

"The Orderly Resolution of Financial Crises- A G20-Led Initiative"

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The Orderly Resolution of Financial Crises

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The 1997-2003 debate about reforming the international financial architecture produced little by way of new kinds of international support for the orderly resolution of debt crises beyond voluntary codes of conduct for investors, and financial codes and standards for governments (many of which have been signed up with little real change in behaviour). After Argentina's dramatic default and its aftermath in 2003, countries have simply been muddling through however they can. It is likely that over the next few years we will see several more serious financial crises which will renew attention to the international architecture and efforts to ensure a more orderly working out of financial crises.

This note examines in what ways a G20 meeting would add value to global policy on the issue of resolving debt crises, and at what level of G20 (Finance Ministers or Leaders level) this would be most likely.

Different priorities?

The membership of the G20, if structured so as not to marginalize the non-G7 members, would automatically put different priorities on the table and therefore influence the agenda, and equally importantly, the priority accorded to specific issues within the agenda. Within the G7 structure, it is obvious that managing financial crises is an issue for Finance Ministers. This is not the case for emerging countries whose crises put in jeopardy every aspect of the social and political status quo, sometimes including the position of the head of state. For this reason, in a G20 in which all members had a significant voice, there would be a strong rationale for meeting on this issue at leaders' level.

Within the agenda, one can imagine emerging economy leaders emphasizing different aspects of resolving crises. For example:

Burden-sharing in the resolution of crises: Although G7 Finance Ministers have always paid lip-service to the need for symmetric burden-sharing, a G20 Leaders' meeting might be more prepared to examine precisely how the burden is being distributed between debtor and investors and within the debtor country among different social and sectoral groups. A more detailed and effective policy could then be constructed based on a more concrete definition of what the appropriate sharing of burden should be.

The role of international institutions: The governance structure of the IMF, BIS and FSF leaves little room for genuine contributions, leadership or strategic input from emerging market economies. The G20 (at Finance Ministers level) could be a bridge in this. That said, there is also a strong case for a Leaders' level forum on this – highlighted by the debate over a statutory standstill mechanism in the Fund. What was lacking in that debate was a long-term public sector vision from emerging market economies about how to achieve a balance between external support, the Fund's limited resources, and its jurisdiction (or the strengthening thereof). Here perhaps, Finance Ministers have too sensitive a role to play in signaling to their own investors and markets. At the Leaders' level, one presumes, these responsibilities are counter-balanced by wider concerns.

The role of regional institutions: Too much of the debate has simply eschewed developing a role for regional institutions. In part this has been a question of turf (preserve institutions which we know, have experience of, and have influence within). However, serious discussion needs to take place about the experience of China and ASEAN+3 bilateral agreements as well as CAF and discussion of whether such arrangements could/should be deepened and developed in other regions. Agreement as to how desirable it is for regional institutions to act independently of IMF and other international organizations and what kinds of support might be given to them. The G20 (at whatever level) could bring different views to the table on this, with a much more varied stake in the status quo.

A different structure?

This note does not intend to lay out a structure for the preparation and hosting of G20 meetings. Clearly some careful thinking would be required about the sherpa process since more G20 activity would considerably stretch that process. A G20 Secretariat would pose some obvious

advantages and disadvantages. It would be ideal to achieve a sharing of resources with existing international and regional organizations in this regard.

What kinds of decisions would a G20 make on these issues?

Perhaps the most critical issue is whether the G20 is perceived as a legitimate forum to declare on any of the issues touched upon above. This is worth exploring by first considering what kinds of decisions a G20 might make.

From minimal to maximal proposals:

A minimal approach:

- Re-endorse voluntary standards approach and exhortations to crisis-ridden countries to improve their domestic banking and financial system institutions (nothing but words required).
- Strengthen regionally based initiatives (bilateral ASEAN+3 agreements, etc.) giving them support. This support could be political and/or financial or logistical (e.g. permit access to using staff/research/data of IMF, WB and BIS).
- Strengthen IMF statutory role: Agreement among members to legislate nationally so as to permit IMF Article 8 to be used to protect from litigation governments using standstills to ensure orderly workouts (against screams from private sector investors and emerging market short-term concerns: G7 governments would legislate in their own jurisdictions to obviate ambiguities arising from interpretations of Art 8 (4)b).

A maximal approach:

- Create new international arbitration procedure for government-managed debt workouts (would require agreement, and either a treaty creating this institution or an agreement that all investment instruments refer to it)

How legitimate would G20 actions be on these issues?

Let me pose some questions and answers to the question of legitimacy. *Would the G20 make decisions or announcements? Is it the right forum for a decision? And, what effect would an announcement by the G20 have?*

Why would this be different to what the G8 decides on the same issue?

A G20 Leaders' would include crisis-suffering countries as well as those undertaking new ways to insulate against these crises. The sharing not just of experience but of different priorities would be important and informative.

Why would this be different to IMFC discussion of same?

The G20 Leaders' is set to be an informal gathering, thus it would not be hampered by formalities such as set-piece speeches. Agreement within the G20 would require fewer (diluting) trade-offs because the number of governments and their needs are more restricted.

At what level should the G20 meet on this issue?

As already mentioned, obviously on this issue, Finance Ministers would push for it to be dealt with at Finance Ministers' level. However, there is a trade-off here. Leaders of crisis-ridden countries would prioritize the issue in a way that their counterparts in Canada and the United Kingdom would not. And in all countries a heads-of-government might be useful in unblocking a logjam. Finance Ministers have the technical knowledge and capacity; however, they must keep their eyes (and priorities) closely trained first and foremost on their own banking sector, foreign currency reserves and investors. This means that the broader trade-offs are by necessity a lesser priority in their calculations, e.g. broader social costs, political implications, and global governance issues and linkages to other global issues.

Does this point to a G20 meeting at different levels?

e.g. Finance Ministers on some issues, Leaders on others, and Leaders on the Finance Ministers terrain where a logjam occurs.

Does it point to a G20 of variable geometry (with different country composition on different issues?)

The benefits to a fixed membership would be the creation of a core membership with investment and status within the group, permitting a network to be established.

The costs of a shifting membership would be the risk that it will create a first and second class membership – with a core or “fuselage” of countries and “wings”. Where African countries have a seat, the rotation would mean that one country attends one meeting, and another country the next. The networking effect would be lost. These considerations focus us on what we are trying to harness in the G20. Is it a network which works because people come to know and trust one another? Or is it a problem-solving device which serves to focus international community on a broader set of issues of greater relevance to developing countries?