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Global and Regional Financial Governance: Designing Cooperation

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Global and Regional Financial Governance: Designing Cooperation

Across an increasing number of regions of the globe, states have created international financial facilities to preempt financial crises and, when crises strike, to reestablish financial stability. East Asia and Europe are leading examples of regions that have established one of these regional financial arrangements (RFAs). This trend raises the prospect that the world could one day be populated by series of "monetary funds" at the regional level—a European monetary fund, an Asian one, and so on—vying for influence over international finance with the incumbent multilateral institution, the International Monetary Fund (IMF). Although that is a distant and uncertain prospect, the world faces the challenge of coordinating the activities of these institutions as they are currently evolving.

The Group of Twenty (G20) and the institutions themselves are addressing this challenge under the agenda for the global financial safety net (GFSN)—the official multilateral, regional, bilateral, and plurilateral arrangements through which countries access international assistance in response to financial stress or a crisis. Some analysts use the term to include countries' international reserves (a form of self-insurance), while other definitions include market-based instruments as well. Under all of these definitions, the GFSN is expanding in size and complexity. Critically, it is also in danger of becoming fragmented.

Regional financial arrangements are a central component of the GFSN. States in Latin America, Europe, East Asia, the Middle East, and North America created such arrangements to, among other reasons, not rely exclusively on the IMF for crisis finance. The nine largest RFAs pool a total of $1,172.3 billion in resources, more than the total resources at the disposal of the IMF.[1] In most of these cases, however, the regional bodies are not endowed with the resources, personnel, and expertise necessary to conduct meaningful surveillance, identify vulnerabilities, recommend corrective action, design adjustment programs, and propose them to the regional members. Thus, many of these RFAs cooperate with the IMF in providing financial assistance to their members, despite having been formed as alternatives to the IMF.

However, only in few cases is the cooperation between the IMF and these RFAs seamless: the modalities of cooperation have not been developed, are in early stages and as yet untested, or profoundly contentious. Member states' access to the resources devoted to RFAs thus remains uncertain. This uncertainty leads IMF staff to describe RFAs as the "least preferred" element of the GFSN, which, they argue, is increasingly fragmented owing to its decentralization and the lack of coordination of its parts.[2]

The same IMF report, while diagnosing the strengths and weaknesses of the RFAs, is relatively timid in defining the problems of cooperation and in proposing solutions. Should the RFAs be linked to the fund's programs, as many of them are now, or should they be made more independent? If the former, how should that link be operationalized? Through what mechanism should conflicts over policy conditionality be resolved? The future of the safety net rests on whether it is as cohesive as financial markets are global or it decays into a fragmented set of regional equivalents to the IMF.

The European sovereign debt crisis has been a defining experience in cooperation among regional and multilateral financial institutions, thus inspiring a deeper consideration of the GFSN. The IMF worked with the European Commission and the European Central Bank in an arrangement dubbed the troika to design, review, and evaluate lending programs for member countries of the euro area that were stricken by the crisis during 2010 to 2015.[3] Most of the rescue programs have been successful in returning governments' access to the private capital markets, but macroeconomic conditions in the euro area remain weak. The first two programs for Greece failed and the third has been bitterly conflictual—a searing experience for each of these institutions.[4]

The development of RFAs also poses a dilemma for U.S. government policies. The IMF has historically been the central—though not the only—pillar of U.S. policy in combating international financial crises. The United States is influential within the governing arrangements of the IMF compared to some other international economic organizations; indeed, this influence has sometimes motivated countries in other regions to develop alternative arrangements. On the one hand, RFAs could erode U.S. influence over the terms for financial assistance; on the other hand, they bring financial resources, local expertise, and ownership to the table. Should the United States oppose or support the development of these regional arrangements?

A brief word is in order about the concepts used here. When the mechanisms that coordinate different institutions break down, fragmentation occurs. Institutions work cohesively if coordination is effective: several of them can operate in a given area yet not fragment as long as protocols and informal mechanisms sustain and promote cooperation. Conversely, two institutions could be severely fragmented if they are not coordinated and consequently work at cross purposes. The distinction is important because it is a lack of coordination between regional and global institutions that threatens coherence; a greater number of institutions per se does not.

To make the most of these institutions, states should define the principles of engagement between the RFAs and the IMF more clearly and develop mechanisms for the coordination of these institutions. These institutions can compete as long as that competition is confined to information, analysis, and forecasting. Moreover, the United States should clarify the basis for its posture toward RFAs, actively support the agenda for inter-institutional cooperation, and continue its strong support of the IMF.

REGIONAL FINANCIAL ARRANGEMENTS: WHAT'S NEW?

Regional financial arrangements are heterogeneous, ranging in size, purpose, and relationship to the IMF. Table 1 summarizes ten RFAs by these characteristics. Just as the IMF has expanded the range of its lending facilities—from precautionary to long-term financing—regional arrangements have expanded their functions as well, with the European Stability Mechanism (ESM) exhibiting the greatest range of instruments. Some RFAs are motivated by dissatisfaction with the IMF, while others, such as the ESM, have been created to overcome shortcomings in the regional architecture. Geographical coverage is incomplete: some regions lack financial arrangements and thus rely exclusively on the IMF and other multilateral institutions for financial support.

