



Centre for Banking & Finance Law  
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## Working Paper

**CMIM and ESM: ASEAN+3 and Eurozone Crisis Management and Resolution  
Liquidity Provision in Comparative Perspective**

**Ramon PACHECO PARDO**

Adjunct Researcher, Centre for Banking & Finance Law, Faculty of Law, National University of  
Singapore

[ramon.pacheco@kcl.ac.uk](mailto:ramon.pacheco@kcl.ac.uk)

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**Centre for Banking & Finance Law**

Faculty of Law

National University of Singapore

Eu Tong Sen Building

469G Bukit Timah Road

Singapore 259776

Tel: (65) 66013878

Fax: (65) 6779 0979

Email: [cbfl@nus.edu.sg](mailto:cbfl@nus.edu.sg)

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[ramon.pacheco@kcl.ac.uk](mailto:ramon.pacheco@kcl.ac.uk)

**ABSTRACT:**

The 1997 Asian Financial Crisis and the on-going Eurozone Sovereign Debt Crisis elicited similar responses in East Asia and the EU: provision of IMF-led bailout packages and subsequent development of regional stressed sovereign liquidity provision arrangements to limit future dependence on IMF support. These mechanisms are currently institutionalised in the form of the Chiang Mai initiative Multilateralization (CMIM) and the European Stability Mechanism (ESM). This paper seeks to provide a comparative analysis of the evolution and current state of the regulatory basis underpinning these mechanisms in the area of crisis management and resolution. The focus of the paper will be on the key aspects of liquidity provision arrangement access, financial assistance programme monitoring, as well as on the relationship between the two regional mechanisms and the IMF in its liquidity provision function.

**CMIM and ESM: ASEAN+3 and Eurozone  
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Dr Ramon Pacheco Pardo

Adjunct Researcher, Centre for Banking and Finance Law,  
National University of Singapore  
Senior Lecturer, King's College London

## **Abstract**

The 1997 Asian Financial Crisis and the on-going Eurozone Sovereign Debt Crisis elicited similar responses in East Asia and the EU: provision of IMF-led bailout packages and subsequent development of regional stressed sovereign liquidity provision arrangements to limit future dependence on IMF support. These mechanisms are currently institutionalised in the form of the Chiang Mai initiative Multilateralization (CMIM) and the European Stability Mechanism (ESM). This paper seeks to provide a comparative analysis of the evolution and current state of the regulatory basis underpinning these mechanisms in the area of crisis management and resolution. The focus of the paper will be on the key aspects of liquidity provision arrangement access, financial assistance programme monitoring, as well as on the relationship between the two regional mechanisms and the IMF in its liquidity provision function.

## **Keywords**

Asian Financial Crisis, Chiang Mai Initiative Multilateralization, European Stability Mechanism, Eurozone Sovereign Debt Crisis, Global Financial Crisis, International Monetary Fund

## 1. Introduction<sup>1</sup>

Liquidity provision to stressed sovereigns for the purpose of crisis management and resolution is a key tool for policy-makers seeking to contain a crisis and to avoid its spread to third countries.<sup>2</sup> As recurring financial crises have showed, crisis prevention is difficult to achieve in an era of increasing capital account openness and cross-border capital mobility. Indeed, financial crises have been affecting different parts of the world for centuries.<sup>3</sup> Crisis management and resolution, therefore, are more realistic absent a shift in economic thinking towards greater capital controls.

In financial crisis periods, capital flight tends to be one of the main threats that policy-makers have to deal with—when not the reason for the crisis to begin with. Therefore, it is understandable that crisis stricken countries usually seek to prepare to limit the effects of future crises and halt them before they have a significant impact on the wider economy—in parallel, crisis free countries try to learn lessons from their less fortunate counterparts as well.

Three main mechanisms seem to be available to countries seeking to swiftly solve a financial crisis. To begin with, governments have engaged in foreign exchange accumulation and bilateral currency swap arrangements to ensure swift access to capital.<sup>4</sup> In addition, regional liquidity provision arrangements have been launched to prevent crises from spreading throughout a region, as often happens (e.g., Latin America in the 1980s and 1990s, East Asia in 1997-98, or the Eurozone currently).<sup>5</sup> Finally, the IMF has long provided bailout packages to crisis stricken countries. Together, these instruments form the crisis resolution component of a multi-layered global financial safety net (GFSN) architecture including national, regional and global mechanisms.

Regional liquidity provision arrangements, in particular, are poised to become more central components of the GFSN. They are very useful instruments for countries without the economic strength to build foreign exchange reserve buffers or the political clout to develop solid bilateral currency swap networks. Concurrently, regional arrangements can be seen as less intrusive than an IMF often accused of Western dominance and onerous conditionality.

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<sup>1</sup> I would like to thank Florian Gamper and Christian Hofmann for their comments, as well as participants in the seminar organised by the Centre for Banking & Finance Law on 13 April 2015. All remaining errors are mine.

