

Discussion on

*Crisis Lending, Moral Hazard and  
IMF Conditionality*

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# Goal of the Paper

- Proposes a simple framework to analyze
  - Role of the IMF as a provider of liquidity
  - Effects of ex-ante / ex-post conditionality
    - Conditioning of IMF lending to crisis prevention / reforms in crisis

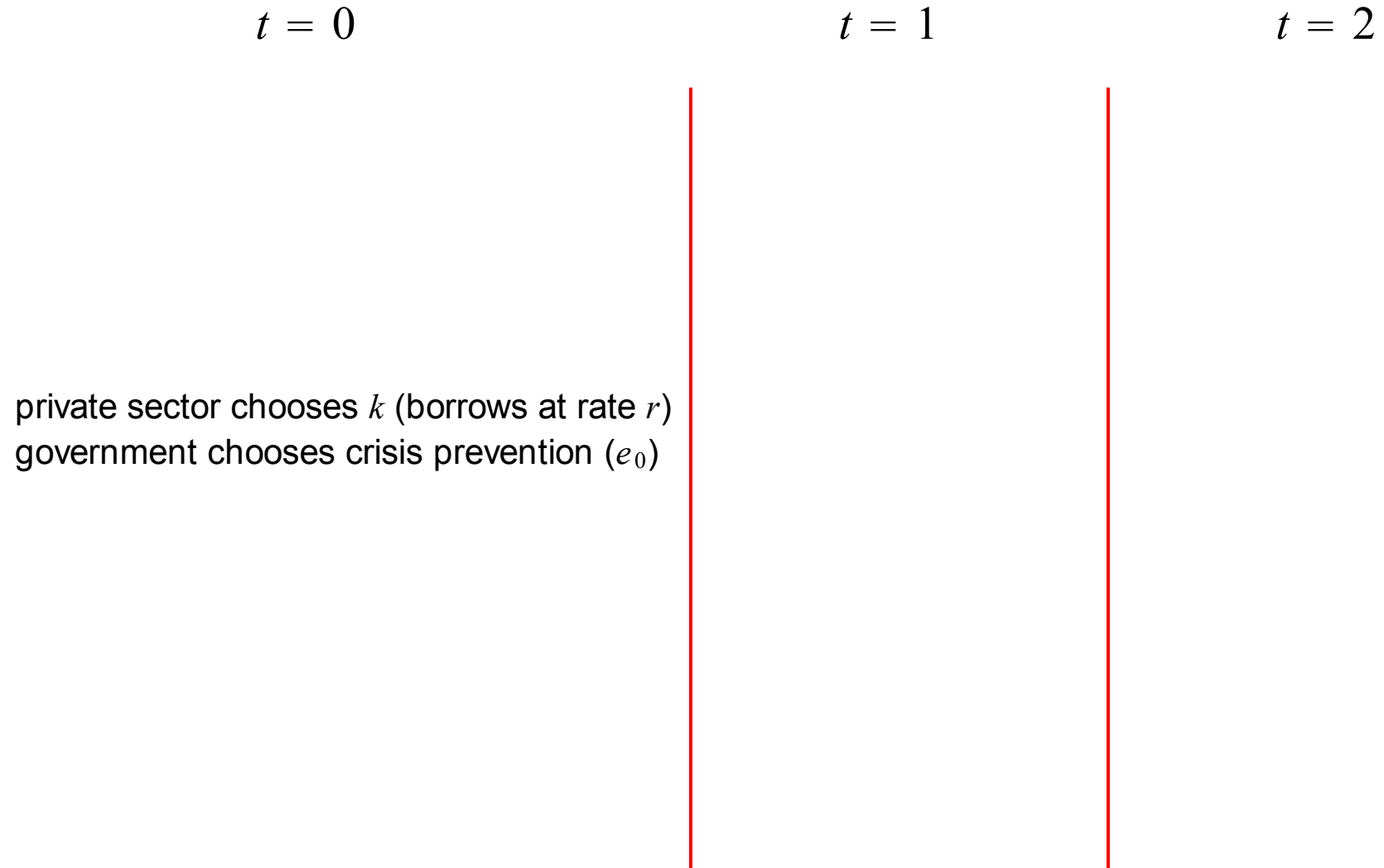
# Basic Model

$t = 0$

$t = 1$

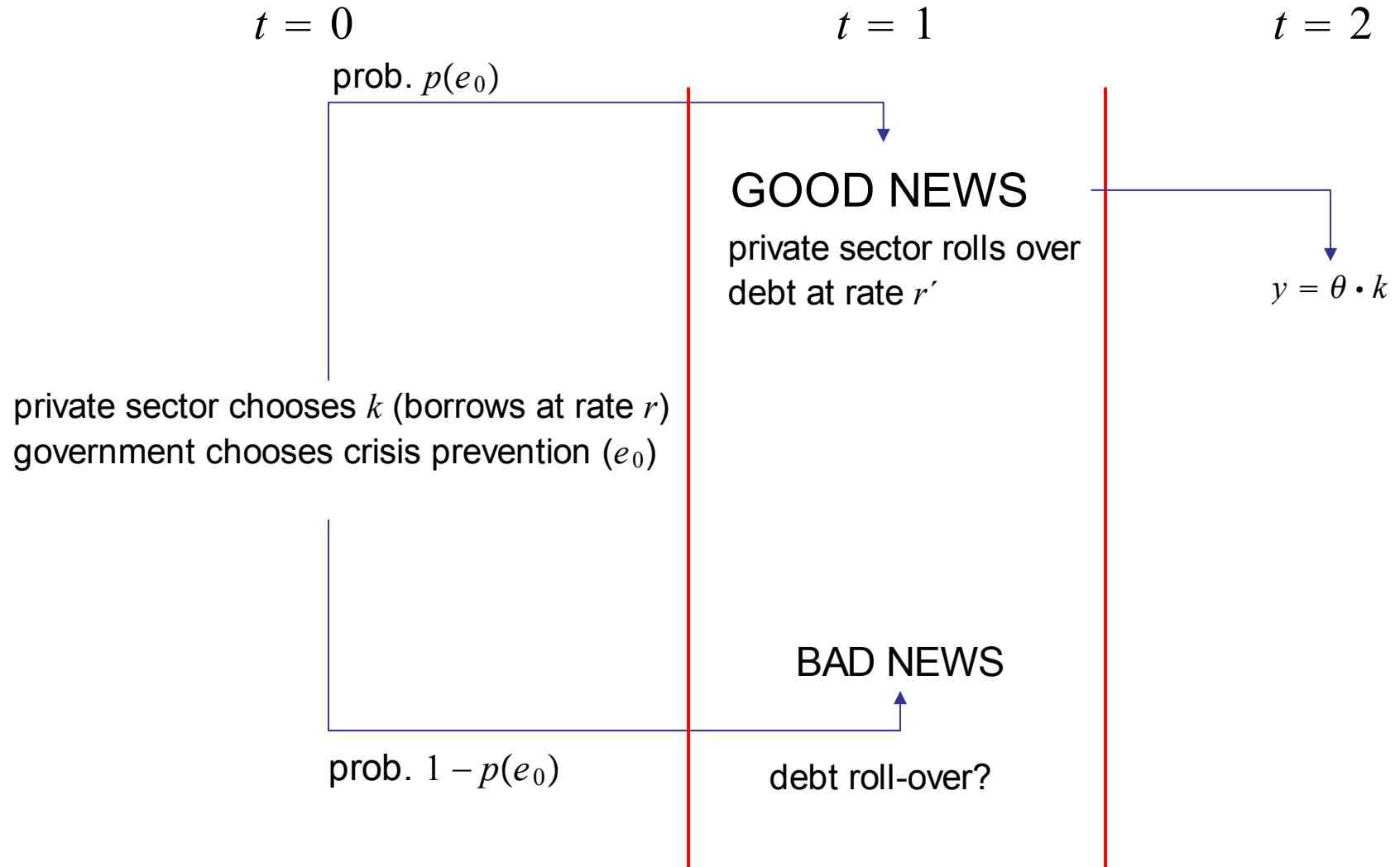
$t = 2$

private sector chooses  $k$  (borrows at rate  $r$ )  
government chooses crisis prevention ( $e_0$ )





# Basic Model








# Main Distortion

- Social Welfare

$$U = [(1 - p(e_0)) \cdot \theta \cdot k - k] - f(k) - g(e_0) \cdot k$$

- Government Welfare

$$V = \beta [(1 - p(e_0)) \cdot \theta \cdot k - k] - f(k) - g(e_0) \cdot k$$


$$\beta < 1$$

- government is “impatient”, suboptimally low effort

# Extended Environment

- Modify Basic Model
  - In bad state, government can avoid crisis by setting  $e_1=1$
  - **Key:** cost of  $e_1$  is  $h(e_0)$  / unit of capital
  - **A1:** Socially optimal to undertake the effort
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  - After roll-over, no incentives to reform

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- Time inconsistency problem: government cannot commit to undertake reforms
  - After roll-over, no incentives to reform
- What if the IMF can obtain reforms in exchange for roll-over?: ex-post conditionality
  - Government reforms “first”, then lending takes place

# Role of the IMF: ex-post conditionality

- Introduction of ex-post conditionality means:
  - Government moves “first” during the crisis
  - IMF rolls over only if  $e_1=1$

- Government at  $t=0$  maximizes:

$$V = \beta[(1 - p(e_0))\theta k + p(e_0)(\theta k - h(e_0)k) - k] - f(k) - g(e_0) \cdot k$$