Table 1. Relationship Between Selected Regional Financial Arrangements and the IMF

Name of Fund	Members	Purpose	Size	Relationship to the IMF
EU Balance of Payments Facility[a]	European Union (EU) members that have not adopted the euro	To provide medium-term financial assistance only to non-euro countries	€50 billion	Not formally linked to IMF programs but organized jointly in recent cases; members obliged to consult EU before approaching IMF
European Financial Stabilization Mechanism	All EU members	To address severe disturbances beyond members' control; available to all EU members	€60 billion	Activation "in the context of a joint EU/IMF support," but also reviewed for consistency with EU rules; linked as a matter of Council policy
European Stability Mechanism	Members of the euro area	To complement EU fiscal framework under strict conditionality; indispensable to safeguard the stability of the euro area as a whole and of its member states	€500 billion[b]	Technical and financial IMF participation to be sought "whenever possible"; while not legally necessary, linked as a matter of Council policy
Chiang Mai Initiative Multilateralization	Ten member states of ASEAN plus China, Japan, and South Korea	To address balance-of-payments and short-term liquidity difficulties; supplements existing international financial arrangements	$240 billion	Beyond 30 percent of a country's allotment, disbursements linked to an IMF program
Arab Monetary Fund	Twenty-two Arab countries in North Africa and the Middle East	To, among others, correct payments disequilibria and currency stability through short- and medium-term credit facilities	$2.8 billion	Ordinary loans usually accompanied by an IMF program; other types of assistance not necessarily linked
Latin American Reserve Fund[c]	Bolivia, Colombia, Costa Rica, Ecuador, Paraguay, Peru, Uruguay, and Venezuela	To support members' balance of payments with credits and guarantees; improve the conditions of international reserve investments	$2.62 billion	No role for the IMF
North American Framework Agreement	Canada, Mexico, and the United States	To provide short-term liquidity support through 90-day central bank swaps renewal up to one year	$9 billion	U.S. Treasury requires letter from IMF managing director
Contingent Reserve Arrangement	Brazil, Russia, India, China, and South Africa	To meet short-term balance-of-payments pressures through liquidity and precautionary instruments	$100 billion	No role for the IMF

a. Formerly referred to as Medium-Term Financial Assistance, created in 1988.

b. Lending capacity; the ESM is capitalized at €704.8 billion.

c. Formerly known as Andean Reserve Fund (FAR), created in 1978; transformed to FLAR in 1989 to include other Latin American countries.

Eurasian Fund for Stabilization and Development[d]	Armenia, Belarus, Kazakhstan, Kyrgyzstan, Russia, and Tajikistan	To provide financial credits, loans and grants to ensure long-run economic stability of members and foster economic integration	$8.5 billion	No role for the IMF
SAARC Swap Arrangement[e]	Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka	Address short-term liquidity or balance-of-payments difficulties; supplement international financing arrangements	$2 billion	No explicit role for the IMF

d. Previously known as the Eurasian Economic Community Anti-Crisis Fund, established in 2009.
e. South Asian Association for Regional Cooperation.

Sources: Henning, "East Asian Financial Cooperation"; C. Randall Henning, "The Future of the Chiang Mai Initiative: An Asian Monetary Fund?," Peterson Institute for International Economics, Policy Brief no. 09-5, February 2009; IMF, "Seminar on Regional Financial Safety Nets," October 8, 2010, http://www.imf.org/external/np/seminars/eng/2010/spr/100810.htm; Toshiyuki Miyoshi et al., "Stocktaking the Fund's Engagement With Regional Financing Arrangements," Staff Report to the Executive Board, IMF, April 11, 2013; IMF, "Adequacy of the Global Financial Net," Staff Report to the Executive Board, IMF, March 10, 2016, https://www.imf.org/external/np/pp/eng/2016/031016.pdf; R.R. Sinha, "Reserve Bank of India Announces SAARC Swap Arrangement," Reserve Bank of India, May 16, 2012, http://rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=26475; Alpana Killawala, "RBI Announces the Extension of SAARC Swap Arrangement," Reserve Bank of India, February 23, 2016, https://rbi.org.in/scripts/BS_PressReleaseDisplay.aspx?prid=36310.

East Asia: Chiang Mai Initiative Multilateralization and ASEAN+3 Macroeconomic Research Office

East Asia was not the first region to create its own financial facility, but the Chiang Mai Initiative Multilateralization (CMIM) is distinguished among RFAs by its origin in a backlash against the IMF, in the wake of the Asian financial crisis of 1997–1998.[5] Regional financial cooperation was driven by the fervent interest of Southeast Asian countries and South Korea in developing alternatives to the IMF, combined with Japan's initial desire to lead in the region. Japan, however, did not harbor the same animosity toward the IMF that some of its regional partners did and insisted that disbursements under the facility be conditioned on an IMF program. Marrying the objectives of Japan and Southeast Asia required a compromise under which the creditors would contribute financing, while the potential borrowers would accept the "IMF link." This compromise, with a number of important issues remaining unresolved, established the base on which the relationship between the regional arrangements and the IMF evolved.