<sup>2</sup> This paper does not concern itself with crisis prevention liquidity provision instruments, which the IMF, CMIM and ESM have been developing over the past few years—most notably, through the approval of precautionary lines. These instruments are not linked to crisis management and resolution strictly speaking, since they are designed to avoid rather than solve a crisis.

<sup>3</sup> Carmen M. Reinhart and Kenneth S. Rogoff, *This Time is Different: Eight Centuries of Financial Folly* (Princeton: Princeton University Press, 2009).

<sup>4</sup> Neither of these will be analysed in this paper, even though, as explained in section 2, the CMIM evolved from a series of bilateral swap arrangements among ASEAN+3 countries.

<sup>5</sup> The New Development Bank comprising the BRICS countries established the US\$100 billion Contingent Reserve Arrangement in July 2014. It is neither a regional nor a global arrangement, but rather a cross-regional facility. It will start lending from 2016. See *Treaty for the Establishment of a BRICS Contingent Reserve Arrangement*, Fortaleza, 15 July 2014.

Even though regional arrangements are common across the world, the Chiang Mai Initiative Multilateralization (CMIM) and the European Stability Mechanism (ESM) are the biggest two (see table 1). They also are two of the most recently created mechanisms, as well as the only two—along with the European Financial Stabilisation Mechanism (EFSM)—with formal links to the IMF.<sup>6</sup> Thus, the CMIM and the ESM are both quantitatively and qualitatively different from other arrangements, given their size and their formal recognition as its counterparts by the global liquidity provision institution.

**Table 1. Global and Regional Financial Arrangements**

	<b>Geographical scope</b>	<b>Number of members</b>	<b>Size</b>	<b>Establishment year</b>
<b>International Monetary Fund</b>	Global	188	US\$885 billion	1945
<b>Arab Monetary Fund</b>	Middle East and North Africa	22	600 million Arab Accounting Dinars (ca. US\$2.5 billion)	1976
<b>Chiang Mai Initiative Multilateralization</b>	ASEAN+3	14	US\$240 billion	2010
<b>EURASEC Anti-Crisis Fund</b>	Central Asia and Russia	6	US\$8.513billion	2009
<b>European Financial Stabilisation Mechanism</b>	European Union	28	€60 billion (ca. US\$66 billion)	2010
<b>European Financial Stability Facility (NB: not providing new assistance anymore)</b>	Eurozone	17	€780 billion (ca. US\$856 billion)	2010
<b>European Union Balance of Payments Facility</b>	European Union	28	€50 billion (ca. US\$55 billion)	1992
<b>European Stability Mechanism</b>	Eurozone	19	€704.80 (ca. US\$773 billion)	2012
<b>Latin American Reserve Fund</b>	Latin America	8	US\$3.61 billion	1978
<b>North America Framework Agreement</b>	North America	3	US\$9 billion	1994
<b>SAARC Arrangement</b>	SAARC	8	US\$2 billion	2012

Source: Compiled by the author from different sources (correct at the time or writing)

This paper will therefore provide a comparative analysis of the regulatory basis underpinning the CMIM and the ESM in the area of crisis management and resolution. In spite of their similarities, this paper will show that there are also significant differences between both mechanisms in terms of liquidity access and monitoring. While explaining in detail the reasons behind this divergence is beyond the scope of this paper, this analysis will serve to understand the technical similarities and differences between both mechanisms.

<sup>6</sup> Changyong Rhee, Lea Sumulong and Shahin Vallee, 'Global and Regional Financial Safety Nets: Lessons from Europe and Asia', in Changyong Rhee and Adam S. Posen (eds.), *Responding to Financial Crisis: Lessons from Asia Then, the United States and Europe Now* (Washington, DC: Asian Development Bank and Peterson Institute for International Economics, 2013), appendix 7A.

Understanding the similarities and differences between the CMIM and ESM regulatory frameworks has interesting implications for academics, policy-makers and researchers seeking to predict how countries in ASEAN+3 and the Eurozone, respectively, would want to prevent the regional spread of future crises. Considering that future financial crises in any of the two regions cannot be ruled out, it is important to know the details of how financial disbursements might be negotiated, approved, monitored, and returned. This is particularly the case for the CMIM– which is yet to be activated–but also for an ESM still testing how current and future programmes might work in practice.

To supplement the study of these technical aspects, the paper will also analyse the relationship between said technical aspects of the CMIM and ESM on the one hand and the IMF on the other–in the area of crisis management and resolution. Regional arrangements have sometimes been cast as substitutes to IMF interventions. Nonetheless, the fact that both the CMIM and the ESM accord the IMF a formal role in crisis management and resolution suggests that this is not the case. The regional and global layers of the GFSN seem to have a degree of complementarity.

