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The Need and Scope for Strengthening Co-operation Between Regional Financing Arrangements and the IMF

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Abstract

This article makes the case for strengthening co-operation between regional financing arrangements (RFAs) and the International Monetary Fund (IMF), and examines ways to do so. It argues that *ex ante* co-operation between RFAs and the IMF is needed to reduce the risk of co-operation failing in the middle of a crisis, to help avoid "forum shopping" and institutional arbitrage, to prevent weakening the IMF's role as the guardian of global financial stability, to minimise duplication, and to generate mutual benefits from a division of labour and specialisation based on the comparative advantages of the respective institutions. It calls for guidelines for organising the inter-institutional relations between the IMF and RFAs, a clear division of labour in crisis lending, and co-operation and exchange in surveillance and analysis. Co-operation with RFAs should be seen as a chance for the IMF to overcome its stigmatisation, strengthen its global role and ensure its continued relevance.

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Keywords: IMF, regional financing arrangements, international co-operation, international monetary and financial stability

Contents

Abbreviations

AMF	Asian Monetary Fund
AMRO	ASEAN+3 Macroeconomic Research Office
ASEAN	Association of Southeast Asian Nations
ASEAN+3	ASEAN plus China, Japan and Korea
CMI	Chiang Mai Initiative
CMIM	Chiang Mai Initiative Multilateralisation
ECB	European Central Bank
EFSF	European Financial Stability Facility
EFSM	European Financial Stabilisation Mechanism
ESM	European Stability Mechanism
EU	European Union
EUR	Euro
FCL	Flexible Credit Line
FLAR	Fondo Latinoamericano de Reservas
G20	Group of Twenty
IEO	Independent Evaluation Office
IMF	International Monetary Fund
PLL	Precautionary and Liquidity Line
RFA	Regional financing arrangement
SAR	Special Administrative Region
UK	United Kingdom
USD	Unites states dollar

1 Introduction

In recent years, the International Monetary Fund (IMF) has enjoyed a good crisis, during which the G20 affirmed the Fund's central role in the international financial system and agreed to quadruple its lending capacity to over USD 1.3 trillion. Although before the global financial crisis, the Fund seemed to have become irrelevant in the eyes of many and was mocked by the Economist magazine as the "Turkish Monetary Fund" (Economist 2007) – because a loan to Ankara accounted for two-thirds of its outstanding credit – it now is experiencing increased lending activity in both developing and advanced countries (e.g. Meltzer 2011). With the G20's Mutual Assessment Process, it also has been assigned a greater role in global economic and financial governance. Yet huge challenges remain. The Fund still suffers from a lack of credibility and resentment on the part of member states, especially in East Asia and Latin America. Moreover, it has not yet managed to remove the stigma that its lending programmes have in most of the developing world. This stigma is one reason why the IMF has faced increasing competition in short-term lending from the World Bank and regional development banks, bilateral swap lines and regional financing arrangements (RFAs).[1]

Defined by McKay et al. (2011, 1) as *"an arrangement within which a group of countries pledges financial support to other members of that group that are experiencing balance of payment problems, either through a pool of contributed or borrowed reserves or through the swap of financial assets (usually foreign exchange reserves)",* RFAs are receiving more attention and increasingly are regarded as important constituents of the evolving international financial architecture. The international community has acknowledged the importance of RFAs and their prospective contribution to a global financial safety net, as well as the necessity of strengthening co-operation between the IMF and RFAs to avoid unhealthy competition and ensure smooth co-operation in times of crisis. In the final declaration of the Cannes Summit in November 2011, the G20 leaders 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"* (G20 2011a, §14). They also agreed on common principles for co-operation between the IMF and RFAs "which will strengthen crisis prevention and resolution efforts" (ibid.). In their "Enhancing the IMF's Response Capacity and Surveillance" communiqué, the G20 leaders stated:

> *"The G20 countries have agreed on principles of cooperation between the IMF and Regional Financial Arrangements to profit fully from the understanding that the Regional Financial Arrangements have of the running of the economies in their area (thanks to their regional focus) and from the IMF's greater surveillance capacity (thanks to its global vision). In times of crisis, greater coherence will be ensured between the lending conditions set out by Regional Financial Arrangements and the IMF, while providing the IMF with preferred creditor status." (G20 2011b, 1)*

Against this background, this article discusses two questions: First, what is the case for co-operation between RFAs and the IMF? And second, what are the possible forms of co-operation? The discussion is based on three premises: (i) given the growing clout and financial resources of the major emerging market economies that back most of them, RFAs are not only here to stay but

1 For an overview of foreign exchange swap arrangements between central banks, see Fender and Gyntelberg (2008, 14–15).

also are likely to gain in importance; (ii) we need a strong IMF to ensure global financial stability; and (iii) RFAs and the IMF can complement each other and contribute to strengthening the global monetary system, as recently argued by McKay et al. (2011).