The Chiang Mai Initiative (CMI) was launched at a meeting of the finance ministers of the ten members of the Association of Southeast Asian Nations plus China, Japan, and South Korea (ASEAN+3) in Thailand in May 2000. Under its rubric, a series of bilateral swap agreements were negotiated among China, Japan, and South Korea (the "Plus Three") and the emerging market countries in Southeast Asia. In response to the global financial crisis of 2008–2009, ASEAN+3 officials agreed to multilateralize their network of bilateral swaps into a commonly administered fund: the CMIM.[6]

Under CMIM, the members make a total of $240 billion available for short-term liquidity in support of multilateral arrangements. The Plus Three contributes 80 percent, while the ten ASEAN governments contribute 20 percent of the total fund. The Plus Three decided that China and Japan would have equal shares and South Korea would have half the share of the larger two.[7] The five largest Southeast Asian states—Indonesia, Malaysia, the Philippines, Singapore, and Thailand—contribute $9.1 billion each.[8]

Decisions on disbursements would be made by a two-thirds majority of weighted votes, with each country's share of total votes determined mostly by its quota contribution. Committing to this process marked an important threshold in regional cooperation: China and Japan, among the others, obligated themselves to contribute funds through a mechanism in which they each could, in principle, be overruled.

Countries are eligible to draw on the CMIM in proportion to their contributions, although the proportion depends on the size and development status of the member. The large ASEAN members can borrow two-and-a-half times their contribution and the small ASEAN members five times their contribution—several times their quotas at the IMF. However, crucially, the IMF link continues to apply: to activate more than 30 percent of their total allotment, members must conclude an agreement with the IMF, which, in the case of a regular standby arrangement, requires submitting to policy conditionality.

The U.S. Treasury had famously opposed the proposal of the Japanese Ministry of Finance to create an Asian monetary fund in 1997. A number of U.S. officials and commentators have expressed a strong preference for the IMF as the vehicle for financial assistance to crisis-stricken countries.[9] The CMI was accepted in 2000 by the U.S. Treasury with the warning that "the devil is in the details," and the U.S. government has repeatedly expressed the position that East Asian arrangements should link to the IMF.[10]

Nonetheless, many within the region would like to break the link and build the CMIM into a full-fledged Asian Monetary Fund. Doing so would require developing an indigenous capacity for gathering economic information, analyzing the vulnerabilities and prospects of members, and designing lending programs, including, inescapably, conditionality applied on the part of the region in lieu of the IMF.

To develop regional surveillance, the member states created the ASEAN+3 Macroeconomic Research Office (AMRO) in 2011.[11] The body is seated in Singapore and was upgraded to the status of a formal international organization under public international law in February 2016. The AMRO's stated purpose is to "contribute to securing the economic and financial stability of the region through conducting regional economic surveillance and supporting the implementation of the regional financial arrangement." This involves assessing and reporting on members' macroeconomic conditions and financial soundness, identifying macroeconomic and financial risks and recommending policies to mitigate them, and supporting members in implementing CMIM, as well as other activities stipulated by its executive committee.[12]

In addition to upgrading AMRO, ASEAN+3 has launched a precautionary facility through CMIM. The precautionary line would, in principle, qualify members *ex ante* for up to two years for six-month financing for funds that were not linked to an IMF program and for one-year financing for funds that were linked. Combining the unlinked and linked portions, the five largest countries within ASEAN could each access up to $22.76 billion. A country that drew liquidity support under a precautionary arrangement but then experienced a deepening of crisis could turn to the CMIM Stability Facility for financing with a three-year maturity.[13]

Owing to the link, activation requires extensive consultation and cooperation with the staff and management of the IMF. The deputies and working groups of ASEAN+3 continue to grapple with the specific mechanisms through which regional and IMF officials would coordinate on requests for activation by a common member, the terms on which financing would be offered, and phasing of decisions and disbursements in any cofinancing contingency. Officials in the region and the IMF are conducting test runs on activating CMIM.

Two large questions loom over East Asian financial cooperation. First, it should be emphasized that CMIM has never been activated. Until it disburses, questions will linger over whether the member states of the region indeed have the political cohesion and technical mechanisms required to operationalize such assistance. The second question is whether intraregional rivalries will block further development of CMIM and AMRO—specifically, if conflicts over international security will spill over into the financial area. These two major uncertainties serve as the backdrop against how the IMF's relationship with these regional institutions will be defined.

BRICS: Contingent Reserve Arrangement

Brazil, Russia, India, China, and South Africa (BRICS) have established a precautionary facility and a short-term balance-of-payments facility under the Contingent Reserve Arrangement (CRA), which entered into force in July 2015 along with the New Development Bank.[14] Together, the two facilities can provide to Brazil, India, and Russia up to the amount of their contribution to the CRA ($18 billion) and to South Africa twice the contribution ($10 billion). Of these amounts, 30 percent can be released without a parallel arrangement with the IMF, while the remaining 70 percent is linked to the IMF—proportions that match exactly those in effect within the CMIM at the time.

Decisions on qualification would be decided by five directors, appointed from the central bank staffs of each of the five members, constituting a standing committee and making decisions on qualification. The criteria by which the standing committee will assess the merits of qualification may not have been decided and have not been disclosed, but conditions for approval include submission of documents and data, pari passu treatment at a minimum, and the absence of arrears to the other BRICS countries and multilateral or regional financial institutions. In addition, members must be in compliance with surveillance and disclosure obligations of the IMF—Article IV, sections 1 and 3, and Article VIII, section 5, are specified.[15] The reason for this provision is that the IMF Article IV reports are the best regular source of economic and financial information that the BRICS countries have about one another.