The debate regarding the competitive or complementary nature of regional financial safety nets (RFSN) and global mechanisms is part of a broader discussion regarding the perceived obsolescence and Western bias of global financial institutions. The IMF–together with the World Bank–is at the centre of this debate. Examining how the ASEAN+3 and Eurozone nets and the IMF have been interacting with each other–or are planning to–serves to shed light on whether RFSNs will supplant, cooperate with or be secondary to the Washington-based institutions. This in turn will contribute to the debate about the future role that global financial bodies might play.

This paper is organised as follows. In the next section, the origins of the CMIM and the ESM will be traced. The section after will focus on liquidity access in both arrangements, discussing both the instruments available and borrowing conditions. The paper will then examine the financial assistance monitoring process. Afterwards, there will be a section on the areas of complementarity and competition between the regional mechanisms and the IMF. A concluding section will summarise the findings of the paper while also advancing some explanations for CMIM-ESM similarities and divergences.

## **2. Origins: Crises, IMF support, and the establishment of regional liquidity provision arrangements**

The origins of the CMIM and ESM can be traced back to the 1970s. During this decade, ASEAN and the EU–along with other regions such as North Africa and the Middle East or Latin America–established first generation regional liquidity provision arrangements.<sup>7</sup> These were the result of changes in the international monetary system. The Bretton Woods institutions had

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<sup>7</sup> Ibid., pp. 214-215.



been designed for a world of monetary stability. But this world had disappeared with the end of the gold standard in 1971 and the oil crisis of 1973.<sup>8</sup> Thus, countries in different regions developed mechanisms to deal with balance of payments difficulties and to promote exchange rate stability.<sup>9</sup> In the case of the EU, the goal of monetary stability would eventually lead to the launch of the euro.<sup>10</sup>

### *From the ASA to the CMIM*

ASEAN launched the ASEAN Swap Arrangement (ASA) in 1977. It was set up as a US\$100 million vehicle with a six-month maximum swap maturity. The source of the funds would be equal shares among the non-requesting members.<sup>11</sup> In 1978, a supplementary agreement doubling the size of the funding available to US\$200 million was signed.<sup>12</sup> Subsequent agreements extended the validity of the ASA to new ASEAN members and increased the funds available, as well as the swap maturity. The last ASA-specific memorandum of understanding—signed in 2005—committed US\$2 billion, with a one-year maximum swap maturity.<sup>13</sup> Subsequent supplemental memorandums of understanding have extended the validity of the ASA. It should be noted, however, that it has never been activated.<sup>14</sup>

Notwithstanding the continuing existence of the ASA, this arrangement also served as the basis for a second generation regional financial liquidity mechanism for East Asia—the Chiang Mai Initiative (CMI). In late 1996, Japan was considering to propose an ‘Asian Monetary Organisation’. Dubious about the commitment of the US government to Asia were a crisis to strike the region, the Japanese government wanted a regional liquidity mechanism.<sup>15</sup> The idea was shelved, only to be resurrected in mid-1997—at the height of the Asian Financial Crisis (AFC). The organisation—now dubbed as the Asian Monetary Fund (AMF)—would be rejected due to American and IMF opposition.<sup>16</sup>

In spite of the failure of the AMF, displeasure with IMF conditionality attached to the bailout packages provided during the AFC led to the launch of the CMI in 2000. Initially, the CMI functioned as an expanded ASA covering all ten members of ASEAN—instead of ASEAN-5 as had been the case until then—plus a network of bilateral swap and repurchase agreements between ASEAN

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<sup>8</sup> Ibid., pp. 214-215.

<sup>9</sup> Ibid., p. 216.

<sup>10</sup> Ibid., p. 216.

<sup>11</sup> *Memorandum of Understanding on the ASEAN Swap Arrangement*, Kuala Lumpur, 5 August 1977.

<sup>12</sup> *Supplementary Agreement to the Memorandum of Understanding on the ASEAN Swap Arrangement*, Washington, DC, 26 September 1978.

<sup>13</sup> *Memorandum of Understanding on the ASEAN Swap Arrangement*, 17 November 2005.

<sup>14</sup> Natasha Hamilton-Hart, ‘Cooperation on Money and Finance: How Important? How Likely?’, in Kanishka Jayasuriya (ed.), *Asian Regional Governance: Crisis and Change* (London: RoutledgeCurzon, 2004), p. 178

<sup>15</sup> Phillip Y. Lipsky, ‘Japan’s Asian Monetary Fund Proposal’, *Stanford Journal of East Asian Affairs* 3:1 (2003), p. 94

<sup>16</sup> Ibid., pp. 95-96.

countries, China, Japan and South Korea. From the onset, the CMI was set up as a supplementary arrangement to the IMF.<sup>17</sup> Most notably, only ten percent of CMI funds would be made available delinked from an IMF programme.

