

Table of Contents

	Acknowledgements	13
1.	Introduction and Theory	15
1.1	Introduction	15
1.2	Theory	20
1.2.1	Regime Theory	21
1.2.2	Public Choice Theory	25
1.2.2.1	Global Public Goods	27
1.2.2.2	Moral Hazard Problems	29
1.2.2.3	Principal-Agent Problems	31
1.2.3	Financial Market Theory	33
1.2.3.1	The Efficient Markets Hypothesis	34
1.2.3.2	The Financial-Instability Hypothesis	37
1.2.3.3	Rational Herding	39
1.3	Structure of the Analysis	42
2.	Financial Crisis Theory	47
2.1	Financial Crises in an International Context	49
2.1.1	Four Types of Currency Crises	50
2.1.2	The Problem of Contagion	52
2.2	Three Generations of Financial Crisis Models	53
2.2.1	First Generation Models	54
2.2.2	Second Generation Models	56
2.2.3	Third Generation Models	58
2.2.3.1	Macroeconomic Feedback Models	58
2.2.3.2	Bank-run and Liquidity Models	59
2.2.3.3	Models of Expectations Formation and Herding Behaviour	60
2.3	Evidence and Evaluation	62
2.3.1	Empirical Evidence	62
2.3.2	Evaluation	63
2.3.3	Lessons and Implications	66
3.	Selected Proposals to Increase Global Financial Stability	68
3.1	General Proposals to Increase Global Financial Stability	68
3.1.1	Improved Transparency and Higher Regulatory Standards	68
3.1.2	An International Credit Insurance	71

3.1.3	The Tobin Tax	72
3.1.4	A Global Central Bank	74
3.1.5	A World Currency	75
3.2	Proposals Addressing the Role of the IMF	76
3.2.1	A Sovereign Debt Restructuring Mechanism	77
3.2.2	The Calomiris Proposal	78
3.2.3	The Report by the Independent Task Force	80
3.2.4	The Meltzer Report	84
3.2.5	The Köhler Approach: Procedural Changes	86
3.3	Conclusion	88
4.	The Lender of Last Resort: The Concept in Theory	90
4.1	The Importance of Foreign Currency	90
4.1.1	Enhancing Access to Foreign Currency	91
4.2	The Concept of a Lender of Last Resort	92
4.2.1	Henry Thornton (1760–1815)	93
4.2.1.1	Issues in Last Resort Lending	94
4.2.1.2	Individual Institutions versus the Monetary System	96
4.2.1.3	Contemporary Response	97
4.2.2	Walter Bagehot (1826–1877)	98
4.2.2.1	Lending Freely	100
4.2.2.2	Penalty Rates	101
4.2.2.3	The Collateral	102
4.2.2.4	Financial Stability after 1866	103
4.3	An International Lender of Last Resort	104
4.3.1	Theoretical Considerations	105
4.3.2	The Case for an International Lender of Last Resort	107
4.3.3	Fundamental Differences between International and Domestic Settings	109
4.3.4	The IMF as International Lender of Last Resort	111
4.3.5	The Fund’s Record as Crisis Manger	113
5.	The Lender of Last Resort: The Concept in Practice	117
5.1	The Panic of 1907	117
5.1.1	The Setting	118
5.1.2	The Run on Banks and Trust Companies	120
5.1.3	Pressure on Money, Stock and Call Loan Markets	121
5.1.4	Lessons of 1907	123
5.2	The 1960s Sterling Crisis	124

5.2.1	The Setting	124
5.2.2	The Crisis	125
5.2.3	Lessons of the Sterling Crisis	128
5.3	Emerging Market Crises in the 1990s	129
5.3.1	The Mexican Peso Crisis	130
5.3.2	The Asian Financial Crisis	131
5.3.2.1	Crisis in Thailand	133
5.3.2.2	Crisis in South Korea	134
5.3.2.3	Crisis in Indonesia	136
5.3.3	The Asian Crisis' Aftermath	138
5.3.3.1	The Rouble Crisis	138
5.3.3.2	Crisis in Brazil	140
5.3.3.3	Crisis in Argentina	142
5.3.4	Lessons from Emerging Market Crises	143
6.	The Principle of Lending Freely	146
6.1	The Fund's Resources	147
6.1.1	Current Funding Needs of the IMF	150
6.2	Funding Needs of an International Lender of Last Resort	153
6.2.1	Lending-in-last-resort as Input in Monetary Policy	155
6.2.2	Lending-in-last-resort as Input in Banking Policy	157
6.2.3	Necessary Funding for an International Lender of Last Resort	160
6.2.4	Estimating Short-term External Obligations in the Developing World	161
6.2.5	Liquidity Gaps in the Past	166
6.3	Conclusion and Implications	170
7.	The Collateral Question	173
7.1	The Concept of Collateral	174
7.2	Assets Acceptable as Collateral	176
7.2.1	Financial Assets	177
7.2.1.1	Argentina's Contingent Repurchase Facility	179
7.2.2	Collateralising Equity	181
7.2.2.1	Privatisation in Latin America	182
7.2.2.2	Privatisation in East Asia	184
7.2.2.3	Privatisation in China	186
7.2.2.4	Privatisation in Russia	187
7.2.3	Securitisation of Future Flow Receivables	188
7.2.3.1	Securitisating Natural Resources	189