These countries experienced severe external financial pressure from 2015 to 2016, but the CRA has not been activated. The contingencies that the members face vary from problems associated with economic and financial sanctions in the case of Russia to severe recession and political risk in the case of Brazil. The BRICS countries' challenge to the IMF and other status quo multilateral institutions appeared more potent during the buoyant phase of the global financial cycle. Whether the group has sufficient common cause to deploy the CRA in difficult times remains the question.

Latin American Reserve Fund

The central banks of Bolivia, Colombia, Ecuador, Peru, and Venezuela created the Andean Reserve Fund (ARF) in 1978. The ARF was expanded in 1988 with the accession of Costa Rica and renamed the Latin American Reserve Fund (FLAR). It expanded further to include Uruguay in 2008 and Paraguay in 2014.

Capitalized at $3.6 billion, FLAR has lent both three-year balance-of-payments loans and liquidity operations of one year or less—amounting to $4.9 billion and $4.4 billion, respectively—from 1978 to 2013. These amounts might be small, but they are larger than IMF support for the Andean countries during the 1980s, the decade of greatest activity for the facility.[16] Over the life of the institution, Ecuador has been the greatest user, followed by Peru and Colombia.

FLAR stands out among RFAs in several respects. It maintains no link to the IMF, has never denied a loan request, and applies no policy conditionality like the IMF to its financial support. In its lending policies, the facility nonetheless appears to have been relatively orthodox, has been effectively accorded preferential status as a creditor by its members, and maintains a credit rating that is higher than the sovereign bonds of its members.[17] Like its precursor ARF, FLAR is also nearly unique among RFAs in that it is created by and at the initiative of debtors.

One important question for the future is whether FLAR could be scaled up by expanding membership to the larger countries within Latin America—Argentina, Brazil, Chile, and Mexico—thereby creating a regional arrangement on par with those in East Asia and Europe. Although a number of experts have advocated this, the larger countries show little appetite for joining.[18] Several factors could explain their reticence: governance by the one-country-one-vote rule, ideological cleavages within the region, and scarcity of reserves relative to other regions.[19] The absence of the link to the IMF could also be responsible for their lack of enthusiasm. Although sometimes critical of the IMF, officials in other Latin American countries do not wish to be responsible for applying austerity to loans in IMF's absence.

European Stability Mechanism

The ESM was fully constituted as a public international organization and established permanently in September 2012. Euro area member states endowed it with €704.8 billion in capital, of which €80 billion was paid in tranches over the following years while the rest is subject to calls if needed. On this capital base, the ESM can borrow on the bond markets. The lending capacity is €500 billion, available through a broad set of instruments: loans, primary and secondary bond market purchases, and precautionary arrangements. Member states can also use the facility to recapitalize private banks. The ESM can be tapped "if indispensable to safeguard the stability of the euro area as a whole and of its Member States" and "under strict conditionality."[20]

The governance of the ESM parallels that of the IMF. The board of governors, constituted by the finance ministers of the Eurogroup, is the senior body. The board of directors, constituted by the finance deputies, prepares decisions for the governors and is chaired by the managing director. Unanimity is effectively required for decisions on capital increases, changes in financial instruments, and, notably, provision of assistance to members. Under the ESM's weighted arrangements, Germany controls 27 percent of total votes, France 20 percent, Italy 18 percent, and Spain almost 12 percent.[21]

The role of the IMF was written into the legal provisions for the ESM.[22] The final text of the ESM treaty (Recital 8) incorporated the general obligation to "cooperate very closely" with the IMF. It added, "A euro area Member State requesting financial assistance from the ESM is expected to address, wherever possible, a similar request to the IMF." The threshold of "whenever possible" is vague and, as a legal matter, leaves the door open to an ESM program that does not include the IMF if its cooperation cannot be secured. As a political matter, however, there is strong support for involvement of the IMF among creditor countries. Given disagreements within the euro area over financial assistance, it is highly likely that a coalition of creditors will seek inclusion of the IMF as a partner in country programs.[23]

In contrast to its posture toward Asian financial facilities, the U.S. government consistently supported the deepening of European integration in the wake of the euro crisis, including the construction of large financial facilities such as the ESM. At the outset of the crisis, the U.S. Treasury supported the inclusion of the IMF. However, as the crisis wore on, U.S. officials became keen for Europeans to avoid making the participation of the IMF a prerequisite for European financial assistance and stressed that the European Central Bank's Outright Monetary Transactions program should not be conditioned on IMF involvement.