Nonetheless, its existence undermined the IMF, insofar it would be more difficult to attach stringent conditionality to a bailout package when other CMI funds were available conditionality-free. Furthermore, the CMI was part of a broader set of initiatives also including the development of the local currency denominated bond market and an ASEAN+3 Economic Review and Policy Dialogue to enhance monitoring.<sup>18</sup> With the launch of the Asian Bond Market Initiative and a minister of finance-level dialogue, the likelihood of a country in the region resorting to the IMF diminished.

Evolution and growth in size of the CMI ensued over the years. In 2005, it was agreed that 20 percent of CMI funds would be delinked from IMF programmes.<sup>19</sup> By 2009, ASEAN+3 countries had pledged US\$120 billion to a multilateral mechanism set to replace the network of bilateral arrangements underpinning the CMI.<sup>20</sup> By then, the maximum swap maturity of IMF-delinked funds was 180 days and that of IMF-linked funds was two years.<sup>21</sup> The sources of the funds were the bilateral swap and repurchase agreements among ASEAN+3 countries.

The CMI would evolve into the Chiang Mai Initiative Multilateralization (CMIM). Discussions about the multilateralization of the CMI can be traced back to 2005.<sup>22</sup> Yet, the CMIM agreement would only be signed in 2009. The response of ASEAN+3 countries to the Global Financial Crisis (GFC) was the key reason behind the agreement. Rather than resorting to the CMI, Singapore, South Korea and Indonesia sought to enter into swap arrangements with the US Federal Reserve. The first two were granted the arrangements, but not Indonesia—which received support from China and Japan instead.<sup>23</sup> This showed both the limitations of the CMI—especially the problems derived from limited IMF-delinked funds availability—and the risks associated with having to rely on a US Federal Reserve unwilling to support some countries in the region.<sup>24</sup>

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<sup>17</sup> *The Joint Ministerial Statement of the ASEAN+3 Finance Ministers Meeting*, Chiang Mai, 6 May 2000.

<sup>18</sup> Masahiro Kawai and Cindy Houser, *Evolving ASEAN+3 ERDP: Towards Peer Review or Due Diligence?*, ADB Institute Discussion Paper No. 79 (September 2007).

<sup>19</sup> *The Joint Ministerial Statement of the 8<sup>th</sup> ASEAN+3 Finance Ministers' Meeting*, Istanbul, 4 May 2005.

<sup>20</sup> *Joint Media Statement – Action Plan to Restore Economic and Financial Stability of the Asian Region*, Phuket, 22 February 2009.

<sup>21</sup> Rhee, Sumulong and Vallee, *op. cit.*

<sup>22</sup> *The Joint Ministerial Statement of the 8<sup>th</sup> ASEAN+3 Finance Ministers' Meeting*, Istanbul, 4 May 2005.

<sup>23</sup> Chalongphob Sussangkarn, *The Chiang Mai Initiative Multilateralization: Origin, Development and Outlook*, ADBI Working Paper Series No. 30 (July 2010), p. 11.

<sup>24</sup> *Ibid.*

The CMIM came into effect in March 2010 with a US\$120 self-managed reserve pool (i.e., not placed in a common pool), with the +3 countries and Hong Kong providing 80 percent of the total and ASEAN the remaining 20 percent. In an important departure from the CMI, disbursement decisions are made collectively rather than by individual creditors.<sup>25</sup> A two-year maximum swap maturity was established. The source of the funds would be all non-requesting economies—exemption would require an executive level decision.<sup>26</sup> Funds are not paid-in but made available on demand.<sup>27</sup> In May 2012, the reserve pool increased to US\$240 billion, with the IMF-delinked portion growing to 30 percent with a view at raising it to 40 percent (see appendix 1). The maturity of the IMF-delinked portion was extended to two years and that of the IMF-linked portion increased to three years.<sup>28</sup> Furthermore, a supranational monitoring office was established in April 2011—the ASEAN+3 Macroeconomic Research Office (AMRO), based in Singapore.<sup>29</sup> An agreement enabling AMRO to become an independent international organisation was signed in October 2014.<sup>30</sup> It should be noted that, at the time of writing, the CMIM remains in developmental stage.

#### *From the STMS and MTF to the ESM*

Evolution of Eurozone regional liquidity provision arrangements is not as linear as in the case with ASEAN+3. Two first-generation arrangements, however, started to shape some of the technical aspects underpinning the ESM today. The EU—or European Economic Community (EEC) as it was known back then—launched the Short Term Monetary Support (STMS) in 1970. Balance of payment difficulties suffered by several EU member states in the years before were the main reason behind the launch. EU member states agreed to provide each other with up to US\$1 billion (expressed in member state national currencies) credit, with a six-month maturity. Funds were allocated proportionally, according to the size of the economy of each member state. Non-requesting member state central banks would take the decision on whether to grant the credit.<sup>31</sup> The size and quotas of the STMS

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<sup>25</sup> Barry Eichengreen, *Regional Financial Arrangements and the International Monetary Fund*, ADBI Working Paper Series No. 394 (November 2012), p. 12.

