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**Regional and Global Monetary
Cooperation**

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Abstract

The increasing occurrence of national, regional, and global financial crises, together with their rising costs and complexity, have increased calls for greater regional and global monetary cooperation. This is particularly necessary in light of volatile capital flow movements that can quickly transmit crisis developments in individual countries to other countries around the world. Global financial safety nets (GFSNs) are one important area for monetary cooperation. This paper reviews the current situation of regional and global monetary cooperation, focusing on financial safety nets, with a view toward developing recommendations for more effective cooperation, especially between the International Monetary Fund (IMF) and regional financial arrangements (RFAs).

A GFSN should have adequate resources to deal with multiple crises, should be capable of rapid and flexible response, and should not be encumbered by historical impediments such as the IMF stigma that would limit its acceptance by recipient countries. Oversight of a GFSN needs to be based on cooperation between global and regional forums, for example, the G20 and ASEAN+3 or East Asia Summit (EAS). Such a GFSN should include the IMF and RFAs at a minimum, and it is highly recommended to find ways to include central banks as providers of swap lines and multilateral banks as well. The basic principles governing the cooperation of IMF and RFAs include rigorous and even-handed surveillance; respect of independence and decision-making processes of each institution and regional specificities; ongoing collaboration as a way to build regional capacity for crisis prevention; open sharing of information and joint missions where necessary; specialization based on comparative advantage; consistency of lending conditions and conditionality, although with flexibility; respect of the IMF as preferred creditor; subsidiarity; avoidance of moral hazard; and transparency.

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Contents

1.	Introduction.....	3
2.	Reasons for and Principles of Regional and Global Monetary Cooperation	3
	2.1 Reasons for cooperation.....	3
	2.2 Key principles of regional and global cooperation	5
3.	Status of Cooperation of Regional and Global Institutions	6
	3.1 Global and regional institutions and their roles.....	7
	3.2 Financial safety nets' cooperation experience.....	12
4.	Cooperation Issues.....	16
	4.1 Pure coordination issues.....	16
	4.2 Surveillance coordination.....	17
	4.3 Coordination of financing activity	19
5.	Possible Changes in Cooperative Arrangements.....	20
	5.1 General principles.....	20
	5.2 Proposals for surveillance.....	21
	5.3 Coordination proposals for financial safety nets.....	22
6.	Conclusions and Policy Implications	23
	References	25

1. INTRODUCTION

The increasing occurrence of national, regional, and global financial crises, together with their rising costs and complexity, have increased calls for greater regional and global monetary cooperation. This is particularly necessary in light of volatile capital flow movements, which can quickly transmit crisis developments in individual countries to other countries around the world. Global financial safety nets (GFSNs) are one important area for monetary cooperation. The Group of Twenty (G20) Cannes summit final declaration noted that:

As a contribution to a more structured approach, we agreed to further strengthen global financial safety nets in which national governments, central banks, regional financial arrangements and international financial institutions will each play a role according to and within their respective mandate...We agreed on common principles for cooperation between the IMF and Regional Financial Arrangements, which will strengthen crisis prevention and resolution efforts. (G20 Secretariat 2011a: 3)

Other potential areas for cooperation include “international harmonization of supervision and regulation as well as crisis prevention, management, and resolution” (Kawai 2009a: 6). In particular, the disruptive effects of volatile international capital flows call for a coordinated approach to global supervision and management of such risks.

This paper reviews the current situation of regional and global monetary cooperation, focusing on financial safety nets, with a view toward developing recommendations for more effective cooperation, especially between the International Monetary Fund (IMF) and regional financial arrangements (RFAs). Section 2 describes the reasons for international monetary cooperation and the basic principles that should guide it. Section 3 describes the background and recent experience of international monetary cooperation. Section 4 describes major cooperation issues. Section 5 provides some suggestions for alternative arrangements for cooperation, and section 6 concludes.

2. REASONS FOR AND PRINCIPLES OF REGIONAL AND GLOBAL MONETARY COOPERATION

2.1 Reasons for cooperation

Major reasons for regional and global monetary cooperation include scale, the need to avoid forum shopping and duplication, gains from specialization, and legacy issues, especially the so-called “legitimacy deficit” or “stigma” of the IMF.

Scale: With the rise in the frequency and severity of financial crises, the expansion in the size and number of regional financial arrangements, and the increase over the last decade in the level of international reserves that can be placed at the disposal of bilateral and regional facilities, the necessity and complexity of coordinating these facilities with the IMF has increased dramatically. ADB and IIE (2011) argue that it is unrealistic to expect a single institution to manage such developments at the global level. Particularly in the case of regional contagion, demands for funds can increase rapidly. The case of southern Europe and Ireland is the most recent and largest example of this. As will be described in more detail below, very few national governments have been content to rely solely on the IMF for balance of payments and other official financing. Many large countries have engaged or contributed to bilateral, regional, and

plurilateral financial facilities as well, including members with substantial influence in the IMF, such as the United States (US), United Kingdom (UK), France, Germany, and Japan.

The scale of most regional facilities is still relatively small. The Chiang Mai Initiative Multilateralization (CMIM)—the world's second largest regional facility after the European Financial Stability Facility (EFSF)—totals \$120 billion¹. However, the borrowing limits for individual ASEAN members of the CMIM (those most likely to make use of the facility) are only about \$12.5 billion at most, and only 20% of that is accessible without an IMF program. Other regional facilities, such as the Arab Monetary Fund (AMF) and the Latin American Reserve Fund (FLAR) are much smaller, both less than \$3 billion total.

The possible provision of currency swap lines by central banks of reserve currency countries potentially changes the equation for lending, because of the ability of such banks to print unlimited amounts of their currencies. Theoretically, the CMIM, for example, could borrow any amount from the Bank of Japan, and therefore would not need to cooperate with the IMF. However, as will be explained below, there are many practical obstacles and limitations to this possibility. Moreover, this would not obviate the need for cooperation in surveillance activity.

Reduce forum shopping: The existence of multiple sources of funding makes it possible for borrowing countries to “shop” for the easiest borrowing conditions leading to institutional arbitrage, thereby undermining the effectiveness of surveillance. However, as discussed in more detail below, there will be a strong incentive to offer consistent conditionality among cooperating safety nets, given the need for cooperation in the face of large borrowing requirements.

Reduce duplication or cancelling out: Existence of multiple facilities can lead to wasteful duplication. Even worse, on the other hand they could lead to cancelling out of facilities, where the opening of one credit line leads to another being closed. These potential problems underscore the need for cooperation between regional and global safety nets.

Mutual gains from division of labor and specialization along lines of comparative advantage: Global and regional institutions may bring different strengths and weaknesses, offering room for specialization to comparative advantage. The IMF clearly dominates in terms of the amount of resources available for both surveillance and financial assistance, but may lack local knowledge and/or legitimacy. The case of the IMF stigma in Asia (and Latin America) is a major example of where countries would be extremely reluctant to rely on IMF funding and programs if this was not made palatable by coordination with a regional facility. On the other hand, the regional entity may lack sufficient resources, both in terms of staff and reserves, particularly if more than one country in the region is hit as a result of contagion (Glick and Rose 1998, Eichengreen 2006, Park and Wyplosz 2008). Some scholars, for example, Takagi (2010), argue that regional groupings have greater ability to apply peer pressure to members, but others are skeptical.

