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About the Author

C. Randall Henning is professor of international economic relations at the School of International Service, American University. He specializes in international and comparative political economy, global governance and regional integration. He has focused recently on multilateral and regional financial institutions, Europe's monetary union, fiscal federalism and the Group of Twenty. His most recent book is *Tangled Governance: International Regime Complexity, the Troika, and the Euro Crisis* (Oxford, April 2017) and he has published in several academic journals. Previously, he served as visiting fellow at the Peterson Institute for International Economics. Currently, he is conducting a comparative project on international regime complexity.

About Global Economy

Addressing the need for sustainable and balanced economic growth, the global economy is a central area of CIGI expertise. The Global Economy initiative examines macroeconomic regulation (such as fiscal, monetary, financial and exchange rate policies), trade policy and productivity and innovation policies, including governance around the digital economy (such as big data and artificial intelligence). We live in an increasingly interdependent world, where rapid change in one nation's economic system and governance policies may affect many nations. CIGI believes improved governance of the global economy can increase prosperity for all humankind.

Acronyms and Abbreviations

AMRO	ASEAN+3 Macroeconomic Research Office
ASEAN	Association of Southeast Asian Nations
BRICS	Brazil, Russia, India, China and South Africa
CIGI	Centre for International Governance Innovation
CMIM	Chiang Mai Initiative Multilateralization
ECB	European Central Bank
EMDCs	emerging-market and developing countries
EPG	Eminent Persons Group
ESM	European Stability Mechanism
FLAR	Latin American Reserve Fund
G20	Group of Twenty
IEO	Independent Evaluation Office
IMF	International Monetary Fund
IRC	International Relations Committee (of the ECB)
NAB	New Arrangements to Borrow
PCI	Policy Coordination Instrument
RFAs	regional financial arrangements

Executive Summary

The growth and proliferation of regional financial arrangements (RFAs) have substantially increased the complexity of the global financial safety net. The International Monetary Fund (IMF) often shares the task of fighting crises with such institutions. But, in addition to significant benefits, institutional overlap poses potential pitfalls that architects of financial governance should anticipate and avoid. This paper addresses seven such pitfalls, as they relate to competition, transparency, moral hazard, special-interest capture, secretariat autonomy, conflict resolution and creditor seniority. The paper also provides an update on regional arrangements in Europe, East Asia and Latin America, reviews their engagement with the IMF and offers recommendations for their further development. Critiquing official reports on financial governance, the paper concludes, among other things, that institutional competition, while harmful in program conditionality, can be beneficial in economic analysis and surveillance; regional arrangements should become more transparent; and the acuteness of moral hazard depends critically on institutional governance. Finally, because each affects the ability of others to carry out their tasks, these institutions should co-evolve.

Introduction

July 2019 marks the seventy-fifth anniversary of the conference at Bretton Woods, New Hampshire, that created the World Bank and the IMF. These institutions confront challenges now that are more severe than those on earlier major anniversaries. Nationalist political movements in several advanced and emerging-market countries threaten the commitment to multilateral institutions and the effectiveness of global financial governance. When the global economic and financial cycle begins a downturn, any weakening of international financial institutions and arrangements by which they cooperate would impair their ability to combat crises and stabilize the global economy. It is important to ensure that these institutions are not only healthy, but also equipped to cooperate effectively with one another to deliver financial assistance.

The Trump administration appears to have blocked the IMF, which has historically been at the centre of global financial governance, from receiving a quota increase (US Treasury 2018). Member governments that wish to support the multilateral institution will probably instead renew the arrangements by which the IMF can borrow from its members (the New Arrangements to Borrow and bilateral borrowing agreements). Under this scenario, quotas will not be reweighted in favour of emerging-market and developing countries (EMDCs) during the fifteenth review, perpetuating under-representation of fast-growing members. With the recent appointment of another US citizen as president of the World Bank, the abandonment of the convention by which the managing director of the IMF is also a European appears to be a receding prospect.

Many EMDCs have been hedging against resistance to modernizing global financial governance on the part of the United States and some European countries by creating and developing alternatives to the multilateral institution over the last two decades. These countries have accumulated international reserves unilaterally, entered into currency swap agreements bilaterally and created financial arrangements regionally and cross-regionally. Together with the IMF, these financial facilities comprise an institutional complex that is often called the "global financial safety net."

One important question at this juncture is how EMDCs will use the new options that they now have at their disposal. These countries have by no means abandoned the IMF; they continue to support and draw from the institution. However, if the United States and other leading countries refuse to update the Fund, these countries are likely to build up alternative institutions further, including their RFAs.

The proliferation of these financial arrangements and institutions substantially increases the complexity of the financial safety net. Such complexity has some advantages — it protects the ability of the system as a whole to respond to crises against the capture (or starvation) of any one of its parts by a narrowly self-serving government. Redundant layers of the safety net serve as insurance against the immobilization of any one layer and augment the total resources that can be brought to bear in a crisis. But, considerable though such advantages might be, complexity is ultimately beneficial only if the different elements are effectively coordinated

and thus do not interfere with one another in a crisis. Such coordination cannot be taken for granted — especially when member states that stand behind the institutions are embroiled in disputes over trade, immigration and/or security.