<sup>26</sup> *The Joint Ministerial Statement of the 13<sup>th</sup> ASEAN+3 Finance Ministers' Meeting – Annex 1*, Tashkent, 2 May 2010.

<sup>27</sup> Barbara Fritz and Larissa Muhlich, *Regional Monetary Co-operation in the Developing World – Taking Stock*, Working Paper for the UNCTAD project 'Strengthening Pro-growth Macroeconomic Management Capacities for Enhanced Regional Financial and Monetary Co-operation among Selected Countries of Latin America and the Caribbean, and West and Central Africa' (2014), p. 14

<sup>28</sup> *The Joint Ministerial Statement of the 15<sup>th</sup> ASEAN+3 Finance Ministers and Central Bank Governors' Meeting – Annex 1*, Manila, 3 May 2012.

<sup>29</sup> 'History', AMRO (2013), available at <<http://www.amro-asia.org/about-amro/history/>> (accessed on 6 April 2015).

<sup>30</sup> AMRO, *AMRO Director's Statement regarding the Completion of the Signing of the Agreement Establishing ASEAN+3 Macroeconomic Research Office ("AMRO Agreement")*, 10 October 2014.

<sup>31</sup> *Agreement Setting up a System of Short-term Monetary Support among the Central Banks of the Member States of the European Economic Community*, Brussels, 9 February 1970.

changed as the EU expanded. The STMS was first activated by Italy in 1974, which also received—yet did not use—a second credit line in 1976.<sup>32</sup>

Shortly after the establishment of the STMS, the Medium Term Financial Assistance (MTFA) was launched in 1971. Several waves of currency devaluation, together with the Werner Report of 1970 establishing a route map for an economic and monetary union provided the background for the MTFA. Initially, it was a two-billion units of account (US\$42 billion at the time) vehicle with a two- to five-year credit maturity. Funds would be allocated proportionally to the size of the EU economies at the time—Germany and France provided 30 per cent of the total each. Disbursement of the funds was decided by the European Council using a qualified majority system and on the recommendation of the European Commission.<sup>33</sup> This meant that the supranational executive institution of the EU took the initiative to activate the MTFA, but the intergovernmental body representing the executive power of member states was responsible for taking the final decision. The size and quotas of the MTFA increased several times as new countries joined the EU. Importantly, conditionality was attached to the credits.<sup>34</sup> It was only activated once though—by Italy in 1974.<sup>35</sup>

With the end of the gold standard and the decision by the EU to move towards the establishment of a common currency—eventually, the euro—Brussels launched several instruments to ensure that currency exchange rates only fluctuated within a very narrow band of  $\pm 2.25\%$ . The European Monetary Cooperation Fund of 1973, the Exchange Rate Mechanism of 1979, the Balance of Payments Facility (BPF) of 1992, and the European Monetary Institute of 1994 were all instruments to ensure achievement of this goal. These instruments, however, cannot be considered precursors of the ESM. The BPF continues to exist, albeit only for non-euro member states.<sup>36</sup>

The origins of the ESM are directly linked to the GFC and subsequent Eurozone Sovereign Debt Crisis (ESDC).<sup>37</sup> When the GFC first struck the EU,

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<sup>32</sup> Horst Ungerer, *A Concise History of European Monetary Integration: From EPU to EMU* (Westport: Quorum Books, 1997), p. 90

<sup>33</sup> Council Decision of 22 March 1971 Setting Up Machinery for Medium-term Financial Assistance (71/143/EEC), Official Journal of the European Communities L73/15 (1971).

<sup>34</sup> Rhee, Sumulong and Vallee, op. cit., appendix 7A.

<sup>35</sup> Ungerer, op. cit., p. 91

<sup>36</sup> 'Balance of Payments', *European Commission* (21 August 2014), available at <[http://ec.europa.eu/economy\\_finance/eu\\_borrower/balance\\_of\\_payments/index\\_en.htm](http://ec.europa.eu/economy_finance/eu_borrower/balance_of_payments/index_en.htm)> (accessed on 6 April 2015).