Need for general improvement of international financial architecture: There is a widespread view that the current international monetary system, centered on the IMF and the Financial Stability Board (FSB), failed in its basic mission in the run-up to the global financial crisis. Camdessus et al. (2011) notes that the IMF, as the central institution of the system, has suffered from a “legitimacy deficit”, reflecting both the underrepresentation of some emerging market and developing countries, and the failure of the IMF's peer review process to have much influence over the policies of its largest members. Fernández-Arias and Levy-Yeyati (2010) argue that the IMF's lending facilities were not sufficiently effective during the global financial

¹ In this paper, \$ refers to US dollars.

crisis. Goldstein (2010) argues that IMF surveillance of the People's Republic of China's (the PRC) currency policy was ineffectual. Cho (2011) and Park and Wyplosz (2008) assert that the IMF, as a key institution of the international monetary system (IMS), has not played an effective role in the surveillance or management of the global economy and financial market. Kawai (2009a: 5) concludes:

[T]hey failed to detect the buildup of systemic risk in the US, the UK, and the eurozone, send clear warnings to policymakers, and provide policy advice on measures to reduce the risk. These organizations clearly underestimated the looming risk in the shadow banking system, interconnections across financial firms, markets, and countries and global macroeconomic–financial links.

Schinasi and Truman (2010) argue that the global financial architecture was not effective in encouraging or persuading remedial actions at the national, regional, continental, or global level until a full-scale global systemic crisis was a reality to be dealt with. They are similarly critical of the role of the Financial Stability Forum (FSF, the predecessor of the FSB) in the period prior to the global crisis, although it must be said that FSF staff were some of the most vocal in terms of warning about the buildup of systemic risks prior to the crisis.

2.2 Key principles of regional and global cooperation

Recognizing the need for increased cooperation between the IMF and RFAs, the G20 member countries have agreed on the following six principles for cooperation:

1. An enhanced cooperation between RFAs and the IMF would be a step forward towards better crisis prevention, more effective crisis resolution and would reduce moral hazard. Cooperation between RFAs and the IMF should foster rigorous and even-handed surveillance and promote the common goals of regional and global financial and monetary stability.
2. Cooperation should respect the roles, independence and decision-making processes of each institution, taking into account regional specificities in a flexible manner.
3. While cooperation between RFAs and the IMF may be triggered by a crisis, ongoing collaboration should be promoted as a way to build regional capacity for crisis prevention.
4. Cooperation should commence as early as possible and include open sharing of information and joint missions where necessary. It is clear that each institution has comparative advantages and would benefit from the expertise of the other. Specifically, RFAs have better understanding of regional circumstances and the IMF has a greater global surveillance capacity.
5. Consistency of lending conditions should be sought to the extent possible, in order to prevent arbitrage and facility shopping, in particular as concerns policy conditions and facility pricing. However, some flexibility would be needed as regards adjustments to conditionality, if necessary, and on the timing of the reviews. In addition, definitive decisions about financial assistance within a joint programme should be taken by the respective institutions participating in the programme.
6. RFAs must respect the preferred creditor status of the IMF. (G20 Secretariat 2011b)

Principle 3 is important because it highlights the need for greater pre-crisis planning and institutionalization of cooperation. Such cooperation and coordination should start as early as possible. The emphasis on the role of the IMF in regional capacity building is also positive. Principle 4 highlights the needs for information sharing and specialization according to comparative advantage, which will be discussed further in Section 5 below. Principle 5

regarding consistency of lending conditionality to reduce forum shopping is crucially important. As discussed in Section 5 below, we believe that Principles 4 and 5 will impose significant limits on the ability of RFAs to be truly independent from the IMF. Principle 6 means that the IMF gets priority in terms of loan repayment relative to sovereign lenders.

Some additional principles that we believe should be included are subsidiarity, avoidance of moral hazard, and transparency. The principle of subsidiarity suggests that government activities should be devolved to the lowest level that is capable of handling them. This is on the grounds that the lower-level entity has greater local knowledge and fewer potential conflicts of interest. Subsidiarity is one of the general principles of the European Union Law. Using the approach of club theory, Kawai, Petri, and Sisli-Ciamarra (2009) argue for a “decentralized” approach to coordination of global and regional institutions, where activity is shifted from the global to the sub-global level where feasible. Regarding the IMF, such decentralization could include institutionalization of the involvement of regional and national co-lenders, strengthening those regional institutions, and expanding cooperation in surveillance.

Moral hazard arises when the existence of insurance may lead a country to take riskier policies than it would otherwise, since it is assured of being bailed out of difficulties. The main way to avoid moral hazard is through surveillance and conditionality (Eichengreen 2006). This strongly suggests the need to coordinate surveillance standards and loan conditionality to minimize moral hazard in the presence of multiple insurance institutions. However, countries may resist conditionality if other options are available, such as swap agreements. Perhaps two cases need to be distinguished: (i) a country experiences a liquidity squeeze because of inappropriate policies that require a structural adjustment program; and (ii) a country experiences a liquidity squeeze as an “innocent bystander”, as a result of, for example, stresses elsewhere that result in large-scale capital outflows from that country. Conditionality would be appropriate in the first case but not in the second.

The basis for surveillance is gradually becoming more transparent, partly as a result of pressure from the G20 countries for a more consistent approach. Other areas that require further improvements in transparency include prequalification for lending and coordination activities. Finally, it should be noted that the principles quoted above only refer to cooperation between the IMF and RFAs, and do not refer to other possible cooperating entities, that is, central banks and multilateral banks. As will be seen, a broad-based and effective GSFN requires their participation as well.

3. STATUS OF COOPERATION OF REGIONAL AND GLOBAL INSTITUTIONS

This section describes the current major global and regional institutions concerned with the international monetary system, as well as some of the major recent cooperation episodes. Global and regional entities involved in surveillance and stabilization lending are summarized in Table 1. The table shows that most but not all entities conduct both surveillance and lending activities.

Table 1: Global and Regional Entities Involved in International Monetary Cooperation

Institution	Surveillance	Lending
Global		
International Monetary Fund	X	X
Bank for International Settlements-FSB	X	
Regional		
EU Commission	X	X
EU Balance of Payments Facility		X
European Financial Stability Mechanism (EFSM)		X
European Financial Stability Facility (EFSF)		X
Chiang Mai Initiative Multilateralization	X	X
ASEAN+3 ERPD	X	
Asian Development Bank	X	X
Arab Monetary Fund		X
Latin American Reserve Fund	X	X
North American Framework Agreement	X	X

ASEAN=Association of Southeast Asian Nations; ASEAN+3=ASEAN members plus the People's Republic of China, Japan, and Korea; ERPD=Economic Review and Policy Dialogue; EU=European Union; FSB=Financial Stability Board.

Source: Authors' compilation.

3.1 Global and regional institutions and their roles

Global level: The IMF has had prime responsibility for both surveillance and lending activity within the international monetary system. Its role in these activities has been increasingly formalized over time, as a result of crisis experiences and pressures from international bodies. The IMF is still unique among crisis-fighting facilities in the universality and diversity of its membership, and remains the final resort in efforts to combat national and regionwide systemic financial crises. Whereas an RFA can turn to the IMF if the former's operation alone is considered inadequate, there is no similar fallback among international financial facilities (ADB and IIE 2011).

The IMF's surveillance activity is massive. In terms of human resources alone, the IMF is estimated to have devoted over 1,100 staff years to surveillance activities in fiscal year (FY) 2005, which is the last year for which such numbers are publicly available. Given the additional expenditures associated with surveillance, the total financial cost of IMF surveillance activities is likely to total hundreds of millions of US dollars per year (Takagi 2010).