This paper addresses RFAs and their relationship to the IMF, presenting key points of a larger study prepared by the author for the Centre for International Governance Innovation (CIGI) (Henning forthcoming). It reviews the recent development of three particular RFAs — those in the euro area, East Asia and Latin America — and the challenges facing them and the Fund, recommending the next steps that member states should take to strengthen them. The paper then identifies the pitfalls that arise from marshalling several institutions to work together on financial crises, assesses the threats they pose and offers recommendations for pre-empting or managing them. Given the limitations of space in this paper, seven such problems were selected for discussion: competition, transparency, moral hazard, special-interest capture, secretariat autonomy, conflict resolution and creditor seniority. Likewise, the historical evolution of the institutions has been left for examination elsewhere. Rather than advocating for RFAs over the IMF or vice versa, this paper seeks to strengthen both and improve their coordination, in order to limit the severity of crises and provide financial assistance to vulnerable countries.

The paper emphasizes the need for recommendations that are not only desirable from the economic or technocratic point of view, but also feasible from a political standpoint, given the intergovernmental character of these particular institutions. The IMF and RFAs are, in principle, complementary, but the complementarity must be actively designed into the institutions as they grow together within the complex.

Reports and Perspectives

Concern over the coherence of financial governance has spawned a cottage industry of blue-ribbon panels and expert studies over the future of these institutions and how they should be "knit" together. These include studies by the IMF and RFAs themselves, as well as the European Central Bank (ECB) and independent scholars.[1]

The IMF offers six principles to guide its relationships with regional arrangements (IMF 2017a, 18-19, 36-37). The first of these is that mutual engagement must respect the independence of the institutions from one another. The other five principles state that: institutional mandates and expertise should guide institutions' roles in cooperation; collaboration should be ongoing; program terms and conditions should be consistent from the borrower's standpoint; the Fund's engagement should be even-handed across the regions; and the IMF's preferred creditor status must be respected.

The IMF also lays out two overall visions by which it would collaborate with RFAs in the future — the "lead agency" model and the "coherent program design" model. The choice of the model would depend on the characteristics and capabilities of the RFA and the possibilities for a reasonably clear division of labour. Where "some division of labour" between the IMF and RFA is possible, the two institutions would defer to one another in their respective areas of comparative advantage when designing and implementing programs. Where the overlaps between the capabilities and mandates of the two institutions are so large as to make selective deference infeasible, the coherent-design model would apply. The latter would see early engagement between the institutions and the Fund would adhere to its macroeconomic framework and debt sustainability analysis (IMF 2017a, 2, 17, 22, 25). Authors from the RFAs call for clarification of the modalities, division of labour and combined use of lending instruments (Cheng et al. 2018, 16–18). However, it would be fair to surmise that the IMF expects to follow the coherent program design model in European contingencies and to serve as the lead agency everywhere else.

The Group of Twenty (G20) convened an Eminent Persons Group (EPG) under the leadership of Singapore's Deputy Prime Minister Tharman Shanmugaratnam, and they delivered their report in October 2018. Calling generally for cooperation, the EPG report advocated strengthening

1 In addition to the work cited in this section, see Miyoshi et al. (2013); Rhee, Sumulong and Vallé (2013); Ocampo (2017); Grabel (2017); Henning (2017a; 2017b); Roberts, Armijo, and Katada (2017); Lombardi, Eichengreen and Malkin (2018); Triggs (2018); Kring and Grimes (2019); and Malone and Medhora (2019).

coordination of multilateral development institutions, facilitating countries' openness to international capital markets and integrating the surveillance activities of the IMF, Financial Stability Board and Bank for International Settlements. With respect to the IMF and RFAs specifically, the report recommended establishing a "clear assignment of responsibilities and protocols for joint actions," which would include "discussions of coherence of ex-post conditionality" and liquidity needs. The group wanted to keep alive proposals for an IMF liquidity facility, which could be coordinated with similar facilities offered by the RFAs. The EPG recommends that the Articles of Agreement of the Fund, World Bank and other multilateral development banks be amended to delegate greater decision making — presumably with respect to design and approval of programs and projects — to the management of each institution (G20 EPG 2018, 1–27).

José de Gregorio, Barry Eichengreen, Taketoshi Ito and Charles Wyplosz address the relationship of the IMF to RFAs in the context of an ambitious report on IMF reform.[2] They propose that the IMF "negotiate formal agreements with current and future RFAs and consider a binding arbitration procedure to resolve disagreements" (Geneva Report 2018, 53–55). They advocate that the IMF create a fast-qualifying, non-conditional facility that would effectively substitute for bilateral swap agreements. They also propose to reorganize the governance of the IMF along the lines of an independent central bank, wherein the management team would make decisions and take responsibility for program design and disbursements. The management team would be selected by a new voting procedure and accountable to an executive board that could be made non-resident and convene six to eight times a year (ibid., xx-xxiii, 72-73). The authors base their argument on the IMF's susceptibility to time inconsistency: it might declare *ex ante* that it will not lend to countries whose debt is not sustainable, such as Greece, but in the event will nevertheless succumb to pleas for lending from executive directors who represent countries that would otherwise suffer from a debt restructuring.

By contrast, the Independent Evaluation Office (IEO) of the IMF expressed concern that distancing program approval and lending decisions from national governments would weaken the Fund's accountability and legitimacy, not strengthen them (IEO-IMF 2018). The EPG, for its part, takes a nuanced view on governance within the international financial institutions. The executive boards should focus on strategic priorities for the institution and hold management to account for advancing them, although IMF "surveillance and lending programs may involve broader considerations that require Board discussion" (G20 EPG 2018, 73–75, n. 83). Such reforms impact the ability of the IMF to collaborate with RFAs.