The rest of this article is structured as follows: Section 2 discusses motivations for a country to join an RFA and the factors that have made RFAs more attractive as an alternative source of liquidity financing for member states than IMF financing. Section 3 then analyses the need to strengthen co-operation between RFAs and the IMF. Subsequently, Section 4 reflects on the G20 principles of co-operation between the IMF and RFAs and discusses modes of co-operation between RFAs and the IMF that could ensure the efficient co-existence of regional and global liquidity providers that supports international financial stability. It also reviews recent examples of co-operation between the Fund and European authorities. Section 5 concludes.

2 Why do RFAs exist?

Historically, RFAs were created to complement real economic integration processes and provide rapid crisis support to member states. Despite the existence of a global lender, namely the IMF, a region might choose to create an RFA for at least three reasons. First, RFAs can help reinforce regional economic and financial co-operation, most especially by strengthening regional surveillance and monitoring, which is hoped to reduce the risk of financial contagion in the face of developing regional economic ties. Second, RFAs can supplement IMF lending so that member countries need not rely on the IMF alone. In particular, RFAs can help member countries bridge temporary liquidity shortages so they need not apply for an IMF programme, or bridge the time until a (larger) IMF arrangement is agreed. A third motivation for establishing or expanding an RFA is dissatisfaction with the IMF. This dissatisfaction may relate to IMF policies (including the speed and conditionality of loans), IMF governance and a lack of ownership and the stigma attached to IMF lending. Member governments can use RFAs to underscore their demands for IMF reform and threaten a loss of interest in the IMF unless they get more say in the Fund's governance and policies or, if the Fund and member governments are already alienated, an RFA could become a full-fledged substitute for IMF lending, allowing countries to bypass the Fund entirely. Member governments may seek to develop alternatives to the Fund if they believe that the stigma of borrowing from the IMF is politically too costly.

The first and second motivations can make RFAs important complements to IMF lending and contribute to regional and global financial stability. However, if a region develops an RFA for the third reason, the Fund's authority and ability to effectively carry out its mandate could be eroded (McKay et al. 2011).

The development of the Chiang Mai Initiative (CMI) in East Asia illustrates why countries that long had almost no interest in any form of regional economic co-operation (not to speak of financial co-operation), started to take an interest in regional financial co-operation, including establishment of an RFA. The financial crisis of 1997–98 marked a turning point for East Asia; as Padoa-Schioppa (2005, 30) wrote, it was *"the key catalytic event to propel regional co-operation"* in the region. Not only did the Asian crisis reveal the dangers of regional financial contagion and the importance of policy-co-ordination for preventing future crises, it also evoked great discontent about how the crisis was handled by the international community, and

the IMF in particular. IMF opposition to the Japanese Asian Monetary Fund (AMF) proposal in 1997 reinforced the resentment.[2] The Korean economist Il Sakong expressed the widespread view of East Asian policy makers when he said, *"[w]e need to have some kind of defence mechanism. Since not much is expected to be done at the global level, something should be done at the regional level"* (Montagnon 2000, 9). The 2000 launch of the CMI as a network of bilateral swap agreements among the ten member countries of the Association of Southeast Asian Nations (ASEAN) plus China, Japan and Korea (known as ASEAN+3) should be seen against this background.[3] In 2010, the CMI was transformed into the Chiang Mai Initiative Multilateralisation (CMIM), a self-managed reserve pooling arrangement endowed with USD 120 billion of the region's foreign exchange reserves. The CMIM was brought closer towards an "Asian Monetary Fund" when the ASEAN+3 Macroeconomic Research Office (AMRO) was set up in Singapore in April 2011. In May 2012, it was agreed to double the amounts available under the CMIM to USD 240 billion.