<sup>37</sup> It should be noted that these twin crises have also led to the development of another crisis management mechanism in the EU: the Single Resolution Mechanism (SRM). The SRM—which entered into force in August 2014 and to be fully operational in January 2016—is an instrument for the resolution (i.e., winding up) of failing banks in the Eurozone and other EU member states who decide to join the SRM. For more information, see Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 Establishing Uniform Rules and a Uniform Procedure for the Resolution of Credit Institutions and Certain Investment Firms in the Framework of a Single Resolution Mechanism and a Single Resolution Fund and Amending Regulation (EU) No 1093/2010, Official Journal of the European Union L225/1 (2014). The SRM is designed to prevent a banking crisis from escalating into a sovereign financial crisis. It is not analysed in this paper insofar the SRM is

it became clear that there were no contingency liquidity provision mechanisms in place. In 2008-09, Hungary, Latvia and Romania became recipients of IMF-led bailout packages granted under the BPF.<sup>38</sup> This facility had been forgotten, and was only activated following Hungary's decision to seek an IMF loan.<sup>39</sup> The packages received by the three non-euro member states ended up including a mixture of EU and IMF funds and attached conditionality—with monitoring also including both institutions.<sup>40</sup> Divergences between the EU and the IMF surfaced, for example regarding the suggestion by the latter that Latvia needed a currency devaluation, which was opposed by Brussels.<sup>41</sup>

The GFC evolved into the ESDC when it reached Greece. Until then, the EU had been reluctant to create specific liquidity provision mechanisms. Greece membership of the euro, however, convinced the EU that said mechanisms were necessary.<sup>42</sup> Thus, the EFSM and the European Financial Stability Facility (EFSF) were launched in 2010.

The EFSM is an EU-wide €60 billion (US\$66 billion at the time of writing) emergency mechanism. The EFSM operates similarly to the BPF. The European Commission is allowed to borrow in financial markets on behalf of the EU and under an implicit EU budget guarantee. The European Commission then extends a credit line to the requesting member state, which repays the loan principal and interest.<sup>43</sup> Even though legally a joint EU-IMF programme is not necessary for disbursement of the funds, Brussels has explicitly stated that activation would only be in the context of such a programme.<sup>44</sup> The EFSM should eventually be terminated, once the “exceptional circumstances” behind its creation disappear.<sup>45</sup> Between 2011 and 2014, Ireland and Portugal received several loans with maturities ranging from five to 30 years. In 2015, Greece received a short-term loan of €7.16.<sup>46</sup>

The EFSF is a Eurozone-only €780 billion (US\$856 billion at the time of writing, up from €440 billion when first launched) temporary mechanism. Funds are provided by 17 of the 19 Eurozone members on a proportional

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not a stressed sovereign liquidity provision mechanism per se, instead being akin to a sovereign crisis prevention mechanism.

<sup>38</sup> ‘Balance of Payments’, *European Commission* (21 August 2014), available at <[http://ec.europa.eu/economy\\_finance/eu\\_borrower/balance\\_of\\_payments/index\\_en.htm](http://ec.europa.eu/economy_finance/eu_borrower/balance_of_payments/index_en.htm)> (accessed on 6 April 2015).

<sup>39</sup> Rhee, Sumulong and Vallee, op. cit., p. 219

<sup>40</sup> ‘Balance of Payments’, *European Commission* (21 August 2014), available at <[http://ec.europa.eu/economy\\_finance/eu\\_borrower/balance\\_of\\_payments/index\\_en.htm](http://ec.europa.eu/economy_finance/eu_borrower/balance_of_payments/index_en.htm)> (accessed on 6 April 2015).

<sup>41</sup> Rhee, Sumulong and Vallee, op. cit., p. 230.

<sup>42</sup> Ibid., p. 220

<sup>43</sup> Council Regulation (EU) No 707/2010 of 11 May 2010 Establishing a European Financial Stabilisation Mechanism, Official Journal of the European Union L118/1 (2010).

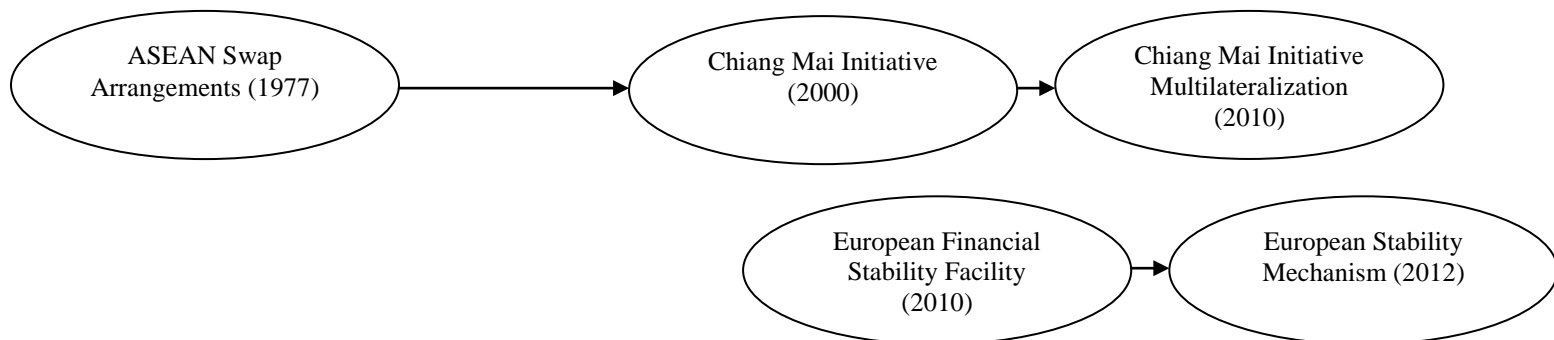
<sup>44</sup> Rhee, Sumulong and Vallee, op. cit.