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- Ex-post conditionality has ambiguous effects on  $e_0$  :
  - Increases  $e_0$  through impact on  $h(e_0)$
  - Decreases  $e_0$  through decrease in the cost of crisis (efficient)
- It may also reduce welfare (by reducing  $e_0$  ):
  - The government might choose to “postpone” reform even though it is socially optimal

# Role of the IMF: ex-ante conditionality

- Introduction of ex-ante conditionality means:
  - Government eligible for IMF help only if  $e_0$  is above some threshold
  - Threshold must be incentive compatible
- Ex-ante conditionality can always be used to:
  - Increases  $e_0$
  - Increase welfare

# The model

- Clean, simple model, but: results surprising?
- Ex-post conditionality:
  - Might generate decrease in crisis-prevention (no moral hazard)
  - Might decrease welfare with domestic distortions
- Ex-ante conditionality
  - Always can be used to increase welfare
- What defines the IMF?
  - In the model, ability to observe policies / commitment
  - Does it need to lend at all?

# Applied implications

- IMF commitment is crucial
  - How plausible is this?
  - Change of government, etc...
- On conditionality:
  - How do we quantify  $e_0$  and  $e_1$ ?
    - Argentina (possibly satisfied ex-ante / ex-post conditionality)
  - In multi-country world:
    - Heterogeneous distortions
    - Heterogeneous costs of policies/reforms
    - Different qualification standards for different countries?
    - Here, the model could be useful

## Conclude with a quote....

- “While the basic case for prequalification is straightforward, it is also clear that the devil is in the details: a flawed prequalification system, could obviously do more harm than good..”

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  - Sturzenegger and Zettelmeyer
- It would be interesting to see the details