The IMF's main surveillance mechanism is the bilateral consultation process it conducts with members, usually once a year, under Article IV of the IMF's Articles of Agreement. There are two other surveillance mechanisms. One is through multilateral discussions held in the context of twice-yearly World Economic Outlook reviews by the IMF Executive Board. The other is through IMF lending programs to support adjustment in member countries, although this is usually referred to as conditionality. An important aspect of IMF surveillance pursued in collaboration with the World Bank is the Financial Sector Assessment Program (FSAP). This program aims to increase the effectiveness of efforts to promote the soundness of financial systems in member countries.

On the lending side, the IMF's lending capacity was tripled to \$750 billion as a result of a G20 agreement in April 2009, plus a general allocation of Special Drawing Rights (SDRs) totaling \$250 billion, and the introduction of two new lending facilities—the Flexible Credit Line (FCL) and the Precautionary Credit Line (PCL) that provide member countries access to financing

(with some conditionality in the case of the PCL) for crisis prevention, rather than crisis resolution (ADB and IIE 2011)².

Nevertheless, the resources available to the IMF are still far smaller than current global capital flows, and are a small fraction of total foreign reserves held by emerging market economies.

The Bank for International Settlements (BIS) is also involved in international monetary cooperation and surveillance by virtue of its role in assisting central banks and other financial authorities in their efforts to promote greater monetary and financial stability; and acting as a bank, almost exclusively for central banks. In particular, it provides a forum to promote discussion and facilitate decision making among central banks and within the international financial and supervisory community. The meetings of governors and senior officials of member central banks that are held every two months represent the primary instrument through which the BIS seeks to promote international financial cooperation (Lamberte 2005). Various committees tied to the BIS also perform important roles in monetary cooperation. The Committee on the Global Financial System is a central bank forum with a mandate to identify and assess potential sources of stress in global financial markets, to further the understanding of the functioning and underpinnings of financial markets, and to promote the development of well functioning and stable financial markets. The FSB, whose secretariat is based at the BIS, promotes international financial stability through enhanced information exchange and cooperation in financial supervision and surveillance. Unlike the IMF, the BIS does not provide loan support to countries.

Since 2007, the G20 has assumed the primary role of coordinating global economic and financial policies, including providing guidance to the IMF and the FSB. The members of the G20 account for about 85% of world GDP (in purchasing power parity terms) and about 65% of the world's population. They also hold 65.8% of the quotas and 64.7% of the votes of the IMF. Moreover, almost all of them participate in a bilateral or regional financial arrangements. One member, the European Union, is itself a regional organization that operates several financial arrangements which are described below.

Since the G20 membership includes major emerging economies that at times have been the recipients of IMF programs and policies, or at least been recipients of IMF criticism, the G20 has been instrumental in pushing for broad-based reforms of the IMF, including its governance, voting shares, surveillance activity, and lending activity. As noted above, the Seoul Summit gave the G20 a broader mandate to strengthen GFSNs. Work on the GFSNs is currently being steered in the G20 by a Financial Safety Nets Experts Group, co-chaired by Korea and the UK (ADB and IIE 2011).

The G20 finance ministers and central bank governors agreed to strengthen the international monetary system by focusing their work in the short term on assessing developments in global liquidity, developing an improved toolkit to strengthen the GFSNs, enhancing cooperation between the IMF and regional financial arrangements, and strengthening the effectiveness and coherence of bilateral and multilateral IMF surveillance, among others (ADB and IIE 2011).

One major product of G20 activity has been the development of the Mutual Assessment Process (MAP) that is aimed at both identifying areas of international systemic risk and putting pressure on members to take corrective actions to reduce those risk factors.³ All G20 member countries are subject to this assessment process. This mutual assessment of macroeconomic policies represents the first instance of multilateral surveillance on a global scale in recent history (Cho 2011: 10). This is a response to the perception that the IMF was not even-handed

² More recent developments in IMF lending programs are discussed below in section 3.2.

³ See IMF 2011 for a detailed description.

in its approach to analyzing risks in the major advanced economies as compared with emerging economies. The IMF provides technical assistance to the MAP, but this is separate from the IMF's own bilateral and multi-lateral surveillance processes.

The MAP has been further strengthened through improvements in the IMF's surveillance activities. Shortly after the onset of the global financial crisis, the G20 tasked the IMF and the Financial Stability Board (FSB) to collaborate on regular early warning exercises (EWEs). EWEs have since become firmly established, and now provide timely information on high impact risks to the global economy (ADB and IIE 2011). In surveillance, the biggest challenge lies in strengthening the MAP as a framework of global policy dialogue and cooperation to deal with policy spillovers. The G20 needs to support the establishment of a stronger peer review process that will "discipline" countries and make them internalize policy spillovers (ADB and IIE 2011).

As described in section 3.2, the World Bank has also played a role in international bailout programs, although this has been much more limited than that of the IMF, as it is not part of the World Bank's major mission.

Regional level: Table 2 summarizes the features of the major regional financial arrangements, including their contributing members, stated purpose, size of reserves, and relationship with the IMF.

Table 2: Relation between Selected Regional Financial Arrangements and the IMF

Name of fund	Contributing member:	Purpose	Size	Relationship to the IMF
EU Balance of Payments Facility	All EU members	Medium-term financial assistance for non-euro members of the European Union	€50 bn	Not formally linked to IMF programs, but organized jointly in recent cases; members obliged to consult EU before approaching IMF
European Financial Stabilization Mechanism (EFSM)	All EU members	To address severe disturbances beyond members' control; available to all EU members	€60 bn	Not legally linked to IMF programs, but linked as a matter of Council policy
European Financial Stability Facility (EFSF)*	All members of the euro area	Preserve financial stability of monetary union via temporary financial assistance to euro area members (only) with exceptional problems beyond their control	€440 bn	Not legally linked to IMF programs, but linked as a matter of Council policy and members' domestic politics
Chiang Mai Initiative Multilateralization (CMIM)	Ten member states of ASEAN plus PRC, Japan, Korea, and Hong Kong, China	Address balance of payments and short-term liquidity difficulties; supplement existing international financial arrangements	\$120 bn	Beyond 20 percent of a country's allotment, disbursements must be linked to an IMF program; not yet activated
Arab Monetary Fund	Twenty-two Arab countries in North Africa and the Middle East	Broad, including correcting payments disequilibria and currency instability, through short- and medium-term credit facilities	\$2.7 bn	Ordinary loans are usually accompanied by an IMF program; other types of assistance are not necessarily linked
Latin American Reserve Fund	Bolivia, Colombia, Ecuador, Costa Rica, Peru, Uruguay, and Venezuela	Support members' balance of payments with credits and guarantees	\$2.34 bn	No role for the IMF
North American Framework Agreement	United States, Canada and Mexico	Provide short-term liquidity support through 90-day central bank swaps, renewable up to one year	\$9 bn	US Treasury requires letter from IMF managing director

*The EFSF will be superseded by the establishment of a permanent European Stability Mechanism (ESM) with a lending capacity of €500 billion in July 2012, although both will coexist for some time as existing EFSF programs are wound down (European Commission 2012).

bn=billion; EU=European Union; IMF=International Monetary Fund; PRC=People's Republic of China; US=United States.

Source: Henning (2011).

European institutions, including the EU Balance of Payments Facility (EUBPF), the European Financial Stabilization Mechanism (EFSM), and the European Financial Stability Facility (EFSF) collectively have by far the biggest resources among RFAs. The EUBPF was created in 1988, and the EFSM and the EFSF are much more recent, having been created in 2010 in response to the sovereign debt crises in a number of European countries. The former two can be accessed by any EU member, while the last is available only to euro area members. None of these programs are legally linked to IMF programs, but all EU programs have conditionality and are linked to IMF programs as a matter of policy. In the case of the EUBPF, members are obliged to consult with the EUBPF first before approaching the IMF.