Meanwhile, Beatrice Weder di Mauro and Jeromin Zettelmeyer (2017) raise the alarm against moral hazard when the IMF and RFAs are brought together. They argue that the IMF failed to anchor the European Stability Mechanism (ESM) against drift toward "soft financing" in the case of Greece, and advocate that RFAs develop their own policy frameworks with safeguards against lending to countries with unsustainable debt. Authors located at the ECB (Scheubel and Stracca 2016; International Relations Committee [IRC] Task Force on IMF Issues 2018) raise similar concerns.

Technocratic versus Political Prescription

Most of the reports on global financial governance, including the G20 EPG and Geneva reports, are guided by an approach that is technocratic, seeking to advance financial stability and the economic welfare of the global system. Normatively speaking, they resist the constraints that are imposed on institutional design and interaction by virtue of the intergovernmental nature of these organizations. Revealingly, the G20 EPG (2018) report states, "policy thinking on the issue has often been shaped by whether one sits in [capital] sending or receiving countries. We have to move beyond this."

If the resources for crisis finance were to come from non-state actors, the world might indeed "move beyond this." But that is not realistic over the relevant planning horizon. For the time being, the relationships among the IMF and RFAs must be designed with the understanding that national finance ministries and central banks will insist

2 Hereafter referred to as the "Geneva Report" for the series in which it appears.

on control over the institutions — that is, within an intergovernmental paradigm. Rather than ask creditors and debtors to put aside financial status, architects of governance must search for institutional pathways along which they can cooperate that are consistent with these interests — a pathway that might be narrow but, insofar as states' interests do overlap, can be found.

Moreover, it would be dangerous for architects of global financial governance to feign innocence of institutional politics. This is one of the greatest lessons of the euro crisis. In Europe, monetary integration had gotten out in front of political integration, creating severe vulnerabilities. While it is possible to envision a more complete monetary union, one in which risk is better shared across the membership, this would require deep changes in euro-area governance. If governance does not catch up — and this remains to be seen — monetary integration could be endangered once again.

Fundamentally, international financial institutions are created by, maintained by and responsible to their member states. For various reasons, however, institutions often migrate away from the preferences of powerful states, a tendency called "agency drift." The euro crisis shows that states can use one institution to correct such drift and reassert control over institutions (Henning 2017a; 2019). Involving multiple institutions in financial rescues, as in the case of the "troika," can give rise to expensive disputes, but states prioritize control instead. When institutional disagreements become intense and create deadlock, key states, usually creditors, mediate the disputes. In so doing, they put their thumb on the scale and tilt the outcome toward their preferences. Mediation is thus one way in which key states maintain control and, as a consequence, they *under*invest in mechanisms that might otherwise better anticipate and resolve institutional conflict *ex ante*.

As a consequence, mechanisms of *ex ante* coordination of intergovernmental institutions are rarely, perhaps never, going to fully satisfy architects who take a functionalist approach to the design of complexes of institutions. When designing institutions and the relationships among them, architects of the safety net should identify both what is desirable *and* feasible, not simply one or the other; however, they should *act* at the intersection of the two approaches, rational-technocratic and political-institutional.

Parenthetically, it should be noted that, although states in some emerging regions of the world originally created financial arrangements to bypass or constrain the IMF, the RFAs themselves are not immune from agency drift. So, the pivotal states in each region might use the IMF to constrain drift on the part of an RFA, rather than necessarily vice versa — as witnessed during the euro crisis.

The Institutions

RFAs have emerged in most, but not all, regions of the world. The IMF (2017a, 6) defines them simply as "a financing mechanism backed by pooled resources through which a group of countries pledge common financial support to a fellow member in the event of external liquidity needs or balance of payments difficulties."[3] Table 1 lists 10 institutions that qualify as RFAs. Notice, first, that they are quite heterogeneous: some have a mandate and capacity for economic surveillance and analysis, but others do not. Some RFAs have mandates for economic integration of the region and economic development. The ESM, with a lending capacity of €500 billion, is very large, while others can mobilize only a few billion US dollars. The heterogeneity of RFAs complicates efforts to develop general protocols for other institutions' engagement with them.

This section briefly considers the challenges that presently confront the ESM, Chiang Mai Initiative Multilateralization (CMIM) and the ASEAN+3 Macroeconomic Research Office (AMRO),[4] and the Latin American Reserve Fund (FLAR by its Spanish acronym) — a set in which the RFAs range from large to small and whose relationships with the IMF vary.[5] In addition, reforms to these RFAs that would better enable them to stabilize their region and engage with the IMF are considered. The section

3 The RFA authors adopt a somewhat different definition: "a crisis prevention or resolution mechanism for a defined region or a group of countries sharing similar economic characteristics (for example, BRICS [Brazil, Russia, India, China and South Africa]) and mandated to provide emergency liquidity to its member countries" (Cheng et al. 2018, 5-6).

4 ASEAN+3 refers to the Association of Southeast Asian Nations plus China, Japan and South Korea.

5 More historical accounts and elaborate description of the RFAs can be found, in, for example, IMF (2017b); Cheng et al. (2018); and Miyoshi et al. (2013).

