF policy on the basis of their actions would thus be misplaced.

This leaves constrained discretion as the only sound basis for IMF lending policy.

with concentrated stakes have sufficient incentive to invest in this process of monitoring and accountability. This means that it is ultimately the governments of the member countries, operating through the Executive Board, the International Monetary and Financial Committee, and the Board of Governors on which we must

References

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