After the European institutions, the second largest regional entity is the Chiang Mai Initiative Multilateralization (CMIM), which includes the 10 member countries of the Association of Southeast Asian Nations (ASEAN)⁴ and the People's Republic of China (the PRC), Japan, and the Republic of Korea (hereafter Korea), known collectively as ASEAN+3. It was originally formed as a set of bilateral swap agreements in 2001 in the aftermath of the Asian financial crisis, and then was expanded to a multilateral pooling arrangement in 2009. Unlike the European regional arrangements, it has a formal link with the IMF, as members must have an IMF program in order to borrow beyond 20% of their borrowing limit. In 2011, the ASEAN+3 Macroeconomic Research Office (AMRO) was established in Singapore as a formal surveillance unit for the CMIM. However, its scale is small, with only 12 professional staff in early 2012, and expected to increase to 20 by the end of 2012.

Several other bodies in Asia also have surveillance responsibilities, including the Economic Review and Policy Dialogue (ERPD) under ASEAN+3, the ASEAN Integration Monitoring Office (AIMO) within the ASEAN Secretariat, and the Asian Development Bank (ADB). ADB's Office of Regional Integration has 21 staff working to support ERPD-related activities. It remains to be seen how the AMRO will interact with these other bodies. Currently the AIMO has a professional staff of four, and total required staffing of 10 economists depending on budget availability. AIMO's mandate is to monitor regional economic integration while AMRO is doing IMF-style macroeconomic surveillance.

The Arab Monetary Fund (AMF), founded in 1976, includes 22 member countries in North Africa and the Middle East. It has a broad mandate including not only assistance in balance of payments adjustment but also wider monetary cooperation and paving the way for a unified Arab currency (AMF 2011). Total funding is \$2.7 billion. Ordinary loans are usually accompanied by an IMF program, and it does not appear to have its own macroeconomic surveillance activity.

The Latin American Reserve Fund (FLAR) is a common reserve fund that seeks the stability of member countries by improving their external position and strengthening regional support. The FLAR was established in 1978. Member countries include Bolivia, Colombia, Costa Rica, Ecuador, Peru, Uruguay, and Venezuela. The objectives of the FLAR are:

- Support the balance of payments of member countries by granting loans or guaranteeing third-party loans.
- Improve the conditions of international reserve investments made by member countries.
- Contribute to the harmonization of exchange rate, monetary, and financial policies of member countries (FLAR 2011).

⁴ Brunei Darussalam, Cambodia, Indonesia, Lao People's Democratic Republic, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Viet Nam. The CMIM also includes Hong Kong, China.

Total funding of the FLAR is about \$2.34 billion. There is no role for the IMF, and the FLAR does have its own regular surveillance activity of member countries.

The North American Framework Agreement (NAFA) comprising the United States (US), Canada, and Mexico was established in 1994. Total funding is US\$9 billion, and the US Treasury requires a letter from the IMF managing director to activate cooperation with the IMF.

The most salient difference between the European institutions, the CMIM, and the NAFA versus the AMF and the FLAR is that the former RFAs include large reserve-currency economies as members, while the latter do not. Therefore, in theory at least, the members of the former groups could obtain unlimited amounts of reserve currencies via swap agreements from member reserve-currency central bank or banks, while the latter cannot. This highlights two important points: (i) the need to include the role of reserve-currency banks in the discussion of regional and global monetary cooperation; and (ii) the need to understand the relative strengths and weaknesses of all three categories of participants in international monetary cooperation.

3.2 Financial safety nets' cooperation experience

This section describes the recent experience of regional and global cooperation for financial safety nets and summarizes some major lessons from this experience. In some cases, the absence of cooperation provides significant information as well. Table 3 summarizes the major episodes of joint programs by global institutions (mainly the IMF) and regional financial facilities since 1997. Strikingly, among major episodes, only the experiences of Europe included the participation of one of the RFAs.⁵ As a result of the global financial crisis of 2007–2009 and the ongoing sovereign debt crisis in Europe, there have been programs for Greece, Hungary, Ireland, Latvia, Portugal, and Romania.⁶ Notably, the program for Ireland included contributions from a number of individual European governments as well, while those for Greece and Hungary also included contributions from the World Bank. For Greece, the European Central Bank (ECB) provided technical support rather than direct contributions, although it has also been active in buying Greek government bonds in the secondary market.

⁵ The AMF has also cooperated with the IMF, as will be discussed below, but the amounts have been small in comparison.

⁶ The programs for Hungary, Latvia, and Romania were under the Balance of Payments Adjustment Program.

Table 3: Joint Programs of Global and Regional Institutions, 1997–2011

Country	Global Institution	Regional Facility	Other	Total
Portugal 2011	IMF: €26 bn	EFSM: €26 bn EFSF: €26 bn		€78 bn
Ireland 2010	IMF: €22.5 bn	EFSM: €22.5 bn EFSF: €22.5 bn	National contribution: Ireland Treasury, Pension: €17.5 bn	€85 bn
Greece 2010	IMF: €30 bn	EU: €80 bn	ECB: provides technical support	€110 bn
Romania 2009	IMF: €13 bn Others: €2 bn	EC: €5 bn		€20 bn
Latvia 2008	IMF: €1.68 bn World Bank: €0.4 bn	EU: €3.1 bn	Other central banks: €1.9 bn Others: €0.4 bn	€7.5 bn
Hungary 2008	IMF: €12.5 bn World Bank: €1.0 bn	EC: €6.5 bn		€20 bn
Brazil 1998	IMF: \$18.1bn World Bank: \$4.5 bn	IDB: \$4.5 bn	Bilateral guarantees of BIS credits: \$41.5 bn \$14.5 bn	
Indonesia	IMF: \$15 bn World Bank: \$5.5 bn	ADB: \$4.5 bn	Japan: \$5.0 bn Others: \$19 bn	\$49 bn
Korea 1997	IMF: \$21 bn World Bank: \$10 bn	ADB: \$4.015 bn	Japan: \$10 bn	\$55 bn
Thailand 1997	IMF: \$3.9 bn World Bank: \$1.5 bn	ADB: \$1.2 bn	Bilateral loans: Japan, \$4 bn; Others: \$1 bn–500 mn each	\$17.2 bn

ADB=Asian Development Bank; BIS=Bank for International Settlements; bn=billion; ECB=European Central Bank; EFSF=European Financial Stability Facility; EFSM= European Financial Stabilization Mechanism; EU=European Union; IDB=Inter-American Development Bank; IMF=International Monetary Fund; mn=million; US=United States.

Source: Adapted from EC (2011), Henning (2011), IMF (2000), Radelet and Sachs (1998).

The Latvian program is particularly interesting because it is a case where the IMF disagreed with the regional partner about the program, the European Union, yet the conflict was successfully resolved (Henning 2011). The IMF had originally proposed currency devaluation as part of the program, but the European Union resisted this, since Latvia was a candidate for euro membership. The IMF eventually agreed to a more stringent program that was not accompanied by currency devaluation.

None of the other four cases in Table 3—Brazil, Indonesia, Korea, and Thailand—involved any of the regional facilities described in the previous section. The reasons are simple—the CMIM did not exist at that time, and Brazil is not a member of the FLAR. Instead, in all four cases there was significant participation by the relevant multilateral bank—the Asian Development Bank or the Inter-American Development Bank. This highlights another important point—multilateral banks also need to be included in the discussion of regional and global monetary cooperation.