Table 1: RFAs and Their Relationship to the IMF

Name of Fund	Eligible Members	Size	Nature of Link to the IMF
EU Macro Financial Assistance Facility	EU neighbouring countries	€2.0 billion	Formal
EU Balance of Payments Facility	Non-euro members of EU	€50 billion	As a matter of practice
European Financial Stabilization Mechanism	All EU members	€60 billion	Formal presumption
ESM	Members of euro area	€500 billion	Formal presumption
CMIM	ASEAN+3 countries	$240 billion	Formal for 70 percent of allotment
Arab Monetary Fund	22 Arab countries	$4.8 billion	Loans usually with IMF program
FLAR	Andean countries, plus	$4.7 billion	Not formal, but often de facto
North American Framework Agreement	Canada, Mexico and the United States	$14 billion	US Treasury requires letter from IMF
Contingent Reserve Arrangement	BRICS	$100 billion	Formal for 70 percent of allotment
Eurasian Fund for Stabilization & Development	Russia and Central Asia	$8.5 billion	Not formal, often de facto
SAARC Swap Arrangement	South Asian countries	$2.0 billion	No explicit role for IMF

Sources: IMF (2017a); institutional websites; author's assessment.

also discusses recent changes at the IMF and their implications for inter-institutional cooperation.

Europe

The ESM has wound down its programs for the euro-crisis countries, although it continues to conduct post-program monitoring for them alongside the European Commission and the IMF.[6] The Eurogroup and European Council have agreed on a set of changes to the ESM that would enhance its role in surveillance, program design, precautionary financing and support for the Single Resolution Fund in future contingencies.[7] These have been rendered into formal amendments to the ESM treaty and, once a broader package of euro-area reforms is agreed, are expected to be submitted for ratification by the member states. As of this writing, it is not clear when these changes will take effect — given uncertainties surrounding elections in several countries, European leadership selection and Brexit. Meanwhile, the ESM and European Commission are redefining their division of labour with respect to surveillance, debt sustainability assessment and program design, which will take the form of a new memorandum of understanding.[8]

Euro-area member states should finalize the remaining elements of the reform package and ratify the changes to the ESM treaty. The rest of the world should welcome these changes as contributions to the European and international architecture and thus financial stability.

Two further points must be added, however. First, while they are improvements over the status quo, the current changes to the ESM alone are not likely to suffice in ensuring stability of the euro area over the long term. They are renovations to the existing institutional design rather than wholesale redesign of the architecture. Abandoning the unanimity decision rule for financial assistance in favour of qualified majority voting, among other reforms, will probably ultimately be necessary.

Second, until that is accomplished, the goal of Europe-only rescues is likely to remain elusive

6 Work on the troika arrangement in the euro crisis includes Pisani-Ferry, Wolff and Sapir (2013); European Parliament (2014); IEO-IMF (2016); Kincaid (2016); Véron (2016); Blustein (2016); Moschella (2016); Lundsager (2017); and Henning (2017a).

7 See www.consilium.europa.eu/media/37535/14-euco-final-conclusions-en.pdf and www.consilium.europa.eu/en/press/press-releases/2019/06/15/economic-and-monetary-union-eurogroup-agrees-term-sheet-on-euro-area-budgetary-instrument-and-revised-esm-treaty/.

8 See www.esm.europa.eu/press-releases/joint-position-future-cooperation-between-european-commission-and-esm.

in the judgment of this author. With unanimity decision making, one country or another is likely to request inclusion of the IMF in financial rescues — just as occurred repeatedly in the euro-crisis programs — a likelihood that is accentuated by the fragmented nature of electoral politics within several European countries. Under these circumstances, planning must continue for contingencies in which the IMF will be co-lending to euro-area countries or otherwise involved in program design and implementation.

Relations among the institutions in any "new troika" could be even more strained than during the euro crisis, however. The United States and other non-European countries within the Fund, as well as Fund management, are likely to scrutinize euro-area-wide policies that impinge on programs more carefully and drive a harder bargain on debt restructuring.

Prior to the emergence of a crisis, therefore, the ESM, the European Commission and the IMF should conduct dry runs on reconciliation of their respective debt sustainability analyses of high-debt countries, in order to identify points of disagreement in advance, and tee up the informal mechanisms by which disputes over program design can be resolved. Specific scenarios that should be anticipated are the joint use of precautionary arrangements, deployment of the Fund's Policy Coordination Instrument (PCI), and a Fund program that would complement activation of Outright Monetary Transactions on the part of the ECB.

East Asia

In East Asia,[9] the ASEAN+3 group is also in the process of evolving its two regional institutions — AMRO, which is based in Singapore, and the CMIM, which is managed by the finance ministers and central bank governors and their deputies. The CMIM is nominally large, US$240 billion in total, but has never been activated.[10] Borrowers must secure a program with the IMF in order to access more than 30 percent of their allocation under the arrangement — a provision known as the "IMF link." Whether to raise the de-linked portion has been a subject of debate within the group. Looming over these institutions are security tensions between China and Japan, as well as among other countries in the region.