During the global financial crisis, the CMI was not activated because of its "IMF link", which at the time stipulated that a country can only access 20 % of the funds available from the CMI without having an IMF programme. That meant that in principle Korea – in need of foreign currency liquidity support in 2008 – could have accessed USD 18.5 billion under the CMI, but because it had no IMF programme, it was limited to just USD 3.7 billion. Korea arranged a USD 30 billion swap with the US Federal Reserve instead – followed by other swaps with China and Japan. This shows how the CMI(M) link to the IMF renders it ineffective, since more than a decade after the Asian crisis borrowing from the IMF remains stigmatised – and thus too costly for East Asian governments.[4]

The IMF is still regarded as being dominated by American and European interests and unresponsive to Asian concerns. In Korea, the crisis of 1997 is still today commonly referred to as the "IMF crisis", with the IMF acronym standing for "I'M Fired". The Financial Times comment of 2004 (when a candidate for finance minister was vetoed because she had worked at the Fund) that, in Indonesia, "the IMF label on any policy is virtually a kiss of death" still holds true. When the Indonesian government needed support in March 2009, instead of turning to the IMF, it secured a USD 2 billion Development Policy Loan with a deferred drawdown option from the World Bank (Marino / Volz 2012, 26), which was renewed in May 2012.

Several ASEAN countries are demanding that the CMIM will sever ties to the IMF once AMRO has built up sufficient capacity to survey and monitor regional financial markets. Already in May 2012, the ASEAN+3 Finance Ministers and Central Bank Governors decided *"to increase the IMF de-linked portion to 30% in 2012 with a view to increasing it to 40% in 2014 subject to review should conditions warrant"* (ASEAN+3 Finance Ministers and Central Bank Governors 2012, 7.ii).[5]

2 It should be noted that at the time, China also opposed the Japanese AMF proposal.

3 The ten ASEAN members are Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam.

4 On the IMF's stigma in Asia, see Ito (2012).

5 For a discussion of recent developments in regional financial and monetary co-operation in East Asia, see Volz (2012).

3 The need for greater co-operation between RFAs and the IMF

As Henning (2011) points out, currently no explicit set of rules or formal conventions guides the relationship between RFAs and the IMF. In the past there were cases of *ad hoc* co-operation or informal conventions, but nothing to compare with Article XXIV of the General Agreement on Tariffs and Trade and Article V of the General Agreement on Trade in Services that set out the rules of the international trade regime and guide the relationship between customs unions and free trade areas and the global trade regime under the World Trade Organization. Henning persuasively argues that co-operation should begin before a crisis hits to reduce the risk of co-operation failing in the middle of a crisis. The additional time that is needed to agree modes of co-operation in the midst of a crisis can be costly. The recent, relatively smooth co-operation between the IMF, the European Commission and the European Central Bank (ECB) should not be taken for granted in other regions.[6]

There are other arguments in favour of *ex ante* co-operation between RFAs and the IMF:[7] (i) co-operation would help to avoid "forum shopping" and institutional arbitrage; (ii) co-operation would prevent weakening the IMF's role as the guardian of global financial stability, a role that RFAs cannot assume because of their limited regional mandates; (iii) co-operation would minimise duplication, while at the same time allowing for healthy institutional competition; (iv) co-operation would ensure that the resources provided by one institution are additional, rather than substitutes for the resources provided by another institution; and (v) co-operation would generate mutual benefits from a division of labour and specialisation based on the comparative advantages of the respective institutions.

Moreover, co-operation with RFAs should be seen as a chance for the IMF to strengthen its global role and ensure its continued relevance. To overcome its stigmatisation, the IMF needs to engage with RFAs. The IMF has changed significantly over the last decade: it has become more transparent, it has made advances in governance reform, giving a greater say to developing and emerging economies, and it has overhauled its lending facilities and conditionality.[8] Yet many developing and emerging economies still resent the IMF, and for that reason have become more interested in RFAs. Co-operation with RFAs should be viewed as an opportunity to bridge the divide and increase regional and local ownership of potential IMF programmes. Co-operation does not preclude competition; indeed, competition for the best analysis and of the brightest ideas should be welcome.

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6 Although the IMF staff's discontentment with the European strategy has not been made public, its collaboration on the Greek programme has already experienced severe tensions. John Dizard (2012) commented in the *Financial Times, "Never mind the disagreements between the Greeks and the 'troika' of the euro group, the European Central Bank and the International Monetary Fund. Those are predictable. Though I was surprised at how annoyed IMF officials became with their counterparts at the ECB over its unwillingness to book any losses on their Greek securities."*

7 Cf. Henning (2010, 2011) and McKay et al. (2011).

8 See Marino and Volz (2012) for early experience with the IMF's recent precautionary facilities.

4 Ways to co-operate

On 15 October 2011, in preparation for the Cannes Summit, the G20 Finance Ministers and Central Bank Governors (2011) agreed on six "Principles for Cooperation between the IMF and Regional Financing Arrangements", that were endorsed by the G20 leaders in Cannes the following month.[9] The principles are reproduced in Box 1.