The experiences of Europe provide two broad lessons. “First, the region with the best-developed regional institutions, including a common currency and elaborate regional surveillance mechanism, was not sufficiently equipped to deal with a major financial emergency among one of its member governments.” (Henning 2011: 6)

The ad hoc nature of cooperation between the IMF and the European Union has been risky on a number of fronts. For example, the crisis highlighted the fact that there is no institutional mechanism for the IMF to commit itself in advance to a hypothetical contingency, much less one of such an unprecedented magnitude (Henning 2011). Also, the IMF had no formal mechanism for negotiating directly with the European Commission. Historically, the process of IMF–EU

interaction has been complicated. The executive director of the country holding the chair of the Eurogroup (euro area member countries) represents the euro area countries at the IMF, while the Economic and Financial Committee's Sub-Committee on the International Monetary Fund (SCIMF) is responsible for coordinating EU policy on IMF business from Brussels. The SCIMF alone includes over 60 officials and operates on the basis of consensus. The informal "EURIMF" body facilitates exchanges of views in Washington, DC between IMF executive directors and alternate directors from EU member states, the ECB's observer to the IMF, and an official from the EU Delegation to the US. (Hodson 2011).

The system worked relatively smoothly when the rescue package for Romania was arranged in October 2008 between the EU, the IMF, and the World Bank. Moreover, the EU was able to retain a say over the conditions attached to the overall package and the assessments of its implementation (Hodson 2011). The EU also moved quickly during the financial crisis to coordinate international efforts to support Latvia and Romania. However, unlike the cases of Hungary, Latvia, and Romania, the political processes of the European Union led to significant indecision and hesitation regarding policies on euro area states such as Greece. In particular, there was (and is) much local political resistance to large bailouts and international fiscal transfers, as well as to a full lender-of-last-resort role for the European Central Bank. For example, it took three months of haggling between member countries before the terms of a rescue package for Greece were finally agreed on, and these difficulties continued in negotiating later packages as well. This suggests that the basic problem of political coordination among the EU members is a bigger issue than the specific mode of coordination with the IMF. This has important implications for other RFAs such as the CMIM.

Second, despite the above points, the IMF–EU relation has been relatively close, and may not be easily transferrable to other regional institutions (Henning 2011, ADB and IIE 2011). This reflects, among others, the strong European orientation of the leadership and staff of the IMF and the lack of a historical IMF stigma problem in Europe. There is a broad perception, certainly among Asian countries, that IMF programs for European economies were significantly less stringent and more narrowly focused than those imposed on Asian economies during the Asian financial crisis of 1997–1998.

There have been numerous instances of joint lending by the IMF and the AMF to AMF member countries. As mentioned above, AMF ordinary loans are usually accompanied by IMF programs. It would be interesting to identify the reasons for this difference in cooperation behavior. It may have reflected the lack of the AMF resources to conduct its own surveillance activity. This pattern strongly suggests that, for whatever reason, the IMF stigma has not been an important factor in this region. Perhaps closeness to Europe is the most obvious reason.

In contrast, the most obvious feature about Asia during the global financial crisis was the lack of involvement of either the IMF or the CMIM. Two countries experienced significant difficulties arising from shortages of foreign exchange—Korea and Indonesia. However, both ended up resorting instead to bilateral swap agreements with central banks or other arrangements. Korea obtained a \$30 billion swap agreement with the US Federal Reserve (Fed), while Indonesia secured a \$5.5 billion "standby loan facility"—or "deferred drawdown options"—from Japan (\$1 billion), Australia (\$1 billion), ADB (\$1.5 billion), and the World Bank (\$2 billion) in 2009 (Kawai 2009b).⁷ The key reason appears to be the IMF stigma and the continuing linkage of the CMIM with an IMF program. The IMF stigma remains so strong in Asia (and Latin America) that it is considered politically unacceptable to go the IMF unless all other options have been exhausted.

⁷ Singapore also obtained a \$30 billion swap agreement with the Fed, but never drew on it.

There appears to have been no instance of joint lending by the IMF and the FLAR. In years when member countries had IMF programs, they did not borrow from the FLAR, and vice versa. Thus, loans from the IMF and the FLAR appear historically to have been substitutes rather than complementary, an unsatisfactory situation that also may be a reflection of an IMF stigma problem.

The recent experiences of regional and global lending programs have sparked debate on a number of other issues, including the need for an international lender of last resort, the need for precautionary lending facilities, the need for prequalification and reduced conditionality for qualified borrowers to allow rapid disbursement, the need for a broader array of instruments, including swap arrangements and emergency SDR allocations, and the need for a more formalized multi-tier structure of a global financial safety net. For example, Camdessus et al. (2011: 12) proposed that:

The IMF should work with relevant governments, central banks, and regional pools to put in place, with appropriate safeguards, permanent crisis financing mechanisms akin to a global lender of last resort.

Such calls have been echoed by Eichengreen (2006) and Kawai (2009a) among others.

The IMF has been rethinking its global crisis prevention programs, with two related issues in mind: the need for rapid disbursement without significant conditionality, encouraging a trend toward “preapproval-type” approaches based on the comprehensive assessment for prequalification, and the IMF stigma problem. This led to the development of the Flexible Credit Line (FCL), which offers pre-approved loans without conditionality to highly qualified borrowers, in 2009, and the Precautionary Credit Line (PCL), which offers pre-approved loans with limited conditionality to somewhat less qualified borrowers, in 2011. However, the response to these programs has been quite limited so far, suggesting that these have not solved the stigma problem. For example, so far only Colombia, Mexico, and Poland have applied for the FCL, and only Macedonia for the PCL.

More ambitiously, the IMF is also studying the establishment of a Global Stabilization Mechanism (GSM), with itself at the center of a network of central banks and regional financial arrangements.⁸ The GSM would be specifically aimed at dealing with systemic crises that might affect a large number of countries simultaneously, requiring a rapid and relatively standardized approach fund disbursement. Such an approach would also reduce any stigma involved with countries being a “first mover” to apply for aid. The IMF Board would play a key role in the system, as the GSM would be activated after it made an assessment that a “systemic event” had taken place (IMF 2010b).

Once the system is activated, the Board would have a number of options to provide and expand funding, including making unilateral offers to member countries; activating short-term liquidity instruments available only in systemic events; augmenting existing arrangements; modifying access limits; increasing access under the first credit tranche; coordination with central banks and multilateral institutions; augmentation of the Fund’s sources where judged necessary; and making a general SDR allocation (IMF 2010b). These measures could require substantial cooperation with central banks and multilateral institutions, but the details of such coordination, especially with regard to the availability of central bank swap lines, have not yet been spelled out. A key aspect is that the plan would extend the scope of prequalification by creating a new liquidity window (the Short-term Liquidity Line, or SLL) without ex post conditionality, which would be available to some PCL-eligible countries during episodes of global distress.

⁸ See IMF (2010b) for a description.

Nevertheless, Fernández-Arias and Levy-Yeyati (2010) point out that the plan entails considerable uncertainties, such as access to credit would still be decided by the IMF Executive Board, the criteria for the Executive Board to declare a systemic crisis are unclear; and the increased access to non-conditional liquidity by non-systemic countries would be limited. Access to such credit would still entail considerably more uncertainty than a country having its own reserves.

Other proposals envisage somewhat different structures to attain the same ends. For example, (Camdessus et al. 2011: 12) proposes "...a single three-level architecture, ensuring universal representation through a system of constituencies, The Finance Ministers and Central Bank Governors, taking strategic decisions related to the functioning of the international monetary system in the framework of a 'Council' as envisaged in the Fund's Articles of Agreement." The report also suggests that the BIS, the FSB, the World Trade Organization (WTO), the World Bank, and possibly other organizations should be invited to meetings of the Council. Swap arrangements have also been proposed by Bénassy-Quéré, Pisani-Ferry, and Yu (2011), Cho (2011) and Cordella and Levy-Yeyati (2005). The government of the Republic of Korea made a proposal to the G20 for extending the system of official currency swaps on a more multilateral basis. Fernández-Arias and Levy-Yeyati (2010) also argue that the IMF should be the core intermediary in an international network of swap lines.