The ESM benefits from the surveillance, analytical capacity, and expertise of the European Commission, the European Central Bank, and other European institutions. Some have advocated combining some of the resources of these institutions into a European Monetary Fund (EMF).[24] Such a scenario could possibly also obviate the need for the IMF's involvement in the programs for Cyprus, Greece, Ireland, and Portugal. One opportunity to consider movement in this direction is the five-year review of the ESM, at which point member states agreed to consider bringing the mechanism within the ambit of the formal treaty structure of the European Union (EU).[25] However, the political consensus that would be necessary to create an EMF is nowhere to be seen. Europe is more likely to soldier on with the functions of an EMF dispersed across the three institutions. According to Klaus Regling, the managing director of the ESM, the now well-practiced cooperation provides the functional equivalent.[26]

THE IMF, THE EURO CRISIS, AND RISKS OF FRAGMENTATION

The IMF has now implemented the 2010 quota increase and reform that had been delayed for so long by the U.S. Congress. The increase raised total quotas to about $660 billion. In addition to its quota resources, which are permanent, the IMF can borrow about $253 billion through the New Arrangements to Borrow (NAB) and bilateral loan agreements in the amount of about $400 billion. Borrowed resources can be loaned to members in need, but they are phased out if not renewed periodically.[27] In response to objections to countries about its handling of crises, the IMF has also expanded the range of facilities that it offers and increased access limits. It offers precautionary financing through the Flexible Credit Line (FCL) and the Precautionary and Liquidity Line. IMF officials have sought to develop relations with regional arrangements and maintain generally good relations with the IMF's largest shareholders, China being especially important for its future. So, the IMF is in generally good health at the moment.

But, in the meantime, the euro crisis has prompted a deep rethink of its relationship with regional arrangements and institutions.[28] During the euro crisis, the IMF contributed as a financing partner to five country programs and is presently considering contributing to a sixth.[29] It participated in the design and monitoring, but not its financing, of the Spanish banking program of 2012 to 2014. The IMF conducted regular Article IV surveillance of European countries and the euro area as a whole and published reports on fiscal policies and banking union in the euro area. It also lent to central and eastern European countries, inside and outside the EU.

Most of the country programs have been successful—using extinguishing the crisis and returning to market access as the measure of success—and troika institutions profess to have good cooperation at the working level. But it is also fair to say that cooperation has been, at times, deeply frustrating for all of them and has placed support for the IMF among its members, particularly its non-European members, at considerable risk. Some areas of contention are listed below.[30]

- *Initial consultations.* Although the rules of the EU are clear, confusion prevails among national officials on the sequence in which member states are obligated to consult EU institutions versus the IMF. Given the tendency to delay seeking external assistance until the last possible moment and to forum shop, confusion at this early stage can be costly in terms of the size of the total program once agreement is reached.
- *Division of labor*. While the institutions have comparative advantage in some areas of program analysis and design and comparative disadvantage in others, the division of labor was, at best, incomplete.[31] Ultimately, each of the institutions was deeply involved across a broad range, if not the full range, of program issues.
- *Program design.* The institutions in the troika disagreed on many aspects of adjustment programs, including the fiscal path, deleveraging, structural reforms, privatization, and bank restructuring. European officials complained that the IMF did not take due account of the likely spillovers from, for example, imposing losses on private creditors within the euro area. Most vexing from the standpoint of the IMF was probably the fact that eurozone-wide policies that affected the viability of programs—such as the European Central Bank's and banking regulation—lay outside the scope of conditionality.[32]
- *Debt sustainability*. Whether to lend to a country whose debt is potentially unsustainable has been a long-standing and hard-fought question for the IMF. Debt sustainability has thus become a central feature of program analysis. Because euro area countries are embedded in the institutional edifice of the EU and its banking system, the European institutions, by contrast, exercised greater forbearance with respect to government debt. Thus, the IMF and the European institutions clashed repeatedly over how debt sustainability should be assessed—particularly in the case of Greece.
- *Regional governance*. Officials at the IMF lamented the style, pace, and effectiveness of decision-making within the Eurogroup, European Council, and European institutions generally as ill-suited to fighting fast-moving financial crises. Unanimity was either formally or effectively required for approval of programs and the creation of financial facilities, among other things. In many cases, country ratification required the explicit approval of national parliaments.

The fallout from the three successive programs for Greece has been particularly consequential for the IMF. The first Greek program was approved by the IMF despite widespread concern that Greece's debt was not sustainable. To permit the loan under the access rules within the IMF, the executive board approved an exemption to the requirement that debt be certified as sustainable—known as the "systemic exemption"—for cases in which the stability of the international financial system was threatened. In this case, debt proved to be unsustainable and was restructured in 2012. It had also become clear that the first program had not prevented systemic contagion. Staff officials and non-European and even some European members of the executive board thus came to believe that the IMF had compromised an important principle with no compensating benefit, and the systemic exemption was closed in January 2016.[33] This means that a country whose debt is not clearly sustainable will, in principle, undergo a reprofiling or restructuring before the IMF can lend.

The closure of the exemption has at least two consequences for regional financial arrangements, one immediate and the other long-term. In the coming months, the IMF will decide whether to join the third Greek program as a financing partner. The closure of the exemption means that some kind of restructuring of official European claims on Greece would be necessary to clear the IMF financing. In the long term, the assessment of debt sustainability could well be a flashpoint in relations between the IMF and other RFAs. Regional neighbors can be expected to be more invested, financially and politically, in the economies of their neighbors and thus, like Europe, inclined to greater forbearance on debt than the IMF. Whether RFAs will in the future be willing to lend in cases where debt might be unsustainable without cofinancing from the IMF remains to be seen.

Differences between RFAs and the IMF can also be anticipated with respect to the other four areas on which the IMF and the Europeans have differed. The fact that the European institutions are associated with a monetary union while the other RFAs are not means that the lessons from Europe cannot be translated directly to the IMF's relationship to these regions. The monetary union has particular implications for program design: the size and duration of programs and internal—as opposed to external—devaluation. Nonetheless, while making allowances for the difference between monetary unions and freestanding cases, governance, program design, program initiation, and division of labor are likely to define the hot spots in relations between the non-European financial arrangements and the IMF in the future.

