

Comment on “Do Reforms in Global Governance Matter for Global Growth?” by Ngaire Woods

Pierre Yared

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Current Policy Questions

- Who should control the IMF?
 - This paper: There should be a democratization of control
- Who should fund the IMF?
 - This paper: There should be more participation
- Should the IMF have more power?
 - This paper: It should encourage the US to cut its deficit
 - This paper: It should better monitor reserves accumulation by emerging economies

Challenges to this Approach

- Global imbalances can emerge as a market phenomenon
 - EM want safe asset provided by industrialized countries
 - See Caballero, Farhi, and Gourinchas (2008), Perri and Fogli (2009),
 - Estimate suggests that US consumption increases by 2% a year as a consequence of imbalances (Mendoza, Quadrini, and Rios-Rul, 2009)
- Correcting a market phenomenon by regulating flows may generate economic inefficiencies
- Targeted intervention on non-borrower nations may be politically infeasible

Another Approach

- Financial markets work well, but are subject to distortions
- Implications:
 - Pre crisis: IMF should focus on root cause of financial distortions rather than directly regulate capital flows
 - During crisis: IMF should focus on private market solutions as opposed to direct intervention
- This approach may facilitate the democratization of the IMF by making it less political

One Measure: International Bankruptcy Court

- Proposal received much attention prior to crisis (see Sachs, 1996)
- Outstanding problem: Miscoordination by creditors
 - Can generate panics in healthy economies
 - Can hinder debt work out in unhealthy economies
 - Effect ripples through rest of economy. Rose (2002) estimates a decline in bilateral trade is approximately eight percent a year and persists for around fifteen years
- Basic features of a system (e.g., Ch 9 for municipalities)
 - Automatic stay provision
 - Treat creditors in same class equally
 - Debtor in possession

Benefits from a Successful System

- Ex-post:
 - Reduces prevalence of panics
 - Facilitates debt work out
 - Reduces need for IMF's role as lender of last resort
 - Protects the country's economy during proceedings
- Ex-ante:
 - Reduces need for IMF to raise as many funds or intervene
 - Reduces need for EM's to raise precautionary reserves
 - Alleviates moral hazard problem associated with IMF's role as lender of last resort
 - Promotes greater transparency
 - Allow governments to borrow at longer maturities

Challenges

- Analogy to municipal bankruptcy ignores sovereign nature of governments
- Legal enforcement and implementation very difficult
 - How does a country declare bankruptcy?
 - What if court outcome is not accepted?
- A reduction in the cost of bankruptcy can raise the cost of capital (Eaton, 2002)

Summary

- Democratization of IMF has many benefits
 - More funding sources
 - Better perception of fairness
- Cost that cannot be ignored is that political deadlock can be more likely, making general IMF reform more pressing
- Reforms aimed at making the IMF a facilitator as opposed to a limiter of international capital flows seem most promising