If ASEAN+3 member states decided to create a full-fledged RFA that mirrored the institutional model of the ESM or the IMF, they would need to adopt three important institutional reforms. First, the member states would agree to combine AMRO and the CMIM into a unified institution, allowing the secretariat to analyze requests for disbursements without national officials serving as intermediaries and to design programs, negotiate them with borrowers, and propose agreements to the decision-making body for approval. This change would also allow the secretariat to represent the combined institution to third parties, including other institutions such as the IMF. Second, ASEAN+3 member states would agree to pool the reserves that back the CMIM into a single account, in the form of either a quota contribution or a capital subscription. Either path would simplify financial operations and give more certainty to disbursements. Finally, the agreement underpinning the new, combined institution should be made public, which is not presently the case with the CMIM Agreement. Disclosure would be essential for an institution that lends large sums on programs of its own design, whether they are lenient or austere.

Latin America

Originally founded in 1978, FLAR has been an active lender during the debt crisis of the 1980s and other periods of financial stress in the region. The institution is nominally independent from the IMF, a point in which many advocates of Latin American regionalism take pride.[11] However, it also must be said that FLAR's programs are closely related to financing from other institutions. Its activations have often bridged to IMF programs — the current program with Ecuador being a case in point — or follow up on them. While FLAR's lending eases members' liquidity constraints, severe crises in the region require

9 On financial arrangements in East Asia, see Grimes (2009); Katada (2012); Kawai (2015); Chang (2016); Henning (2002; 2017b); Sterland (2017); Pitakdumrongkit (2016); Sussangkarn (2011; 2017); and Chabchitrchaidol, Nakagawa and Nemoto (2018).

10 ASEAN+3 finance ministers and central bank governors recently reviewed and amended the CMIM Agreement; these amendments are now in the process of being ratified by member states. See their 2018 and 2019 statements at https://asean.org/category/asean-statement-communiques/.

11 On the evolution of and challenges confronting FLAR, see Ocampo and Titelman (2012); Latin American Shadow Financial Regulatory Committee (2012); Haggard (2013); Perry (2013); Rosero (2014); Grabel (2017, 152–59); FLAR (2017); and Kring and Grimes (2019). For discussion of bypasses to the IMF, see Medhora (2017).

financing and adjustment on a scale that is larger than FLAR, in its current form, can provide.

FLAR could play a larger, constructive role in common regional projects and emergencies in Latin America. The protracted crisis in Venezuela could be a strategic opportunity for the small regional fund if it worked in partnership with the IMF, multilateral development banks and other international organizations. To facilitate such a contribution, however, member states should scale up FLAR with additional financial resources and enhance its administrative budget. As a strategic objective, FLAR should expand its membership to one or more of the large countries of the region. Achieving that objective is likely to require in turn introducing weighted voting to its governance procedures and/or enhancing the institution's relationship to the IMF — measures that some current members resist.

IMF

The IMF has not been standing still while regions have developed financial arrangements.[12] To the contrary, over the last several years it has reviewed its lending framework, its relationships with regional financial arrangements and its tool kit of financial facilities (IMF 2015; 2017a; 2017b, respectively). It reviewed its lending programs to European countries and its policies toward lending to members of currency unions in general (IMF 2018.) The quota increase and governance reforms that had been agreed in 2010 finally went forward in 2016. As a complement to the quota increase, the systemic exemption to the Exceptional Access Policy was closed in 2016, thus, in principle, preempting future loans to countries whose debt is unsustainable.[13]

The Fund has undertaken a series of more specific measures that would affect its engagement with regional institutions. In 2017, the executive board approved a new tool, the PCI, by which Fund staff can define a program that would be funded by other sources, including an RFA (IMF 2017b). Second, Fund staff proposed, and the executive board considered, but did not approve, the creation of a short-term liquidity swap facility — the functional equivalent of a bilateral swap arrangement. The proposal remains "on the shelf" and could possibly be adopted at a moment when financial markets become volatile. Third, to address members' concerns about the use of its precautionary lines, the IMF refined the qualification framework for the Flexible Credit Line and the Precautionary and Liquidity Line in order to make qualification more predictable. The changes should also facilitate the alignment of the qualification criteria of the Fund's precautionary arrangements with those of the CMIM and the ESM.

The G20 and the International Monetary and Financial Committee have repeatedly affirmed that the IMF remains "at the center" of the global financial safety net.[14] The link is the single most important manifestation of the centrality of the Fund, the glue that holds the safety net together. RFAs link their lending to the IMF differently: some link formally, whereas others link informally or de facto while stressing their formal independence (see Table 1). Use of RFAs without any role for the IMF tends to occur for short-term liquidity contingencies, often drawings on the reserve tranche, or in some cases for sectoral or project loans. Few if any major balance-of-payments programs that require substantial economic adjustment on the part of the borrower have been financed and managed without any involvement or cooperation of the IMF. Predictably, large creditor countries seek the involvement of the Fund to design programs, monitor adjustment and thus assure repayment.

But political opposition within countries that have historically led the IMF, including but not limited to the United States, threatens the strength of the link in the future. At the moment, the IMF's resources amount to somewhat less than US$1.4 trillion, split about evenly between quota contributions and borrowing arrangements with its members. Of the borrowing arrangements, US$265 billion comes from the New Arrangements to Borrow (NAB) and US$450 billion comes from bilateral agreements. However, a number of bilateral agreements could be phased out in 2020 and the NAB could lapse in 2022 if it is not renewed (Truman 2018). Despite the quota increase and reform that came into effect three years ago, the resources that are available to the Fund might soon be declining.

12 On the history of the IMF, see, among others, Boughton (2001; 2012).

13 See IMF (2016). Whether the closure solves the time inconsistency problem in exceptional access remains to be seen, as the executive board could conceivably reopen the exemption in a future crisis.