The heterogeneity of regions poses a particular challenge for the IMF. On inter-institutional cooperation, the role of the IMF will differ across regions, depending on regional institutions and circumstances, and the IMF needs to guard against treating countries differently across regions as a result. East Asian officials are acutely aware, and sometimes resentful, of what they perceive to be an indulgent posture adopted by the IMF toward the member states of the euro area. There is a limit to which the IMF can be stretched across different regional models without violating the principle of equal treatment, though that limit might yet be unknown. Any overarching framework that established the IMF's terms of engagement with RFAs would confront this problem.

RECOMMENDATIONS

In an effort to head off fragmentation of the GFSN, which could occur with the proliferation of RFAs, the G20 adopted a set of principles on cooperation between the IMF and the RFAs at the summit meeting in Cannes in November 2011.[34] The G20 principles are a significant step forward, recognizing areas of comparative advantage and identifying areas of mutual gains from cooperation. They state that institutions will make decisions on financing autonomously and are emphatic on one essential point: "RFAs must respect the preferred creditor status of the IMF."

However, the principles are silent on transparency and, more importantly, are also nonbinding. It is hard to identify any bearing that the principles have had on the operations of the troika, for example, or the evolution of the IMF's relationship with non-European RFAs. So, while they represent an important step in the right direction, the principles do not yet realistically offer much protection against dysfunctional relations among the institutions.

To mitigate the threat of fragmentation, the RFAs and IMF should follow through on the letter and spirit of the principles more fully and the G20 should elaborate on them further.

Adopt Guidelines for Inter-Institutional Cooperation

The G20, IMF, and RFAs should explicitly adopt three broad guidelines that member states and these institutions should follow when considering the modalities of inter-institutional cooperation.[35] These guidelines place greater precision on some of the existing principles.

- *Transparency*. The IMF, once relatively cloaked, has become remarkably more transparent during the nearly two decades since the Asian financial crisis, but most RFAs lag behind it in this respect. Differences across facilities will tempt some parties to use the least transparent facility in a financial rescue. To facilitate public understanding and market credibility, regional financial facilities should be as transparent as the IMF. The terms of programs and governance of multilateral and regional arrangements, moreover, should be shared knowledge at both levels.
- *Specialization along comparative advantage.* Regional institutions have a comparative advantage in local knowledge and "ownership," whereas the IMF has an advantage in universal risk pooling, cross-regional learning, and insulation from backlash against austerity. Both can benefit from specialization according to comparative advantage and exchange, as has been acknowledged in the principles. Because the characteristics of RFAs vary widely, the comparative advantage of the IMF is likely to differ across regions.
- *Prohibition against competition in critical areas*. Member states can be served by competition among institutions in some select areas, such as the provision of information, analysis, and forecasts. However, in other areas, such as terms of lending and policy conditionality, competition is corrosive and destabilizing. Left to their own devices, institutions will not necessarily compete only in the appropriate areas. Governments and institutions should establish clear understandings about where competition is acceptable and where it is not.

Cooperate on Precautionary Financing

Precautionary financing is an arena in which the principles could be put into practice. While most RFAs have created precautionary facilities, they do not have the technical or analytical means to review countries for qualification. (Although the ESM could be an exception, its members have shown a strong attachment to involving the IMF in its programs.) By contrast, the IMF does have the capacity for *ex ante* qualification for precautionary financing. Until regional and plurilateral facilities build their own capacity in this respect, they can effectively borrow the capacity of the IMF.[36] They should accept the IMF's qualification of members for an FCL as sufficient for qualifying their own members for precautionary financing from within the region. This principle should hold under both regular qualification for FCLs at the IMF, as it is now conducted, and for prequalification, as has been proposed.[37]

Review and Elaborate on G20 Principles

The International Financial Architecture Working Group of the G20 should take up the review of the principles for RFA-IMF cooperation in light of the recent experience with programs in Europe. Then, the group should elaborate on them in the following ways:

- *Region-wide policies.* As recommended by IMF staff, the G20 principles should provide guidance on the matter of region-wide policies essential for program success.[38] Region-wide policies will be less critical in areas without monetary unions than they have been in the euro area, but they will often be relevant and become increasingly so over time. The principles could develop a clearer, collective sense on how to navigate cases where the IMF and RFA disagree on debt sustainability.

- *Inter-institutional representation.* The G20 should explicitly advocate that regional governing arrangements specify how they will decide on matters related to their cooperation with the IMF and how, as a regional arrangement, they will work with the multilateral institution.
- *Strength.* The G20 principles should be invested with greater normative force, rather than being simply nonbinding. In strengthening the principles, the G20's objective should be ambitious: to create the international financial equivalent of Article XXIV of the General Agreement on Tariffs and Trade.[39]

Reinforce U.S. Support for International Financial Institutions and Cooperation

The United States has a strong interest in international financial stability, which derives from its global economic and security interests as well as the spillback on the domestic economy from crises abroad.