<sup>45</sup> *Communication from the Commission to the Council and the Economic and Financial committee on the European Financial Stabilisation Mechanism*, COM(2010) 713 final, Brussels, 30 November 2010.

<sup>46</sup> ‘European Financial Stabilisation Mechanism (EFSM)’, *European Commission* (12 November 2014), available at <[http://ec.europa.eu/economy\\_finance/eu\\_borrower/efsm/index\\_en.htm](http://ec.europa.eu/economy_finance/eu_borrower/efsm/index_en.htm)> (accessed on 6 April 2015).

basis—Latvia and Lithuania were not part of the euro when the EFSF was still open to new members—with Germany contributing 27.06 per cent of the total, France 20.32 per cent, and Italy 17.86 per cent. Funds are disbursed in the form of loans coming from the paid-up capital of non-requesting, non-borrowing countries—with the ECB acting as the fiscal agent. They can also be used for secondary market bond purchases by the ECB. The European Commission, ECB and IMF—the so-called ‘Troika’—together negotiate agreements with borrowing countries—with the IMF also providing funds.<sup>47</sup> Average maturity periods range between 20.8 and 31.4 years.<sup>48</sup> Loan conditionality implementation monitoring is conducted by the ‘Troika’. Ireland and Portugal in 2011 and Greece in 2012 activated this facility—which the former two exited in 2013 and 2014, respectively.<sup>49</sup> The facility is not open to new entrants and will close once Greece exits.<sup>50</sup>

**Figure 1. Direct origins of the CMIM and the ESM**



Source: Author’s own

Based in Luxembourg, the ESM is the permanent mechanism that replaced the EFSF. It came into effect in October 2012, with a €704.80 billion (US\$773 billion at the time of writing) authorised capital stock and maximum lending volume of €500 billion (US\$549 billion at the time of writing). €80.54 billion (US\$88.35 billion at the time of writing) is paid-in capital, with the rest being callable capital. Eurozone members are shareholders in the ESM in proportion to the capital subscribed to the vehicle. Germany provides 26.96 per cent of the total funds, with France contributing a further 20.24 per cent and Italy 19.79 per cent (see appendix 2).

Membership comprises the full 19 members of the Eurozone, and future euro adopters are expected to join the facility and contribute to its funding. In addition, the ESM has the right to borrow in capital markets through debt issuance. Financial assistance from the ESM can take the form of loans, primary and secondary bond market purchases, and financial institution indirect recapitalisation.<sup>51</sup> In 2012 Spain became the first country to activate the mechanism with a bank recapitalisation programme, which it exited in

<sup>47</sup> *EFSF Framework Agreement – Consolidated Version*, Brussels, 24 June 2011.

<sup>48</sup> ‘Lending Operation’, *European Financial Stability Facility* (2015) available at <<http://www.efsf.europa.eu/about/operations/>> (accessed on 6 April 2015).

<sup>49</sup> *Ibid.*

<sup>50</sup> ‘About EFSF’, *European Financial Stability Facility* (2015), available at <<http://www.efsf.europa.eu/about/index.htm>> (accessed on 6 April 2015).

<sup>51</sup> *Treaty Establishing the European Stability Mechanism*, Brussels, 2 February 2012.



2013.<sup>52</sup> That same year, Cyprus became the first country to activate the mechanism to manage sovereign stress.<sup>53</sup>

### 3. Liquidity access: Instruments and borrowing conditions

This section will discuss liquidity access in the CMIM and ESM, the regional liquidity provision arrangements set up by ASEAN+3 and the EU, respectively. The focus will be on the two key issues to consider by stressed sovereigns seeking funds from either of these arrangements to manage and resolve a financial crisis—the instruments available to them and the borrowing conditions to be met.

Regional liquidity provision arrangements can be divided into two main types: swap arrangements and budgetary funds. The former are led by central banks, while the latter involve governments represented by their ministries of finance.<sup>54</sup> Swap arrangements entail arrangements among central banks, whereas budgetary—or reserve—funds consist on the pooling of national foreign exchange reserves through a joint contract.<sup>55</sup> Thus, they result in divergent types of legal commitments. This is reflected in the instruments available under each type of arrangement.