Box 1: G20 Principles for co-operation between the IMF and RFAs

Based on contributions by the EU [European Union] 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.

Source: G20 Finance Ministers and Central Bank Governors (2011).

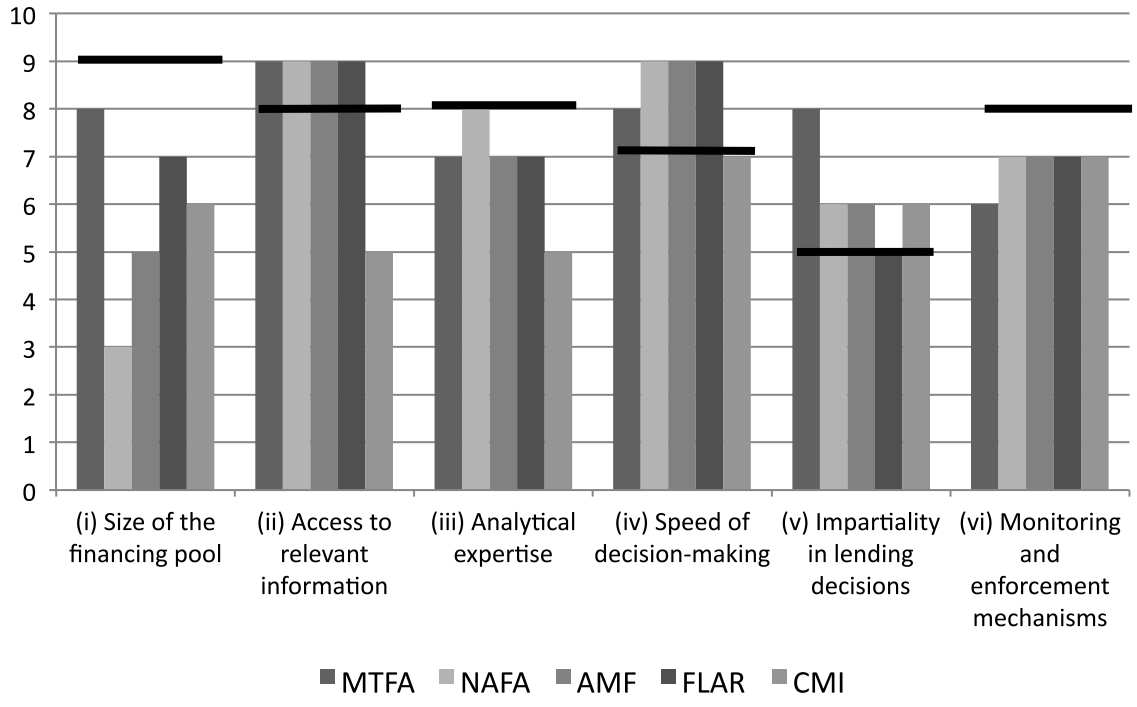
Agreement on these principles among the G20 leaders is a welcome development. But there are two problems with these "non-binding broad principles for cooperation": first, they are *non-binding,* which means that they may or may not be considered in the future; and second, they are *very broad* and hardly go beyond a general agreement that co-operation between RFAs and the IMF is welcome.

Of course, when discussing co-operation between the IMF and RFAs, it is important to acknowledge the differences as well as comparative advantages of respective RFAs. Figure 1

9 With the Korean G20 Presidency's insistence that a global financial safety net be developed, the G20 leaders acknowledged the "need to do further work to improve our capacity to cope with future crises" and tasked the Finance Ministers and Central Bank Governors at the Seoul Summit in November 2010 *"to explore, with input from the IMF: A. A structured approach to cope with shocks of a systemic nature. B. Ways to improve collaboration between RFAs and the IMF across all possible areas and enhance the capability of RFAs for crisis prevention, while recognizing region-specific circumstances and characteristics of each RFA."* (G20 2010, § 25)

shows attempts by McKay et al. (2010) to use different criteria to evaluate five RFAs and compare their performances with the IMF.[10] While the specific ratings can be debated, the respective RFAs and the IMF are clearly shown to have their own strengths and weaknesses. Most RFAs, for instance, enjoy comparative advantages over the IMF with regard to their access to relevant information and greater knowledge of regional economics and politics. However, McKay et al. also show huge differences among the various RFAs with respect to governance, financial resources and analytical expertise, which means that IMF co-operation with RFAs will have to be designed case by case. The G20 Finance Ministers and Central Bank Governors (2011) recognised this, pointing out that "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". Yet the *broad principles for co-operation* are simply too broad to be meaningful. More nuanced guidelines are needed for organising inter-institutional relations, the division of labour in crisis lending, the terms of joint financial rescue missions, and for surveillance and analysis.