To enhance effectiveness of crisis prevention, the alacrity of crisis response, and some degree of influence over the terms of financial rescues, the United States has a strong interest in preserving the coherence of the financial safety net. The development of new financial facilities at the regional and plurilateral levels per se is not a threat, but fragmentation of the system would undermine U.S. interests. Therefore, first of all, U.S. policymakers should support the agenda of coordinating the IMF and RFAs, including inter-institutional agreements and the elaboration of the G20 principles as outlined above.

Second, the U.S. Treasury should adopt and articulate a consistent policy for RFAs and their relationship with the IMF. Such a policy need not approve of all regional arrangements, but it should lay out the principles that differentiate between acceptable and unacceptable RFAs. The U.S. Treasury's enthusiasm for European facilities and coolness toward Asian facilities, for example, should be explained by reference to the fact that Europe operates a monetary union that requires stronger mechanisms of mutual financial support than regions without monetary unions. The rationale should be made explicit in order to establish the objective basis for the difference and allay fears of bias. Whatever legitimate basis the U.S. government might have had for refusing to join the Asian Infrastructure Investment Bank (AIIB) and opposing others' participation, there was a widespread impression that this opposition was self-serving. Articulating a policy for RFAs that advances international financial stability as well as the enlightened interest of the United States would help the U.S. government avoid such setbacks in the future.

Finally, the world needs a robust IMF in order to sustain the coherence of the GFSN. U.S. partners' doubts about congressional support for the IMF has been one of the reasons for the development of RFAs as alternatives to the IMF. The long delay in congressional ratification of the 2010 quota increase and reform contributed to the decision on the part of some close partners to join the AIIB, over U.S. objections. The U.S. Congress should support the IMF strongly.

APPENDIX: G20 PRINCIPLES FOR COOPERATION BETWEEN THE IMF AND REGIONAL FINANCING ARRANGEMENTS

As endorsed by G20 Finance Ministers and Central Bank Governors, October 15, 2011

In November 2010, G20 Leaders also tasked G20 Finance Ministers and Central Bank Governors to explore "ways to improve collaboration between RFAs and the IMF across all possible areas." Based on contributions by the EU and by ASEAN + 3 countries members of the G20, the following non-binding broad principles for cooperation have been agreed. Also, collaboration with the IMF should be tailored to each RFA in a flexible manner in order to take account of region-specific circumstances and the characteristics of RFAs.

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.

ENDNOTES

1. See IMF, "Adequacy of the Global Financial Safety Net," Staff Report to the Executive Board (Washington, DC, March 10, 2016), pp. 14 and 18, http://www.imf.org/external/np/pp/eng/2016/031016.pdf.
2. Ibid, pp. 19–20.
3. To this cluster of institutions that managed the euro crisis programs, we should add the European Council, Council of the European Union, European Stability Mechanism, and Single Supervisory Mechanism.
4. C. Randall Henning, *Tangled Governance: International Regime Complexity, the Troika and the Euro Crisis* (Oxford: Oxford University Press, forthcoming 2017).
5. The origin of these arrangements is analyzed in William W. Grimes, "Japan Confronts the Global Economic Crisis," *Asia-Pacific Review* 16, no. 2, pp. 188–200; Saori Katada, "Why Was the CMI Possible?" (paper presented to the FLASCO-ISA conference, Buenos Aires, Argentina, July 22–25); and C. Randall Henning, "East Asian Financial Cooperation," *Policy Analyses in International Economics,* no. 68 (Washington, DC: Peterson Institute for International Economics, September 2002), among others.
6. I prefer to reserve the term "multilateral" to refer to the global level and to describe the IMF and World Bank as "multilateral institutions," but defer to Asian usage with respect to their arrangements.
7. Hong Kong was included for the first time in these arrangements in 2009. Its $8.4 billion contribution is folded into China's overall contribution of $76.8 billion.
8. The smaller ASEAN members make contributions ranging from $60 million, in the cases of Brunei and Laos, to $2 billion, in the case of Vietnam.
9. Edwin M. Truman, "The G-20 and International Financial Institution Governance," Peterson Institute Working Paper 10-3 (Washington, DC: Peterson Institute for International Economics, September 2010); Morris Goldstein, "The Role of the IMF in a Reformed International Monetary System" (paper for the conference on "The Future of the International Financial System," Bank of Korea, Seoul, South Korea, May 26-27, 2011).
10. Edwin M. Truman, speech delivered on the occasion of the launch of the Chiang Mai Initiative in Chiang Mai, Thailand.
11. ASEAN Finance Ministers, Joint Media Statement of the 14th Meeting, Nha Trang, Vietnam, April 8, 2010, paragraph 14, http://www.aseansec.org/24491.htm; and ASEAN+3 Finance Ministers, joint media statement, Tashkent, Uzbekistan, May 2, 2010, http://www.aseansec.org/documents/JMS_13th_AFMM+3.pdf.
12. "Agreement Establishing ASEAN+3 Macroeconomic Research Office ("AMRO")," September 22, 2015, http://www.amro-asia.org/communiques_keydocuments/key-documents.
13. See the ASEAN+3 May 2012 finance ministers' statement, www.amro-asia.org/wp-content/uploads/2012/05/120503AFMGM+3-JS.pdf. The criteria by which qualification would be assessed are identical to the five criteria for the precautionary and liquidity line of the IMF, which are somewhat more relaxed than for the IMF's FCL ("sound" versus "very strong"), although the thresholds that define the standard remain unclear.
14. "Treaty for the Establishment of a BRICS Contingent Reserve Arrangement—Fortaleza, July 15," July 2014, http://brics.itamaraty.gov.br/category-english/19-press-releases/220-treaty-for-the-establishment-of-a-brics-contingent-reserve-arrangement-fortaleza-july-15.
15. Ibid, Article 14 (b) (v).
16. Daniel Titelman, "Subregional Financial Cooperation: The Experiences of Latin America and the Caribbean," in José Antonio Ocampo, ed., *Regional Financial Cooperation* (Washington, DC: Brookings Institution Press, 2006); José Antonio Ocampo and Daniel Titelman, "Regional Monetary Cooperation in Latin America," Asian Development Bank Institute Working Paper Series no. 373, August 2012.
17. A country's application for balance-of-payments support must include a report on the measures that it has or will adopt to "reestablish the equilibrium in the balance of payments." Contingent and liquidity funding require assurance of repayment or a certified guarantee that satisfies FLAR. See https://www.flar.net/ingles/contenido/contenido.aspx?catID=293&conID=5715.
18. See, for example, Guillermo Perry, "The Future of FLAR: A Latin American Monetary Fund as a Lender of First Resort?" in *35 Años FLAR* (Bogota, Colombia: Latin American Reserve Fund, 2013).
19. As of early 2016, foreign exchange reserves of Latin American countries totaled about $720 billion, of which Brazil held about $350 billion and Mexico $166 billion. The FLAR members held about $148 billion, collectively.
20. "Treaty Establishing the European Stability Mechanism," Article 3. On the establishment of the ESM, see also Ledina Gocaj and Sophie Meunier, "Time Will Tell: The EFSF, the ESM, and the Euro Crisis," *Journal of European Integration* 35, no. 3, March 2013, pp. 239–253.
21. See, for example, Alessandro Leipold, "Making the European Stability Mechanism Work," Lisbon Council Policy Brief, Brussels, February 2012; European Stability Mechanism, "Frequently Asked Questions on the European Stability Mechanism," July 28, 2014.
22. The evolution of the fund's role over successive drafts of the ESM treaty is reviewed by Henning, *Tangled Governance*, chapter 8.
23. Ibid, chapters 1 and 10.