14 See www.imf.org/en/News/Articles/2019/04/13/communique-of-the-thirty-ninth-meeting-of-the-imfc and www.g20.utoronto.ca/2018/2018-leaders-declaration.html.

Unless the US Treasury changes its position in the current fifteenth review of quotas, as discussed at the outset of this paper, the most likely outcome appears to be renewal of borrowing arrangements in lieu of a new quota increase. While better than a sharp decline in overall resources, this outcome would perpetuate a certain dependence of the Fund on its lenders, which is not transparent, and under-representation of fast-growing countries in the Fund's voting structure (Sobel 2018; Lundsager 2019; Truman 2019). As EMDCs invest in alternatives to the Fund as a consequence, pitfalls of institutional overlap become more dangerous.

Pitfalls of Overlap

Notwithstanding the benefits of fallback options, the overlap of the RFAs and the IMF gives rise to a series of potential problems. This section examines pitfalls in seven areas — competition, transparency, moral hazard, special-interest capture, secretariat autonomy, conflict resolution and creditor seniority. It offers guidelines for architects of financial governance seeking to knit the institutions together and, in the process, responds to several of the recommendations put forward in recent reports.

Competition and Complementarity

Institutional overlap raises the general question of competition and complementarity: in what areas should institutions compete and in what areas should they cooperate? In international crisis finance, it is important to distinguish between program design and economic analysis.

Competition among creditor institutions in the area of policy conditionality and program design is generally corrosive. In the presence of two or more potential creditors, borrowers are likely to shop around. Pakistan, for example, recently reportedly approached Saudi Arabia, China and the United Arab Emirates before finally turning to the IMF in October 2018 to negotiate a program. Shopping for creditors runs the risk of seriously delaying programs and weakening the conditions attached to them. Institutional collaboration, such as that undertaken by the troika and the lead agency model, is designed to pre-empt creditor shopping.[15]

The functions of economic analysis, forecasting and surveillance are different, however. Challenges by peer institutions nudge staff to "raise their game," justify their conclusions and communicate the results more carefully. Member states benefit from having multiple views on the table, rather than one. The conclusion is that designers of financial governance can tolerate, perhaps even selectively encourage, competition in the areas of economic analysis and surveillance outside of programs, whereas they should insist upon coordination of program design, including conditionality and financing.

Transparency

The IMF has become progressively more transparent over the last two decades and has outpaced most of the other institutions in this respect. While the ESM has taken significant steps, the other RFAs operate by and large confidentially. ASEAN+3 authorities have published summaries of the CMIM Agreement, for example, but have not published the Agreement itself. The discrepancy is problematic in a couple of different ways when these institutions co-finance with the IMF. It can give rise to transparency arbitrage, driving some functions or decisions toward the least transparent institution in the institutional team. The discrepancy can also impinge on communication when, for example, two institutions are called upon to explain a joint program at the rollout press conference. The practice of the most transparent institution should set the standard for cooperation among them.

Improvements in transparency are vital when and if RFAs tool up for a broader range of activities, including program design and policy conditionality. They cannot oversee adjustment programs, which are inevitably controversial, without being at least as forthcoming about their analysis and rationales as the IMF. Failure to advance further along this dimension would weaken their credibility in financial markets and political standing within their own member states. Moreover, greater transparency is important to facilitating dialogue within the regions themselves over the development and

15 For further analysis of this extensively discussed aspect of institutional overlap in finance, see works referenced in the "Reports and Perspectives" section.

use of their financial arrangements. Although it has been made before,[16] the call for transparency is worth reiterating because it is absent from the IMF principles for institutional collaboration.

Moral Hazard

Institutional overlap and complexity could, in principle, contribute to moral hazard. With the thickening of the safety net, private financial institutions could lend and borrow in the expectation that the prospects for financial rescues by the official institutions have risen. If one institution is blocked, for one reason or another, crisis lending could be mobilized through a substitute channel. In this way, the proliferation of official institutions and facilities could stoke excessive private lending, excessive debt issuance and, eventually, larger crises. The argument could apply equally to the official sector as to the private sector.

The IMF has a lending framework that is designed to avoid incentivizing excessive private lending and protect the resources of the institution in lending programs. It does so primarily by requiring a debt reprofiling or restructuring in cases where the borrower's debt might not be sustainable. This requirement was suspended during the euro crisis, controversially, but was reinstituted in early 2016 as mentioned above (IMF 2015; 2016). One plausible strategy would be for regional arrangements to tie their lending to the Fund as an anchor against moral hazard.

Weder di Mauro and Zettelmeyer (2017, 31-32) ascribe this strategy to the euro area when it sought IMF involvement during the euro crisis, but they despair over the result. Because the troika lent to Greece notwithstanding unsustainable debt, they conclude that "using the IMF as a commitment device may not be a reliable, politically viable option for an RFA — even for an arrangement that builds this commitment device into its charter and is keen to make it work." They recommend that RFAs instead develop their own lending frameworks and exceptional access policies and conduct their own debt sustainability analyses.

Three points are worth making in response. First, a close look at RFAs shows that the risk of moral hazard varies considerably among them. Owing to the large size of the ESM and the demonstrated willingness of members to deploy it, the European arrangements are the most susceptible. The CMIM, by contrast, has never been used and cannot plausibly be blamed for excessive lending until its deployment can be reasonably anticipated. While FLAR has been active, its small size constrains its contribution to excessive debt buildup.