Figure 1: Comparing different RFAs and the IMF



Source: Compiled with data from McKay et al. (2010; 2011).

Note: The black bars indicate the IMF's score. *MTFA:* Medium-term Financial Assistance of the EU; *NAFA:* North American Framework Agreement, involving Canada, Mexico and the US; *AMF:* Arab Monetary Fund, with 22 member countries in the Middle East and North Africa; *FLAR:* Latin American Reserve Fund, with 7 member countries in Latin America.

10 McKay et al. (2010) identify six features of particular importance to RFAs in providing effective crisis financing: (i) the size of the financing pool or accessible resources; (ii) timely access to relevant information; (iii) high quality analytical expertise; (iv) speed in decision-making; (v) impartiality in lending decisions; and (vi) mechanisms for monitoring and enforcing conditionality.

Organising inter-institutional relations

A crucial question for framing co-operation between RFAs and the IMF relates to how inter-institutional relations should be arranged (Henning 2011). This has two dimensions. First, how do RFAs organise their external representation towards the Fund and other multilateral institutions? And second, how does the IMF receive representation from RFAs?

Since eligibility for Fund membership is currently restricted to member states, Henning (2011) asks whether IMF membership should be extended to regional organisations/RFAs much as the EU is a member of the World Trade Organisation. RFAs could also grant the IMF observer status.

An alternative that would not require changing the IMF Articles of Agreement, would be to group member states of RFAs in multiple-state constituencies at the IMF.[11] While most current multiple-state constituencies already group together countries of the same region, this is not always the case. For instance, Switzerland (which does not belong to the EU or any RFA) represents Poland, Serbia, and five Central Asian and Eurasian countries. But even for constituencies that comprise countries of the same region, the membership in an IMF constituency is not identical to membership in RFAs of the region. In Latin America, the seven members of the Fondo Latinoamericano de Reservas (FLAR) – Bolivia, Colombia, Costa Rica, Ecuador, Peru, Uruguay and Venezuela – are distributed in three different constituencies (chaired by Argentina, Brazil and Mexico). Forming a "FLAR constituency" could be an effective way to represent FLAR in the IMF. In East Asia, there is more overlap between current constituencies and RFA membership: the constituency currently chaired by Singapore includes all ten ASEAN member countries, as well as Fiji, Nepal and Tonga, who are not members of ASEAN+3 or the CMIM.[12] ASEAN+3 countries could still try to forge common positions on CMIM-related matters through their respective IMF representations, and present these to the IMF board.[13]

European countries' strong presence on the Executive Board ensures European governments' close interchange with the Fund, which is not replicable with other regions. Yet despite a very high level of institutional integration, Europe does not speak with one voice at the IMF. The EU's 27 member countries are scattered in ten different constituencies (with France, Germany and the UK each having their own seat). The 17 euro area members are scattered in eight constituencies. Ireland is in a constituency with Canada, Belize, Jamaica and various small island states. Spain is grouped with several Latin American countries, and rotates a seat on the Executive Board with Mexico. Recurring demands for a single EU or euro area seat in the IMF (e.g. Bini Smaghi 2004) have met with resistance from EU members that have their own Executive Directors on the Board.[14] A single seat for the EU – or at least the euro area – would strengthen Europe's voice on the IMF Board, since it would be the IMF's largest shareholder, and also facilitate IMF governance reform and provide more room for emerging and developing countries to have a seat on the Board. Yet individual governments cannot be persuaded to give up

11 Currently only eight out of the Fund's 187 member countries have a seat on the IMF's 24-member Executive Board: the United States, Japan, Germany, France, the UK, China, Saudi Arabia and Russia.

12 China and Japan have their own seats on the IMF's Executive Board, while a Korean official is currently Alternate Director in a constituency of 14 Asia-Pacific countries. Hong Kong, SAR, which joined the CMIM in 2010, is not a member of the IMF.

13 It is unthinkable that China or Japan would give up their seats (and Korea its rotating seat) for a common ASEAN+3 seat.

14 These are currently Belgium, Denmark, France, Germany, Italy, the Netherlands, and the UK.

their perceived positions of power. However, this European obstinacy should not deter other regions from trying to better organise their IMF representations.