4. COOPERATION ISSUES

From the above discussion, it can be seen that both the G20's and the IMF's strategies for addressing systemic crises are evolving. Therefore any proposals for regional-global cooperation must take into account the likely evolution of both the G20's and the IMF's surveillance and crisis management frameworks. There are three major aspects of cooperation—pure coordination issues, surveillance, and financing activities.

4.1 Pure coordination issues

Pure coordination issues are those related to institutionalizing relationships and communications between the IMF, RFAs, multilateral banks, and national monetary authorities. (National finance ministries probably should be involved as well.) Traditionally, the IMF dealt only with individual countries, and does not have formal procedures for communicating with regional financial arrangements such as the CMIM. The arrangements with the European Union developed during the current European crisis only emerged in an ad hoc way.

The IMF has begun to take concrete steps toward working more closely with regional financing arrangements (RFAs) in both surveillance and financing. In October 2010, the IMF hosted the first high-level meeting of RFAs, to start a dialogue on developing greater synergies with RFAs (ADB and IIE 2011, IMF 2010a). However, there is still a lack of formal relations/hierarchy between international agencies (Henning 2011). For example, no explicit arrangement for representation has been agreed among ASEAN+3 members; the IMF must engage with CMIM through its members, none of which is authorized by the group to speak for the region (ADB and IIE 2011). The IMF and other international finance institutions (IFIs) should provide mechanisms for facilitating and receiving the collective representation of the regional institutions. They should also consider allowing membership of regional organizations in the IMF (ADB and IIE 2011). Bini Smaghi (2004) proposed that the European Union should become an official member of the IMF, replacing the membership of its constituent states. This would of course raise issues about their voting powers in the IMF, governance, etc.

The IMF also needs to engage more with central banks and vice versa because of the close links and policy challenges in simultaneously achieving and safeguarding both macroeconomic and financial stability. However, Schinasi and Truman (2010) argue that such a division of labor is complicated by the fact that central banks tend not to want to be engaged with the IMF, and are reluctant in any institutional context to consider the global impact of their monetary policies on financial stability.

4.2 Surveillance coordination

The IMF does not have an official definition of what its surveillance activities include, but they have clearly expanded far beyond the initial remit of exchange rate and external balance policies. A recent IMF report accepts the extremely broad characterization of "...all aspects of the Fund's analysis of, scrutiny over, and advice concerning, member countries' economic situations, policies, and prospects" (IMF 2005: 3).

There are ostensible gains to global and regional cooperation in surveillance. ADB and IIE (2011) propose joint surveillance among national, regional, and global institutions. Global forums could identify issues that can lead to systemic failure, regional dialogues could forge common policies to ward off contagion, and national surveillance could identify specific vulnerabilities in individual economies. This could become a three-tiered filtering mechanism for identifying emerging risks and vulnerabilities, and for achieving consensus on shared policy responses. In particular, a regional surveillance mechanism could strengthen channels of communication by taking a "bottom-up" approach to evaluation, with regional institutions playing the central role. The peer dialogue process would then draw on national and regional, rather than global, analyses. Last, but not least, such cooperation could help eliminate the IMF stigma problem.

Nevertheless, such surveillance coordination entails many practical difficulties. The *raison d'être* of some RFAs is to provide an alternative to IMF surveillance and conditionality. However, as mentioned above, there is a huge imbalance between the surveillance resources and expertise at the IMF and those at RFAs. Second, in a serious crisis, it is unlikely that an RFA by itself could supply all the funding needed, particularly if multiple countries in the same group are hit because of contagion. In the absence of access to a sufficiently large central bank swap line, the RFA would be forced to call on the IMF for additional financing, which would make it difficult to overrule the IMF's surveillance assessment. The only clear exception to this was Europe, where the funding provided by the European Union in the case of Latvia was greater than that of the IMF, and the European Commission was actually able to obtain agreement for stricter conditionality than originally proposed by the IMF. Third, the increasing emphasis on precautionary lending facilities calls for a more standardized approach to ex ante classification of countries' economic fundamentals and capacity to borrow.

The literature on surveillance by RFAs shows a wide division of views. Proponents of independent surveillance by the CMIM include ADB and IIE (2011), Kawai (2009a) and Takagi (2010).

With effective surveillance, the multilateralized CMI could rely more on its own judgment to make a lending decision, including both the amount and any conditionality, without creating moral hazard or raising concerns that the problems leading to balance of payments difficulties may be fundamental in nature. (Takagi 2010: 2)

Takagi (2010) argues that East Asia needs its own mechanism because the region has a different objective for conducting surveillance than the IMF. East Asian authorities want to be able to make their own independent decisions with respect to the use of reserves pooled under

the CMIM. Takagi (2010) and ADB and IIE (2011) argue that peer pressure within a regional organizational structure is where regional surveillance potentially has the greatest advantage over global surveillance. When surveillance is undertaken by a regional institution that reports directly to key decision makers, the ability to exercise peer pressure in preventing crises could be considerably enhanced. Cho (2011) also notes that strengthened peer pressure could give the IMF's bilateral surveillance more bite.

Nonetheless, even these authors recognize that it will take much work to raise the AMRO's surveillance capacity to an adequate level. Kawai (2009a: 13) makes the following recommendations:

- Clarify rules for activating CMIM lending;
- Establish a joint forum for finance ministers and central bank governors to intensify policy dialogue among them;
- Set up a strong professional secretariat, with the required analytical expertise and policy experience, to enable it to support regional economic surveillance (ERPD),
- CMIM activation, and independent conditionality formulation; and
- Move beyond the simple "information sharing" stage to a more rigorous "peer review and peer pressure" stage, and eventually to a "due diligence" stage, to improve the quality of economic surveillance.

Takagi (2010) also notes that it would be critical that the surveillance unit be granted complete access to all surveillance outputs produced on the region's economies by the IMF and other institutions. Even so, he concedes that "[f]inancial surveillance, though critical in assessing crisis vulnerability, is another area where duplication with global surveillance should be carefully avoided" (Takagi 2010: 9) because it is a labor-intensive activity that would drain the regional facility's limited resources. This is a very significant concession, and would certainly limit the capacity of the regional body to come up with independent assessments of systemic financial risk.

On the other hand, there are numerous skeptics about the capacity of RFAs to conduct independent surveillance. Eichengreen (2006) argues that peer monitoring is costly and subject to increasing returns; if scale economies are strong, there may be an argument for centralizing it at a global institution like the IMF. He also suggests that there are arguments for why responsibility for surveillance and conditionality should be delegated to an entity outside the region, such as the IMF, that is better capable of following time-consistent policies. Henning (2011) asserts that the AMRO will probably be too small to replicate the work of the IMF; and that a division of labor should be identified. He suggests that AMRO could..."(1) provide contrasting assessments of vulnerabilities within the region when the director and staff disagree with the findings of the IMF; (2) update assessments more frequently than the annual cycle for IMF Article IV consultations; (3) participate in surveillance discussions in which Asian officials might be more candid with one another than in the presence of IMF officials; and (4) otherwise provide a greater sense of Asian ownership (Henning 2011: 16)."

