THE GLOBAL FINANCIAL CRISIS, BAIL-OUTS AND BAIL-INS

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The current global financial crisis: ever-bigger IMF bail-outs

- International rescue packages raise concerns regarding moral hazard
- Finding better ways of involving investors in burden-sharing – key to learning to deal with modern financial crisis
- 10 years from the first private sector involvement exercise in Romania

Some views on better ways to involve the private sector

- Making the official assistance of the IMF conditional on:
  - ✓ Having international banks renewing their credit lines
  - ✓ Renegotiations of government bonds
- Adoption of new provisions in loan contracts to facilitate orderly restructurings
- Rules for IMF lending that impose formulas for bail-ins

Reasons for slow progress in bailing-in the private sector

- Creditors are heterogeneous – identical ways to treat them are inappropriate
- Logistics of orderly restructurings is complicated given the existing financial tissue (credit derivatives, CDS, cross-default clauses, etc.)
- Policy and financial innovations might have unintended consequences precipitating the very crisis

Private sector involvement: the case of Romania in 1999

- The conception: making an agreement with the IMF conditional on private creditors' willingness to continue lending. The experiment involved 4 countries: Ecuador, Romania, Ukraine, Pakistan
- Romania "Too weak to resist the IMF" (Stiglitz); not Russia or Brazil
- Romania "was not threatening a default; it only wanted new money from the IMF to signal that it was creditworthy…" (Stiglitz)
- The scheme: "problematic in conception and flawed in implementation, with high consequences for the countries targeted for the experiment" (Stiglitz)
- The IMF implicitly transferred the decision to conclude an agreement to some private creditors. Increased negotiation power of private creditors, who asked for "regulatory forbearance"

The current financial crisis and Romania

- Romania – too small to pose an international financial problem…
- …But too small not to be fully affected by the current crisis
- Five channels for the spillovers from the global financial crisis to extend to Romania

The special role of the financial channel

- Four out of five channels did not require significant policy action
  - ✓ Foreign trade: exports accounting for 24 percent of GDP as compared to more than 60 percent in other CEECs
  - ✓ Confidence: low risk appetite; decline in FDIs
  - ✓ Exchange rate: reduced capital inflows; depreciation pressure
  - ✓ Wealth and balance sheet
- The **FINANCIAL channel: significant need for external assistance from the EU and the IMF**
  - ✓ Banks dependent on foreign financing; high debt service: 25.4 percent of GDP; strong impact on lending and exchange rate

The 2009 private sector involvement scheme for Romania (I)

- It rightly took into account the disproportionate importance of bank debt, which is a reflection of asymmetrically developed financial sector in Romania
- It would have been more difficult to persuade a larger number of heterogeneous investors, like hedge funds, mutual funds and individual investors by moral suasion to renew their investment
- The problem was transparently a potential liquidity crisis, and the banks were convinced that it is in their own interest to stay in

The 2009 private sector involvement scheme for Romania (II)

- It is clear that Romania has a relatively strong economy: it was easy to convince the banks that the country's plight was a liquidity crisis

- I could hardly say that the 1999 PSI scheme has not created problems, but the current one is paying off

What should be avoided in general in bail-in schemes?

- To create the sentiment among banks and other investors that authorities and the IMF would regularly interfere with their businesses in times of crisis
- A sparing use of the practice is more advisable
- Treating countries in a similar manner is not a good idea. One-size-fits-all is not a solution

Some reasons why one-size-fits-all is not a solution in CEECs

- Some countries are EU members
- The exchange rate regimes are different: Some countries operate currency board-like regimes (Baltic countries and Bulgaria) and others have managed float systems
- There are significant differences within the group of countries with managed float

Macroeconomic Indicators

- 2008 -

	Real GDP	Inflation Rate (HICP)	Current Account Deficit	Openness of the Economy*	Real Exchange Rate (HICP)	External Debt		Public Debt**	Foreign Official Reserves
						Total	Short term		
	percent	annual average	percent of GDP	percent	percent	percent of GDP		percent of GDP	months of goods and services imports
Bulgaria	6.0	12.0	-25.3	115.2	12.0	107.7	38.9	14.1	5.0
Czech Rep.	3.2	6.3	-3.1	130.3	18.3	38.9	12.5	29.8	3.0
Estonia	-3.6	10.6	-9.2	119.3	10.6	120.2	46.6	4.8	2.7
Hungary	0.5	6.0	-8.4	137.2	14.9	113.3	17.5	73.0	3.4
Latvia	-4.6	15.3	-12.7	73.0	11.1	…	…	19.5	3.4
Lithuania	3.0	11.1	-11.6	111.1	5.9	71.4	24.1	15.6	2.3
Poland	5.0	4.2	-5.5	71.0	12.3	47.5	12.7	47.1	3.2
Romania	7.1	7.9	-12.3	62.6	-2.2	53.4	15.9	13.6	5.3

* (imports and exports of goods)/GDP :

** according to ESA95 methodology

Source: Eurostat, NBR, NIS, MPF