7.2.3.1.1	The US-Mexican Framework Agreement	190
7.2.3.2	Securitising Alternative Foreign Currency Receivables	192
7.2.3.2.1	Telephone Receivables	193
7.2.3.2.2	Workers' Remittances	194
7.2.3.2.3	Credit Card Receivables	196
7.2.3.2.4	Taxing Export Earnings	196
7.3	Problems Arising from the Imposition of Strict Collateral Requirements	199
7.4	Implications for the Viability of an International Lender of Last Resort	201
8.	Pre-qualification	203
8.1	Advantages of Pre-qualification	203
8.2	Pre-qualification Criteria	206
8.2.1	Transparency Criteria	207
8.2.2	Criteria Ensuring Financial Sector Stability	211
8.2.2.1	Capital Adequacy Requirements	212
8.2.2.2	Minimum Reserve Requirements	216
8.2.2.3	Internationalisation of the Financial Sector	217
8.2.2.4	Deposit Insurance	220
8.2.3	Criteria Indicating Sustainable Sovereign Indebtedness	222
8.2.3.1	Solvency Ratios	224
8.2.3.2	Liquidity Ratios	226
8.3	Conclusion: Pre-qualification Is the Way Forward	228
9.	Moral Hazard	230
9.1	IMF Induced Moral Hazard	231
9.2	Empirical Evidence on Moral Hazard Issues	233
9.2.1	Evidence on Creditor-side Moral Hazard	234
9.2.2	Evidence on Debtor-side Moral Hazard	241
9.3	Catalytic Finance	244
9.3.1	Empirical Evidence on Catalytic Finance	246
9.4	Instruments Mitigating Moral Hazard Problems	249
10.	Principal-Agent Problems	253
10.1	The Actors' Interests	253
10.1.1	Interests of Borrowing Countries	254
10.1.2	Interests of International Investors	255

10.1.3	Creditor Country Interests	255
10.1.3.1	Foreign Policy Objectives	256
10.1.3.2	Financial Sector Interests	257
10.1.3.3	Creditor Country Costs	258
10.1.4	Evidence on IMF Lending Arrangements	259
10.2	The Distribution of Voting Power at the IMF	260
10.2.1	IMF Voting Weights	261
10.2.2	Voting Power at the IMF	264
10.2.2.1	Voting Power at the Board of Governors	266
10.2.2.2	Voting Power at the Executive Board	269
10.2.2.3	Constituencies at the Executive Board	272
10.2.2.4	The Power of Industrialised and Developing Countries at the IMF	273
10.3	The Case for Reforming IMF Governance Structures	275
10.3.1	Governance Reform Proposals	277
10.3.2	Political Difficulties	279
10.3.3	Governance Reform and Pre-qualification	281
11.	Sovereign Debt Restructuring	283
11.1	Debt Restructuring in the Past	283
11.1.1	New Money Approach	284
11.1.2	The Brady Plan	286
11.2	The Changed Environment	287
11.2.1	Successful Restructurings	288
11.2.2	Problems due to Renegade Creditors	290
11.2.3	Need for Reform	293
11.3	Proposals to Facilitate Sovereign Debt Restructuring	294
11.3.1	A Code of Good Conduct	294
11.3.2	Collective Action Clauses	297
11.3.3	A Sovereign Debt Restructuring Mechanism	300
11.4	SDRM versus CAC and Code of Conduct	303
11.4.1	Concerns on the Effectiveness of Collective Action Clauses	304
11.4.2	Market-based Approach as the Way Forward	309
12.	A Proposal	311
12.1	Underlying Principles	311
12.1.1	Principles for Effective Liquidity Assistance	312
12.1.2	Principles for Effective Monitoring and Supervisory Work	313
12.2	Membership Rules for a Restructured IMF	315
12.2.1	General Membership	315

12.2.2	Access to Large-scale Liquidity Assistance	317
12.2.2.1	Sovereign Stability Criteria	319
12.2.2.2	Criteria Indicating Financial Sector Stability	320
12.3	Lending Rules Governing IMF Facilities	322
12.3.1	Lending Rules Governing PRGF and SBA Facilities	322
12.3.2	Lending Rules Governing ELA Facilities	323
12.3.2.1	Ensuring Liquidity Assistance in Sufficient Amounts	323
12.3.2.2	Ensuring Liquidity Assistance Is Employed Effectively	325
12.3.2.3	Reigning In on Debtor-side Moral Hazard	326
12.4	Funding Issues and Transition Period	327
12.4.1	Funding Issues	328
12.4.2	Transition Period	328
13.	Epilogue: Chances of Implementation	331
13.1	Opposition to Reform	332
13.1.1	Opposition by Developed Countries and the G-7	332
13.1.2	The Lacking Clout of Developing Economies	336
13.2	The Potential for Gradual Reform	337
13.2.1	Regional Monetary Cooperation	338
13.2.2	Changes Inside the IMF	341
Appendix		345
Abbreviations		345
Bibliography		347