Leaving these difficulties aside, there are some practical suggestions for increasing coordination between the IMF and regional groups. The participation of the IMF in the ASEAN+3 finance and central bank deputies' process, as a regular policy dialogue partner, has proved to be quite useful and important. It could be equally useful if regional groups and entities could play a more direct role in the IMF surveillance process. For example, the IMF may invite staff from relevant regional organizations and groups to join the IMF's annual Article IV consultation mission to regional member countries (Kawai 2009a: 15). However, it is important that joint surveillance not

weaken the IMF's approach to surveillance. The independence of the institutions involved needs to be maintained. Also, to be effective, surveillance ultimately needs "strength" in terms of enforcement and coverage.

Monitoring of capital flows is a vitally important aspect of coordinated surveillance, given the vulnerability of emerging economies to fluctuations on capital flows resulting from events that may take place far away. This would include coordination of macroprudential and capital flow management policies to minimize spill-over effects.

Aside from the IMF, the other global body that needs to be liaised with in the area of systemic financial stability is the FSB. ADB President Kuroda (2008) proposed that Asian countries set up an Asian Financial Stability Dialogue (AFSD) to strengthen cross-border financial supervision and regulation at the regional level and further Asia's financial stability, by developing effective early warning systems. The AFSD would be the regional equivalent of the FSB. This forum—to be created among finance ministries, central banks, and financial market regulators and supervisors—could also serve to promote longer-term financial market deepening and integration, establish standards for governance and transparency, and improve investor confidence. A close working relationship should also be established between the AFSD and the AMRO. Of course, these are moot points until the AFSD is actually established.

4.3 Coordination of financing activity

Similar to surveillance activity, coordination of financing activities promises a number of potential gains, including most obviously greater financial resources and the potential of reducing the IMF stigma. ADB and IIE (2011) argue that the biggest challenge lies in addressing the stigma attached to IMF lending. Until it is resolved, efforts to increase IMF resources and improve its lending facilities will not amount to much, and countries will continue to rely on foreign reserves and bilateral swap agreements.

Leaving aside the stigma issue, the experience during the European sovereign debt crisis shows that it is possible to arrange coordinated lending by the IMF and RFAs. Perhaps, the biggest challenge for such cooperation going forward is to address the above-mentioned shift in the IMF's lending policy toward greater emphasis on prequalification and precautionary (pre-crisis) lending. At the moment, the CMIM and other RFAs do not have such precautionary lending facilities or prequalification schemes. Therefore, developing these capabilities at the regional level appears to be important (although not absolutely necessary) for increased cooperation with the IMF going forward.

The ASEAN+3 finance ministers recognized the desirability of establishing precautionary lending facilities at the 2011 Ha Noi meeting, noting that "...we instructed the Deputies to initiate a study on the design of a possible crisis prevention function for CMIM, including the size, further collaboration with the IMF, and the role of AMRO" (ASEAN Secretariat 2011). Kawai (2009b) proposes that CMIM support should be provided flexibly by (i) enabling precautionary lending rather than just crisis lending; (ii) delinking CMIM from IMF programs or requiring that no conditionality be imposed, in a way comparable to the IMF's recently introduced Flexible Credit Line; and (iii) supplementing the CMIM by additional bilateral contributions, involving sufficiently large amounts, from economies inside and outside the region to make ample resources available for potential needs in the region.

If the CMIM developed such facilities, the following issues would need to be examined: the financing mechanisms for such a facility; the conditions under which they would be triggered; conditions regarding the amount of funding available to member countries; and whether or not IMF funding would be required and the allocation of burden sharing (ADB and IIE 2011).

Henning (2011) notes that the IMF's approach of offering different facilities to different categories of countries—"tiering"—has important implications for the solidarity of ASEAN+3 and other regional groupings. The CMIM (or other RFA) would have to decide its own classification scheme for its member countries.

Jeanne (2010) proposes a two-tier system in which the regional RFA lends up to a certain extent, which can be increased by IMF lending associated with more demanding conditionality. This model might make sense if regional conditionality is politically more acceptable than IMF conditionality. On the other hand, if the crisis called for more funding that the RFA could provide, then agreement on conditionality with the IMF would need to be reached. Also, as described below, central bank swap lines and lending by multilateral banks also should be included, making the structure more complex.

This raises further issues regarding IMF conditionality. Currently, the CMIM requires a member to have an IMF program if it borrows more than 20% of its quota. However, recent and proposed IMF financing innovations raise the issue of what constitutes an IMF program and whether precautionary loans should be included. Henning and Khan (2011) propose that the ASEAN+3 members accept qualification for IMF's FCL program as the equivalent of a traditional IMF program, thereby allowing qualifying countries to access more than 20% of their quota. This would be consistent with the two kinds of liquidity crises identified in Section 2.2 above. Of course, if the IMF conditionality is dropped altogether, this point becomes moot.

Another issue is whether the IMF could lend to the CMIM or other RFAs. Currently, it can only lend to countries. If it could lend to the CMIM, this again might ease the stigma problem, assuming that the conditionality issues could be worked out.

Holding reserves is costly and inefficient. ADB and IIE (2011) and Fernández-Arias and Levy-Yeyati (2010), among others, note that, since central banks like the Fed can print unlimited quantities of reserve currencies on short notice, they should occupy a prominent place in discussions of global financial safety net arrangements. The problem is that central banks are reluctant to make blanket or advance guarantees to supply liquidity, both on domestic political grounds and as a result of concerns about possible moral hazard and the risk of not being repaid. Nonetheless, efforts should be made to explore ways to involve key central banks in the development of a global financial safety net and to identify the conditions under which their participation in a GFSN could be institutionalized. As noted above, the IMF's own GSM plan envisions it acting as a broker on the part of central banks, but this is by no means the only possible organizational structure. Indeed, if the CMIM could obtain a swap line from, say, the Bank of Japan, this would greatly reduce the need to cooperate with the IMF, except in the case of a very large crisis.

5. POSSIBLE CHANGES IN COOPERATIVE ARRANGEMENTS

This section suggests some general principles and more specific proposals to help promote regional and global cooperation in the areas of surveillance and financing activity, in order to support the development of more effective financial safety nets.

5.1 General principles

The first requirement is greater coordination at the leader and finance minister levels between regional and global organizations. Since the IMF now takes its marching orders from the G20, regional organizations must make greater efforts to have their views appropriately represented at the G20. This must go beyond expecting the regional G20 member countries to represent the

views of non-member countries in their region. This immediately raises the question of what the relevant regional grouping might be. In the case of Asia, for example, this could either be the ASEAN+3 or the East Asia Summit. Similarly, the G20 needs to make explicit allowance for the representation of such regional views. This also requires establishment and consolidation of various forums for regional finance ministers, central banks and other regulators. The meetings of the ASEAN+3 finance ministers and those of the Executives' Meeting of East Asia and Pacific Central Banks (EMEAP) need to be coordinated more systematically. As described above, the establishment of an Asian Financial Stability Dialogue could contribute to this process.

- A number of institutional innovations need to be made to establish a clear and transparent framework for regional and global monetary cooperation, including:
- RFAs should establish a clear mechanism for their external representation in other forums, rather than simply being represented, for example, by their member countries that belong to the G20, the IMF, or other forums.
- The IMF needs to establish mechanisms to communicate with RFAs, multilateral banks, and other regional bodies, and should consider extending some form of membership to them.
- IMF governance needs to be reformed to accommodate the proposed additions and/or changes to its membership.
- The IMF should have the capacity to lend to RFAs, rather than only lending directly to member countries.