A further option – and the easiest – for organising the representation of RFAs would be to allow RFAs to obtain IMF observer status. Although Europe is a special case with 17 countries sharing a single currency, it still could be used as an example. Since the IMF's Executive Board granted the ECB observer status in 2002, the ECB is invited to send a representative to Executive Board meetings about surveillance over the common monetary and exchange rate policies of the euro area; the policies of individual euro area members (under Article IV); the role of the euro in the international monetary system; the World Economic Outlook; reports on international capital markets; and developments in the global economy (IMF 2010). Moreover, the ECB is *"invited to send a representative to meetings of the Executive Board on agenda items recognized by the ECB and the Fund to be of mutual interest for the performance of their respective mandates"* (ibid.). The ECB representative is also allowed to address the Board about matters the ECB considers important. This could serve as a model for non-European RFAs. Of course, RFAs with observer status at the Fund should report and disclose the details of their institutional arrangements with Fund member countries so as to ensure transparency on both sides.[15]

In line with the G20's flexible approach and taking into account region-specific circumstances, RFA member countries should discuss these options among themselves as well as with the IMF Board and either try to organise joint constituencies or seek observer status for "their" RFA.

The division of labour in crisis lending

A second point relates to the division of labour between the IMF and RFAs in crisis lending. Which circumstances should bring the Fund and RFAs to act as lenders? Should there be any joint lending, and if so, under what conditions?

With reference to the CMIM, Sussangkarn (2012, 215) argues that RFAs should act as providers of short-term liquidity with no conditionality, while the Fund should become active only when it is evident that the underlying problem *"is not a short-term temporary liquidity problem, but a more fundamental one with a need for significant macroeconomic adjustment policies"*. He points out that the CMIM is a short-term swap facility more akin to a central bank swap than a standard IMF loan, given that the CMIM allows the monetary authority of a member country to swap its local currency for an agreed amount of US dollars from the CMIM reserve pool. According to the rules at the time the CMIM was launched, the maturity of each CMIM drawing was 90 days, with an option to roll over the swap up to seven times (i. e. about two years in all).[16] According to Sussangkarn (2012, 215), the CMIM should thus be seen as *"a crisis prevention facility meant to assist an economy in dealing with short-term temporary shortages of foreign currencies such as when a rapid capital outflow occurs like in the case of*

15 See Henning's (2006, 177–178) proposal for a set of principles that RFAs should adopt in order to guide their relationships with the Fund.

16 In May 2012 the ASEAN+3 Finance Ministers and Central Bank Governors (2012, 7.iii) agreed to *"lengthen the maturity and supporting period for the IMF linked portion from 90 days to 1 year and from 2 years to 3 years, respectively; and those for the IMF de-linked portion from 90 days to 6 months and from 1 year to 2 years, respectively"*.

South Korea during the subprime crisis." In such cases it would *"not make sense to impose conditionality of an IMF loan on the economy"* (ibid.), hence Sussangkarn recommends doing away with the IMF link in its present form. In his view, the IMF should get involved once *"an economy's requested rollover of the swap exceeds a number of times – may be three or four times"* (Sussangkarn 2012, 216) since this would signal fundamental weaknesses that would call for structural adjustment.

This proposal raises two concerns. First, where it is clear from the start that a particular economy does not simply face a temporary shortage of foreign currency liquidity but rather has structural deficiencies, valuable time could be lost in making the necessary structural adjustments, since the country's government might be tempted to delay reforms, and instead introduce temporary liquidity support – which would not help to solve the underlying problems. The challenge is to distinguish problems of liquidity and of solvency, since the transition between these is often blurred and a problem with liquidity can quickly turn into a problem of solvency if not addressed quickly.

The second concern relates to the IMF's role as a "bad cop" that takes over RFA crisis management after about a year of unconditional liquidity support. Were this the yardstick for the division of labour between RFAs and the IMF, it would imply that the IMF would only get involved in the tough cases, where painful structural adjustments are needed. Does the IMF want to be in the position to take the blame, leaving RFAs responsible for the "friendly" bit?

An alternative to Sussangkarn's approach of sequencing RFA and IMF involvement would be exploring the establishment of links between the Fund's new precautionary facilities (the Flexible Credit Line, FCL, and the Precautionary and Liquidity Line, PLL) and available contingent financing from the respective RFAs.[17] In the CMIM case, the adjustment to the current IMF link that is needed to make the CMIM fully operational (as argued above) could take the form of recognising the FCL/PLL as a sufficient condition for drawing on the CMIM beyond the first 30% (cf. Henning 2011). This would be a way of maintaining an IMF-CMIM link while allowing CMIM member countries to draw on the CMIM without needing to undergo a standard IMF programme. As Henning (2011) points out, this would also facilitate activation of the CMIM and help reduce the Fund's stigma in the region.[18] The non-linked portion could also be increased from the current 30% – perhaps to 50%.[19] Establishing similar linkages with other RFAs could help improve interaction between RFAs and the Fund while also making the Fund's precautionary arrangements more attractive to member countries.