24. Proponents include the German Minister of Finance Wolfgang Schäuble, and, among others, Jean Pisani-Ferry, Andre Sapir, and Guntram B. Wolff, "EU-IMF assistance to euro area countries: an early assessment," *Bruegel Blueprint* 19, June 16, 2013, http://bruegel.org/2013/06/eu-imf-assistance-to-euro-area-countries-an-early-assessment/.

25. As an intergovernmental treaty, the ESM presently stands outside the EU legal framework.

26. See, for example, "Europe Can Handle Future Crises without IMF—Bailout Fund Chief," *Reuters*, August 28, 2015.

27. In addition, the fund can issue Special Drawing Rights.

28. The European institutions have also undergone a rethink over the troika and, even if the region remains politically committed to fund inclusion, their conclusions can affect their relationship with the IMF. See, for example, European Stability Mechanism, *2014 Annual Report*, June 2015.

29. Among the many books on the euro crisis itself, see James A. Caporaso and Martin Rhodes, *Economic and Political Dynamics of the Eurozone Crisis* (Oxford/New York: Oxford University Press, 2016); Matthias Matthijs and Mark Blyth, eds., *The Future of the Euro* (Oxford: Oxford University Press, 2015); and Jean Pisani-Ferry, *The Euro Crisis and Its Aftermath* (Oxford: Oxford University Press, 2014).

30. For a more comprehensive review, see Henning, *Tangled Governance*.

31. See, for example, IMF, "Crisis Program Review," IMF Staff Paper, November 9, 2015, p. 2.

32. Ibid, pp. 57–60.

33. IMF, "IMF Executive Board Approves Exceptional Access Lending Framework Reforms," press release no. 16/31, January 29, 2016.

34. See G20-G8 France, "Cannes Summit Final Declaration — Building Our Common Future: Renewed Collective Action for the Benefit of All," November 2011, Annex 1, https://www.oecd.org/g20/summits/cannes/Cannes%20Declaration%204%20November%202011.pdf.

35. C. Randall Henning, "Coordinating Regional and Multilateral Financial Institutions," Peterson Institute Working Paper 11-9, March 2011.

36. The case for this proposal is made in Henning, "The Global Liquidity Safety Net: Precautionary Facilities and Central Bank Swaps," in C. Randall Henning and Andrew Walter, eds., *Global Financial Governance Confronts the Rising Powers* (Waterloo, Canada: Center for International Governance Innovation, 2016), pp. 119–150. Twelve countries are identified that would likely qualify, or come very close to qualifying, by the standards that the IMF applies to FCL qualification.

37. Under prequalification, the IMF could compile and maintain a list of countries to which FCL access could be granted if the country in question placed an official request. See Truman, "The G-20 and International Financial Institution Governance," and Raghuram G. Rajan, "Competitive Monetary Easing: Is it Yesterday Once More?" (speech delivered at the Brookings Institution, Washington, DC, April 10, 2014).

38. IMF, "Crisis Program Review," Box 5, p. 60.

39. See Henning, "East Asian Financial Cooperation."

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