Nonetheless, as mentioned above, the lessons of the European sovereign debt crisis suggest that the biggest challenge is to develop cooperation among member countries of an RFA to arrive at a policy consensus. Such policy coordination has not yet been tested in, for example, the CMIM.

5.2 Proposals for surveillance

Cooperation on surveillance activity requires agreement on objectives, delegation of responsibilities, sharing of information, and ultimately, agreeing on standards for assessing the information and analysis assembled collectively. As described previously, delegation of responsibilities is difficult, because of the sheer size of the IMF's resources compared with those of RFAs and the desirability of avoiding needless duplication of effort. The key question is what value-added can an RFA bring to the table. The answer must lie in local knowledge and insight, but how to implement this is not clear. This is particularly difficult in a situation where it is not practical for the RFA to carry out assessments of financial sectors, as suggested by Takagi (2010). A subsidiary question is how the AMRO makes use of the assessments of other regional entities, including the EMEAP, ERPD, and ADB.

Specific steps should be taken to monitor capital flow movements that may have implications for systemic risk, and to coordinate the use of macroeconomic, macroprudential, and capital flow management tools to minimize spillover effects. Such coordination also requires practical innovations. The suggestion by Kawai (2009a) to include RFA members in IMF Article IV assessment missions is a step in the right direction.

5.3 Coordination proposals for financial safety nets

As described above, the evolution of the IMF's lending programs and philosophies, together with the still developing nature of some of the RFAs, especially the CMIM with its nascent AMRO, coordination must aim at a moving target. Perhaps the biggest moving target is the question of what extent the current system should aim to evolve toward becoming an "international lender of last resort" that could be counted on to provide financing on a timely basis without conditionality. Such a facility would be needed particularly during a global systemic financial crisis. This kind of capability was strongly advocated by the Government of Korea at the G20 Seoul Summit of 2010 (SaKong 2010), but this understandably has met strong resistance from the IMF and other potential lenders because of concerns about moral hazard in the absence of conditionality. Similar proposals have been made by Fernández-Arias and Levy-Yeyati (2010) and Kawai (2009a). The most practical approach for achieving this is to move increasingly toward prequalification. This points to a further systematization of the Article IV assessment process to become a kind of certification or rating process that would vary the terms of lending according to the rating applied. Such a rating process also points strongly in the direction of coordinated assessments by the IMF and RFAs. This could leave little room for "independent" assessments by an RFA. Along with this, RFAs also need to develop precautionary credit lines similar to those of the IMF. On the other hand, the experience of the European sovereign debt crisis suggests that conditionality is a key part of the surveillance and financing process, and should not be lightly abandoned, unless it is determined that structural reforms are not necessary.

Another key question is how to involve central banks in financial safety nets. This means identifying ways to overcome their reluctance to make *ex ante* commitments to provide funding, when they typically desire to maintain the maximum degree of flexibility in deciding when and how much to lend to whom. The most practical solution could be to channel such borrowing through the most creditworthy borrowers, with appropriate guarantees. This implies lending either to the IMF or to the RFAs, and using them as a conduit to reach the individual borrowing countries. Either the central banks could lend to the IMF and the RFA separately, or they could lend only to the IMF, and then the IMF would lend to the RFA.

Another potential source of funding is easier expansion of SDR allocations. Bénassy-Quéré, Pisani-Ferry, and Yu (2011) argue that the problem with IMF facilities is that potential beneficiaries might remain unsure that they will get access to them in times of need, which makes them imperfect substitutes for reserves. New SDR allocations would not have this shortcoming, as they would provide countries with SDR reserves that they could exchange for reserves denominated in the currency of their choice. As mentioned above, this is already being considered by the IMF as part of the GSM facility being considered. Again, however, it may not be desirable to eliminate conditionality in some cases.

Involvement of RFAs and increased automaticity of lending are probably the ways forward to reducing the IMF stigma problem. The IMF can still do the heavy lifting in terms of surveillance, but involvement of the RFA can make the lending and conditionality more palatable. However, some degree of stigma is inevitable if conditionality is still required in some cases.

6. CONCLUSIONS AND POLICY IMPLICATIONS

The experience of the global financial crisis, where financial shocks emanating from key countries led to contagion being transmitted around the world, shows the need for a large-scale and effective GFSN. A GFSN should have adequate resources to deal with multiple crises, it should be capable of rapid and flexible response, and it should not be encumbered by historical impediments such as the IMF stigma that would limit its acceptance by recipient countries. Oversight of the GFSN needs to be based on cooperation between global and regional forums, for example the G20 and ASEAN+3 or EAS.

Such a GFSN should include the IMF and RFAs at a minimum, and it is highly recommended to find ways to include central banks as providers of swap lines and multilateral banks as well. The basic principles governing the cooperation of IMF and RFAs include rigorous and even-handed surveillance; respect of independence and decision-making processes of each institution and regional specificities; ongoing collaboration as a way to build regional capacity for crisis prevention; open sharing of information and joint missions where necessary; specialization based on comparative advantage; consistency of lending conditions and conditionality, although with flexibility; respect of the IMF as preferred creditor; subsidiarity; avoidance of moral hazard; and transparency.

Relations between the IMF and RFAs should be institutionalized. This would include having the IMF and other IFIs provide mechanisms for facilitating and receiving the collective representation of the regional institutions, including possibly including RFAs as members in the IMF; and having RFAs establish their own institutions for dealing with the IMF, rather than simply being represented by their member countries. However, probably the biggest challenge is to institutionalize the process of policy consensus among member countries of an RFA.

Cooperation of surveillance activities needs to be institutionalized as well. RFAs should be included in IMF Article IV consultation missions, and a general structure for sharing information and assessments should be established. The most difficult aspect is to decide the division of responsibilities between the IMF and RFAs. For the foreseeable future, most RFAs are unlikely to have sufficient resources to provide viable independent alternatives to IMF surveillance, especially with regard to financial surveillance. Moreover, the increasing shift to prequalification of borrowers means that standardized schemes for classifying the credit-worthiness of borrowers will need to be developed, which will further limit the room for independence of RFAs. The key issue is how to bring their regional expertise to bear in the assessment process. Most likely, the solutions to this issue will need to be developed on a case-by-case basis.

Cooperation in financing activities probably presents the most challenges. A number of key developments need to be taken into account. First, as with surveillance, the relatively small size of most RFAs compared with likely funding demands in possible crisis scenarios means that action independent from the IMF is unlikely to be feasible.⁹ Second, the shift toward prequalification and precautionary lending programs by the IMF requires the RFAs to follow suit if they are to participate at this stage of the lending process. Both these trends will limit the scope for independent action by RFAs.

The development of an effective GFSN requires the involvement of central banks to provide hard currency swap lines. Linking together these disparate elements is likely to prove difficult in light of the desire of central banks' to maintain maximum flexibility in terms of their commitments. The other requirement for an effective GFSN is elimination of the IMF stigma,

⁹ The European Commission is probably the major exception to this.

particularly in Asia and Latin America, where it is strong. Otherwise, countries in those regions will still prefer alternative arrangements, such as directly obtaining swap lines from central banks. The IMF needs to implement reforms of its governance and mission, and make a thorough and open assessment of its previous surveillance and conditionality activities. RFAs need to obtain sufficient resources to give them credibility in terms of the surveillance activity and the size of funding they can provide relative to the IMF. Expanded and more flexible capacity for additional SDR allocations need to be considered. Finally, a reduction in conditionality that requires a shift toward prequalification, needs to be considered. In cases where countries are “innocent bystanders” in global systemic events, conditionality should be dropped completely, but it needs to be retained in the case of inappropriate policies. Distinguishing between these two ex ante and ex post is likely to prove a major challenge.

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