Following a heated discussion in early 2010 about whether the IMF should be involved in the resolution of the European debt crisis, informal co-operation in parallel disbursements has

17 In May 2012 the ASEAN+3 Finance Ministers and Central Bank Governors decided to introduce a "CMIM Precautionary Line", a facility modelled upon the IMF's recently developed crisis prevention facilities. But there is no agreement yet on the details of this facility.

18 A decade ago, Henning (2002) proposed that the ASEAN+3 agree that prequalification for the Contingent Credit Line, which the Fund abandoned in 2003 due to a lack of takers, should satisfy the CMI definition of an IMF programme.

19 There were considerable differences among the ASEAN+3 Finance Ministers and Central Bank Governors at their May 2012 meeting regarding the increase of the IMF de-linked portion in 2012. China and Japan – the two biggest contributors to the CMIM – only reluctantly ceded to the demand of ASEAN countries to increase the de-linked portion from 20% to 30% and include a reference to a further increase to 40% in 2014 that would then be "subject to review should conditions warrant" (ASEAN+3 Finance Ministers and Central Bank Governors 2012, 7.ii).

taken place in Europe between the new European facilities and the IMF. Although lending under the European Financial Stabilisation Mechanism (EFSM) and the European Financial Stability Facility (EFSF) has not been legally tied to IMF disbursement, the IMF and European authorities understand that both will proceed simultaneously.[20] The disbursement of funds is approved by the "troika", which is made up of officials from the IMF, the European Commission and the ECB. The troika also observes enforcement of programme conditionality. However, while EFSM/EFSF lending is implicitly linked to IMF programmes, it remains open whether this practice will also apply to the new, permanent ESM.[21] The IMF's involvement in managing the crisis in Greece is widely held to be a failure because the IMF, which has taken a junior role in the European crisis, agreed to a flawed crisis strategy based on unrealistic assumptions.

The procedure for applying to IMF and RFA financing should also be clarified. EU member states are formally required to consult with the European Commission before asking the IMF, or any other international financial institution, for financial assistance. Unsurprisingly, the European Commission was not happy when Poland sought its FCL arrangement with the Fund in April 2009 without giving them prior notice. (Poland argued that the FCL was not a full IMF programme but rather an insurance facility.) Other RFAs lack comparable provisions.

How can a joint financial rescue by the IMF and an RFA be arranged?

Thirdly, it is necessary to discuss the modalities and negotiation of co-operation in lending, which involves a (formal or informal) agreement regarding the respective IMF and RFA shares of contributions and the terms of assistance in relation to maturity, interest rates and possibilities of renewing (Henning 2011). The respective loan size depends on the type of lending discussed above, as well as the "firepower" of the respective institution, that is the amount available for lending. The amounts available under the prospective ESM and an extended CMIM will enable these RFAs to act on par with – or even outsize – the Fund's lending, whereas other RFAs, such as FLAR, have only a fraction of the Fund's resources at their disposal.[22]

Regarding the terms of assistance, the G20 Principles (§5) appropriately demand that *"[c]onsistency of lending conditions should be sought to the extent possible".* Henning (2011) points out that lending rates need not be identical, but that forum shopping and institutional arbitrage should be avoided (see also McKay et al. 2012). The same applies to the policy conditionality attached to lending. Governments of crisis countries might be inclined to "conditionality shop" – to borrow from the financing arrangement that attaches the weakest conditionality to

20 The EFSM, which was launched in May 2010, provides that the European Commission can borrow up to EUR 60 billion in financial markets on behalf of the EU under an implicit EU budget guarantee. All EU members are eligible to apply for EFSM financing. It is reviewed every six months. The EFSF was created by the member states of the euro area following decisions taken in May 2010. It is backed by guarantee commitments from euro area member states for a total of EUR 780 billion and has a lending capacity of EUR 440 billion. EFSF financing is available only for euro area members. The EFSF is only temporary and will be succeeded by the permanent European Stability Mechanism (ESM), which was inaugurated in October 2012.

21 Article 8 of the Treaty establishing the European Stability Mechanism states: "The ESM will cooperate very closely with the International Monetary Fund ("IMF") in providing stability support. The active participation of the IMF will be sought, both at technical and financial level. A euro area Member State requesting financial assistance from the ESM is expected to address, wherever possible, a similar request to the IMF."