Second, it is nevertheless conceivable that RFAs could be ensnared *ex post* in a moral hazard drama to which they did not contribute *ex ante*. Even if their existence has not stimulated excessive lending or borrowing, they could be tapped for lending under soft conditions. As non-European RFAs are developed in the future, moreover, they could contribute to moral hazard *ex ante* if they do not adopt credible prohibitions against lending to governments with unsustainable debt.

Third, if the euro area, Latin America and ASEAN+3 were to develop their own exceptional access policies and lending frameworks, the consistency of their frameworks with that of the Fund would become a serious question — as foreshadowed by the dispute between the European institutions and the IMF over the sustainability of Greece's debt. But if RFAs were to develop frameworks that differ from the IMF's, the flashpoints with the Fund would multiply.

The bottom line is that the analysis of debt sustainability should be coordinated across the institutions, insofar as it is feasible, and if RFAs develop different debt sustainability analysis frameworks, they should be prepared to "go it alone" when disagreements with the Fund cannot be bridged. Although they implemented the third Greek program without IMF financing, even many euro-area officials have a revealed preference for avoiding this course and, at this point in time, the RFAs outside Europe are not equipped to address a large-scale crisis independently.

Capture

Institutional overlap also gives rise to multiple avenues for private capture of official institutions and the processes by which decisions on financial assistance are made.[17] Private creditors are sometimes well placed to cajole, influence or threaten officials in order to manipulate the complex of institutions to their advantage —

16 See, for example, Henning (2002).

17 Capture can occur even when excessive risk taking is not involved and so, while related, is conceptually distinct from moral hazard.

by, among other means, holding "innocent bystanders" hostage for bailouts. Those responsible for designing financial rescues should be alert to the possibility that, as one institution erects safeguards against abuse (such as the IMF's lending framework and reprofiling requirements), private or official lenders who have been imprudent simply exploit other institutions in the safety net. The design of the safety net should ensure, in other words, that redundancy is not being used to "bypass" safeguards against private capture and moral hazard.

Governance is critically important to understanding the risk of capture, as it is in understanding moral hazard. First, because the influence of different regions varies within the IMF, that institution provides better defence against capture and moral hazard for some regions than others. The Fund's commitment to requiring that private creditors reprofile debt in cases of unsustainability will be stronger and more credible for regions that have lesser voting strength within the executive board. Time inconsistency is a greater danger in the case of Europe, because that region can use its greater voting strength to nudge the institution to back off from strong anti-bailout commitments that are taken *ex ante*.

Second, it follows that the IMF's effectiveness as an anchor against moral hazard will change as the weight of countries and their regions change over time in the quota and voting structure of the Fund. Specifically, as voting shares shift from Europe to the EMDCs, the IMF can be expected to be a *stronger* anchor for contingencies in Europe. But the shift will have the unintended consequence of making it a *weaker* anchor for those regions with growing shares, especially East Asia and South Asia. While the quota and voting structure of the Fund should certainly be made more representative of countries' actual weight in the global economy and finance, this problem should be anticipated.

Third, on the whole, the IMF is still likely to provide better defence against capture and moral hazard than RFAs, for several reasons. The IMF's universal membership makes it more expensive to capture than regional institutions. Compared to the regional arrangements, decision making at the IMF is more "distant" from the politics within member states. A liability in terms of responsiveness and legitimacy, this remoteness can be an asset in terms of resisting narrow, private interests. The Fund's value as an anchor is not obsolete.

Secretariat Autonomy

As mentioned, recent studies of global financial governance disagree over the degree of autonomy to be conferred on institutional secretariats. The Geneva Report on IMF reform advocates unprecedented autonomy for balance-of-payments financing institutions, whereas the IEO would keep such decisions close to political authorities. How should architects of financial governance weigh these arguments?

Three considerations argue for keeping financial decisions in the hands of a body that is constituted by political authorities. First, whereas central banks provide liquidity to solvent institutions on good collateral, crisis finance is risk bearing and the conditionality associated with it has serious distributive consequences. A clean distinction has been made between the two activities for this reason. While it is true that the IMF has retreated from solemn commitments against lending into unsustainability on certain occasions and might be tempted to do so again in the future, secretariat autonomy has limits as a barrier to this temptation. As managing director of the IMF, Dominique Strauss-Kahn was himself the leading advocate for involving the Fund in the first Greek program, after all.

Second, given that national resources ultimately backstop the institutions and the magnitude of the political stakes in a crisis, it does not seem likely that a management team led by the managing director, if granted such autonomy could keep it, if exercising it imposed severe losses. They would need the active political support of leading member states to beat back the backlash against bailing in creditors prior to Fund lending.

The third reason stems from the dynamics of cooperation within a complex of institutions such as the financial safety net. Recall that member states were empowered to mediate institutional conflict during the euro crisis by the influence, informal as well as formal, that they held in the governing bodies. Consider also that discretion in international financial institutions is generally concentrated at the top, in the executive boards, whereas staff tend to be more constrained by rules. When institutions work together, secretariats cooperating alone, being less flexible, are prone to impasses that are likely to require the intercession of key states to overcome (Henning 2017a). Granting operational autonomy to secretariats would

weaken the informal mediating role of states that are represented on their boards. Institutional conflict would probably be more difficult to resolve, unless some alternative mechanism were created.

