Conference International Cooperation in Times of Global Crisis: Views from G20 Countries
Session 5: Financial Safety Nets:

How Can Regional and Multilateral Schemes Coexist?

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1) Need for EMF to pre-empt the end game
2) EMF versus IMF?
European Monetary (Stability) Fund: key goals

1) Pre-empt the end game: 
   Recognize sovereign default as a possibility

2) Limit moral hazard of debtors and creditors by charging the former for excessive deficits and debt and imposing haircuts on the latter for imprudent lending
EMF: Key principles

• Allow sovereign default at minimal cost in terms of systemic stability and public expense.

• EMF puts floor under market price of debt in default through guarantees and/or debt exchange.

• Haircuts: nominal value of debt after haircut = 60% of GDP (of defaulting country).

• GDP warrants align interests of creditors debtors.

• EMF sole/principal creditor of defaulting country (directly through exchange or indirectly through guarantee) => leverage of EU framework.
Preparing for the worst case: debt exchange

- If adjustment (program) is unsuccessful EMF becomes the sole creditor of the insolvent country through (mandatory) debt exchange.
- EMF imposes further conditionality (limits on new borrowing) of the insolvent country so as to assure that the country can repay the EMF.
- Breach of the conditions and/or default on EMF means breach of EU Treaty obligations => leaving € and ultimately (benefits of) EU
Disincentives for default

- Longer-term loss of access to capital market
- Reduced access for the national banking sector to ECB funds as government bonds no longer eligible as collateral for normal policy.
- Loss of political sovereignty.
- Threat of exit from EMU and EU.
EMF = EFSF + ECB?

- EFSF now exists, but only for sovereign default prevention.
- ECB is engaged in “debt exchange” in “dysfunctional” bond markets.
- redeployment of 440 billion Fund would be more than enough for a start-up funding of the EMF and take the ECB out of the business of lender of last resort to EMU sovereigns.
EMF funding in future = automatic ‘sanctions’

- Extra levy on countries that breach Maastricht criteria:
  - $X\%$ of excess debt defined as actual debt ($\%\text{GDP}$) – $60\%$; $X > 1$?
  - $Y\%$ of excess deficit defined as actual deficit ($\%\text{GDP}$) – $3\%$; $Y < 1$?
Professional staff and independence

• Commission/Euro Group failed to present a proper adjustment programme.
• Staff of EMF would be independent and make assessment free of political imperatives.
• New institution or special, shielded, part of Commission?
EMF versus IMF

• Failures of the pre-WWII Gold Standard led to the IMF. Analogue is EMU crisis leading (hopefully) to EMF.

• “Virtual EMF management” could be carved out of European Department of IMF (maybe transferred to Europe?).

• Incentive for unified euro area representation within IMF?
Concluding remark on EMF

• Clearly need systemic solution to this sort of crisis also in long-run perspective (Euro Area 28 members, many small with untested political systems).

• Merely strengthening Stability and Growth Pact useless.

• Policy should not only aim at preventing failure, but also at preparing for it.
Global financial safety net(s) as a pyramid
Thank you

- Something like EMF needed.
- EMF in IMF rather than EMF versus IMF.