22 FLAR had a subscribed capital of USD 2.3 billion as of 19 August 2011.

its loan (or none at all) – which could lead to necessary reforms being deferred and increase the risk of the crisis causing even bigger problems.

A further issue to be discussed *ex ante* between the Fund and RFAs so as to avoid conflicts during crisis negotiations is the creditors' seniority in cases of joint lending by the Fund and RFAs. The IMF has enjoyed *de facto* preferential creditor status in accordance with its status as an international financial institution. The EFSF has not claimed preferred creditor status, since *"[p]rivate investors would be reluctant to provide loans to the country concerned if there were too many preferred creditors"* (EFSF 2012, 3). But it is not clear that other RFAs will follow this stance, so this issue should be clarified; ideally, RFAs should endorse the G20's demand that "RFAs must respect the preferred creditor status of the IMF" (§5).

Co-operation in surveillance and analysis

A fourth point that needs to be addressed relates to co-operation in financial market surveillance and analysis. While in principle, it is desirable to get independent analysis from the IMF and the RFAs – which ideally would stimulate competition for better analysis – co-operation is needed to ensure the efficient use of resources and dissemination of information.

Several concrete steps could be taken: the IMF could invite RFAs to Article IV surveillance missions and (together with the World Bank) to Financial Sector Assessment Programmes, subject to approval by the respective government. The current practice of the IMF, European authorities and EU member states collaborating on surveillance, with European officials involved in Article IV consultations, could serve as a model for other regional frameworks.[23]

Discussions and information exchanges during joint missions would not only increase overall understanding of the economy in question, but also help build trust between staff from the IMF and RFAs, and facilitate institutional co-operation in times of crisis. Regular staff exchanges and joint training programmes would further enhance knowledge about how all the institutions function. The IMF could also provide capacity-building measures for RFA staff at one of its seven regional training centres – just as it offers training for officials from its member countries.

Enhanced co-operation should not erode the independence of RFAs and reduce them to mere outposts of the IMF, however. The RFA's analytical independence should be maintained, and a competition of ideas should be encouraged in order to avoid the "silo mentality and insular culture" for which the Fund was criticised by its own Independent Evaluation Office (IEO 2011, 1).

23 It should be noted that while the IMF delegation meets with European officials during its Article IV consultations to EU member countries, European officials are not part of the delegation.

5 Conclusions

In the decade following the Asian financial crisis, the IMF underwent its own reputational and financial crisis, during which it was forced to lay off staff on a large scale for the first time. Although the IMF is back in business, it urgently needs further governance reform, including a reform of quota shares, changes regarding country representation on the Executive Board, and the selection of the managing director and other senior staff. Building on the recent introduction of precautionary facilities, the Fund also ought to continue to reform its lending tools.

With the Fund still stigmatised, RFAs have become an attractive alternative to IMF lending, and a means for emerging economies to insist on further IMF governance reform. While RFAs can be constructive in preventing or combating financial crises, and a healthy competition for surveillance and ideas between RFAs and the IMF should be welcome, dangers to (global) financial stability could arise should an RFA undermine the Fund's authority and *complicate* the Fund's work instead of *complementing* it. Efficient forms of interaction between RFAs and the Fund are needed. Co-operation would also help the Fund to engage with the different regions and increase member countries' sense of ownership in joint programmes – which in turn would help the Fund to shed its stigma.

The G20 has recognised there is a strong case for *ex ante* co-operation between the IMF and RFAs in order to avoid institutional arbitrage and ensure efficient co-operation in times of crisis. While principles and modalities of co-operation should be general enough to account for differences among RFAs, the G20 Principles endorsed at the Cannes Summit in November 2011 are too general to be meaningful. More specific guidelines are needed regarding inter-institutional relations, the division of labour in lending, surveillance and analysis, and the terms of joint financial rescue missions. In this respect, the adoption of a "code of conduct" (Henning 2006) to guide IMF-RFA relations would be helpful. The IMF should actively seek to negotiate individual agreements with the respective RFAs, taking into account regional specifics and differences. RFAs that agree on a formal code of conduct could be granted observer status at the Fund.

The current co-operation between the IMF, the European Commission and the ECB to solve the European sovereign debt and banking crisis sets an important precedent for co-operation between the Fund and other regional arrangements. Not only are European countries among the most influential members of the Fund and heavily represented on its Executive Board, but the EU is also the world's most advanced form of regional financial co-operation. European policymakers should recognise the far-reaching implications of how Europe crafts its relationship with the Fund.

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