B. Comparison of Regional Financing Arrangements and Implications for Development of the Chiang Mai Initiative Multilateralization

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1. Introduction

According to the IMF, the global financial safety net refers to a set of crisis prevention and resolution instruments, encompassing self-insurance (reserves); bilateral arrangements (e.g. swap lines between central banks during periods of stress); regional arrangements such as those in Asia, Europe and Latin America; and, multilateral arrangements with the IMF at their center.

In this article, we consider the role of global financial safety nets as a liquidity provision mechanism to prevent and resolve financial crises, and identify the position of regional financial safety nets in the global architecture. Then, we compare other regional financial safety nets with the Chiang Mai Initiative Multilateralization (CMIM) and present policy recommendations for strengthening the CMIM function.

2. Emergence of Regional Financing Arrangements

The cross-border capital flows in the global financial market have increased rapidly in the last 20 years. Gross capital inflows have reached an unprecedented level during the run-up to the recent global financial crisis not only in nominal term, but also in GDP percentage, surpassing 20% of GDP in advanced economies and 10% of GDP in emerging economies.

The large swing of cross-border capital flows over time has made it more likely that problems in a particular region to spread to the rest of the world very quickly.
and affect those countries which have maintained sound macroeconomic policies and have no solvency problem. Although capital flow management measures may help reduce the risk associated with volatile capital flow, stringent government regulations cannot fully insulate emerging market economies from the risks of sudden stop of capital flows. Notwithstanding, there exists no international lender of last resort when an emerging market economy suffers from liquidity shortage of internationally accepted hard currency. This drawback is an incentive for markets to bet against a country at the first sign of liquidity pressure. In this regard, it is important to enhance the global financial safety nets which allow countries in need to have access to potentially substantial resources to prevent and reduce the costs of financial crises.

Regional financing arrangements are positioned as a building block of global financial safety nets through which international cooperation is pursued to provide adequate liquidity for more stable global financial markets.

There has been a growing emphasis on strengthening the role of regional financial arrangements and enhancing the cooperation between the international financial institutions, such as the IMF and regional financing arrangements in surveillance and financing. Furthermore, the G20 leaders endorsed the “G20 Principles for Cooperation between the IMF and Regional Financing Arrangements” at the 2011 Cannes Summit.

3. Comparison of Regional Financing Arrangements

During the 2008 global financial crisis, regional monetary cooperation played critical roles to mitigate adverse effects of the crisis. Europe currently has three regional monetary cooperation systems: 1) the Medium Term Financial Assistance Mechanism (MTFA, also known as Balance-of-Payments Assistance), 2) the European Financial Stabilization Mechanism (EFSM) and, 3) the European Financial Stability Facility (EFSF).