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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Structure

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

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Thinking ahead for Europe

- 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 (%GDP) – 60%; X > 1?
  - Y % of excess deficit defined as actual deficit (%GDP) – 3%; Y < 1?

Professional staff and independence

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Thinking ahead for Europe

- 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?

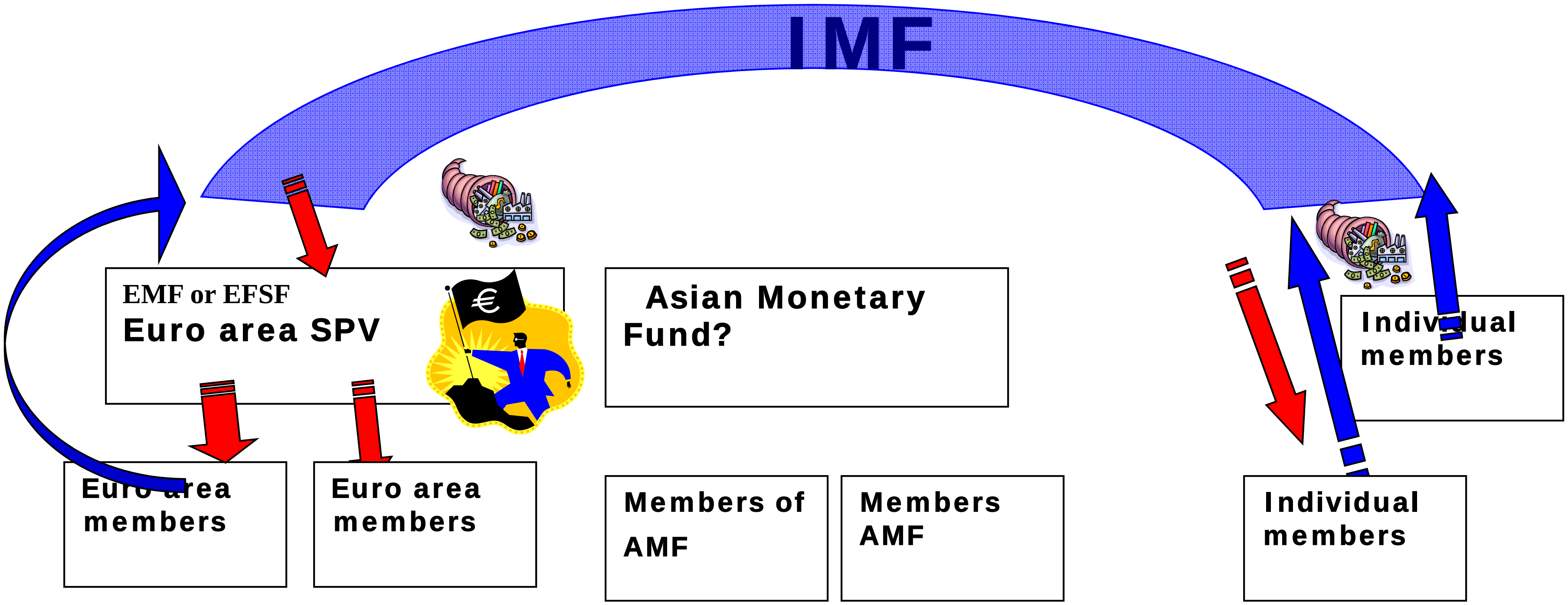
EMF versus IMF

- 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

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Thinking ahead for Europe

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