In sum, the staff and management of international financial institutions, RFAs and the IMF alike, should be granted full autonomy in the technical and analytical functions underpinning surveillance, program design, policy conditionality, debt sustainability analysis, and monitoring and assessment of program implementation. The integrity of the analysis, including of the macroeconomic consequences of policy adjustments in borrowing countries, should be untainted by political considerations. However, program approvals should be the province of a board with political responsibility. Moreover, the board would have difficulty enforcing overall performance goals without approval authority for individual programs. Such a division of responsibility aligns competence with risk bearing and facilitates members' mediation of compromises among the institutions when that becomes necessary.

Conflict Resolution

How are conflicts among the institutions that are called upon to cooperate on crisis program lending to be reconciled? The G20 EPG report (2018, 72) advocates vigorous dialogue among the RFAs and the IMF to facilitate cooperation, but otherwise offers little guidance on this particular question. The Geneva Report proposes binding arbitration of disputes by a three-person panel chaired by a neutral expert, a procedure modelled on investment-dispute resolution. Arbitrators would need to have access to specialized experts and produce a settlement quickly, within the compressed time horizon of program negotiations.

The Fund itself has taken the view that formal dispute resolution would be "counterproductive," and any binding mechanism would run afoul of the principle that decisions must comply with each institution's own policies and governance structures (the independence principle). Institutions must seek coherent program design while respecting differences among them with respect to lending practices. This way, if institutions cannot agree, the member state can borrow from one of them alone (IMF 2017a, 26).

The problem of dispute resolution is made yet more complicated by the fact that states created RFAs in the first place in order to limit their dependence on the Fund in a crisis. This means that the large creditor countries in each region are unlikely to cast their lot completely with either the IMF or the RFA in advance, but rather will retain the option to lean toward one or the other in the event (Henning 2019).

The consequences for dispute resolution are two-fold. First, notwithstanding the plans of secretariats and well-intentioned academics, *ex ante* resolution is unlikely to be complete; much of it is likely to occur in the heat of program negotiations *ex post*. Second, to a substantial degree, resolution will have to be conducted informally by key principals, the influential member states. Such was the pattern in the euro crisis, where, time and again, institutional deadlock was resolved through mediation by key states — sometimes the Group of Seven finance ministers, sometimes the German chancellor, and so forth.

When designing institutions and bringing them together in a complex, the mechanisms of *informal* coordination by member states should be nurtured, rather than expunged because they operate in the shadows. Space can be created for informalism even within the formal provisions of institutions, legitimizing member-state mediation when institutions are deadlocked. By announcing consultations and meetings, and disclosing their results more completely, informal mediation can be brought more substantially into the open.

The effectiveness of informal mediation of institutional disputes by key states depends in turn on a convergence of preferences among them. Coordination worked satisfactorily, albeit sometimes awkwardly, from the standpoint of the European creditor states over the course of the crisis programs. But the robustness of this model for mediation is vulnerable to changes in governments, leaders and ministers. By facilitating staff-level resolution, coordination can be more robust to changes in state preferences, but there are limits to which this can be done in these intergovernmental institutions.

Consider, finally, informal mediation in light of the movement to accommodate emerging-market countries in global institutions. The convention under which the managing director of the IMF has always been a European, while

anachronistic, greatly facilitated informal coordination between the Fund and European institutions. Appointing a non-European to lead the Fund might strengthen its relationship with RFAs in Asia, Africa or Latin America but would likely have the unintended consequence of weakening informal cooperation with Europe. New channels would have to be created to sustain cooperation with European institutions.

Creditor Seniority

The IMF has historically been treated as the most senior creditor. Although this status might be questioned from time to time, there are several good reasons for it. The IMF is available in principle for all sovereign borrowers, takes on the most difficult cases, carries a high-risk portfolio and its responsibilities are fundamental to maintaining the stability of the international financial system as a whole. If a regional arrangement attempts but fails to treat a crisis on its own, the problem will migrate to the global multilateral institution, in this sense a lender of last resort. If the IMF is to remain at the centre of the global safety net, states that contribute to it must know that their financial support is not subordinate to that of other creditors.

Member states and other creditors should uphold and respect the preferred creditor status of the IMF. Whenever the occasion might permit, this status should be formalized in the Articles of Agreement of the Fund. The RFAs should have status that, while subordinate to the Fund, is senior to other creditors, as the ESM has asserted. But, as regional arrangements develop further, it is important to guard against the possibility that one member state or another asserts status for its RFA that is senior to the Fund.

Concluding Note

The delegates to the original Bretton Woods conference had a daunting task before them, to design the post-World War II international economic order. But the task that confronts architects of financial governance on the seventy-fifth anniversary of that conference is yet more challenging in institutional terms. The Bretton Woods conferees delineated functional boundaries between the World Bank and the Fund, and between those two institutions and what later became the General Agreement on Tariffs and Trade. In their conception, one global multilateral institution could cover each issue area, and those days are long gone. In international crisis finance today, the IMF contends with a host of RFAs and other facilities. Each institution's ability to gather economic data, conduct surveillance and provide financial assistance affects the ability of other institutions to carry out their tasks. Architects can no longer design institutions in isolation, but rather must do so in context, focusing as well on the institutional complex as a whole. As work is undertaken to retool them to fight the crises to come, institutions should *co-evolve*.

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