#### *Instruments*

The CMIM and the ESM differ substantially in terms of the instruments offered to requesting members. In the case of the ASEAN+3 vehicle only one instrument is available: loans. The CMIM Stability Facility offers loans with a one-year maturity renewable twice up to a maximum of three years for the IMF linked portion, and with a six-month maturity renewable three times up to two years for the IMF-delinked portion—the linked portion is 30 per cent of the total, with a view at increasing it to 40 per cent. The supporting period is three years for the IMF linked portion and two years for the delinked portion.<sup>56</sup> Since no country has yet activated the CMIM, it is not possible to know whether there is flexibility with loan terms.<sup>57</sup>

The ESM, for its part, has four instruments available to requesting countries. To begin with—and in common with the CMIM—the ESM offers loans. There is no specified maturity limits for the loans; they are decided on a case-by-case

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<sup>52</sup> 'Spain's Exit', *European Stability Mechanism* (2015), available at <<http://www.esm.europa.eu/assistance/spain/index.htm>> (accessed on 6 April 2015).

<sup>53</sup> 'ESM Financial Assistance for Cyprus', *European Stability Mechanism* (2015), available at <<http://www.esm.europa.eu/assistance/cyprus/index.htm>> (accessed on 6 April 2015).

<sup>54</sup> Sergei Shatalov, *Coordination between the IMF and Regional Financial Arrangements: The ACF Experience*, Presentation at G20-IMF Seminar 'Regional Financial Arrangements: Their Role in the International Financial Architecture and Cooperation with the IMF', Washington, DC, 17 April 2013.

<sup>55</sup> Fritz and Muhlich, op. cit., pp. 7-8.

<sup>56</sup> *The Joint Ministerial Statement of the 15<sup>th</sup> ASEAN+3 Finance Ministers and Central Bank Governors' Meeting – Annex 1*, Manila, 3 May 2012.

<sup>57</sup> Since 2012, the CMIM also offers a Precautionary Line in the form of loans. Nonetheless, this is a crisis prevention mechanism and therefore is not analysed in this paper. See *The Joint Ministerial Statement of the 15<sup>th</sup> ASEAN+3 Finance Ministers and Central Bank Governors' Meeting – Annex 1*, Manila, 3 May 2012.

basis.<sup>58</sup> Loans might be disbursed in one or more tranches.<sup>59</sup> At the time of writing, Cyprus has received a €5.70 billion loan (US\$6.23 billion) in six tranches with a weighted average maturity of 14.88 years.<sup>60</sup> Meanwhile, the ESM also agreed to offer loans to Greece in 2015.<sup>61</sup> A first disbursement of €13 billion (US\$14.16 billion) might be followed by subsequent tranches if necessary.<sup>62</sup> No other country has activated this instrument.<sup>63</sup>

Two closely related instruments offered by the ESM are the Primary Market Support Facility (PMSF) and the Secondary Market Support Facility (SMSF). Under the PMSF, the ESM can engage in primary market purchases of bonds issued by Eurozone member states to help restore access to capital markets. Requesting countries can only ask for the use of the PMSF when requesting a loan or after having received a loan line from the ESM. Primary market purchases will be implemented via ESM participation in auctions or in syndicated transactions, at market prices, and with a 50 per cent of the final issuance amount limit.<sup>64</sup> The ESM will not engage in PMSF purchases if there is insufficient market demand for an issuance.<sup>65</sup> This instrument is yet to be activated.

With regards to the SMSF, the ESM can engage in secondary market intervention to improve market liquidity and through means decided on a case-by-case basis.<sup>66</sup> The ECB will act as the fiscal agent for the ESM.<sup>67</sup> Requesting countries can ask for the use of the SMSF after receiving a loan line from the ESM. They can also request the use of this instrument if they are subject to financial market disruptions even without an ESM loan line; in this case, they would have to meet deficit, debt and prior market access criteria.<sup>68</sup> No country has activated this instrument thus far.

The final ESM stressed sovereign liquidity provision instrument is indirect financial assistance for the recapitalisation of financial institutions—usually systemic banks. This instrument consists of a loan from the ESM to a Eurozone member state, which is then channelled by the member state to one

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<sup>58</sup> European Stability Mechanism, *Frequently Asked Questions on the European Stability Mechanism (ESM)*, 23 March 2015.

<sup>59</sup> European Stability Mechanism, *Guideline on Loans*, 2015.

<sup>60</sup> 'ESM Financial Assistance for Cyprus', *European Stability Mechanism* (2015), available at <<http://www.esm.europa.eu/assistance/cyprus/index.htm>> (accessed on 6 April 2015).

<sup>61</sup> European Stability Mechanism, *ESM Board of Governors Approves Decision to Grant, in Principle, Stability Support to Greece*, 17 July 2015.

<sup>62</sup> European Council, *Eurogroup Statement on the ESM Programme for Greece*, 14 August 2015.

<sup>63</sup> The ESM also offers precautionary financial assistance via a Precautionary Conditioned Credit Line and an Enhanced Conditions Credit Line. These are crisis prevention rather than resolution instruments. See European Stability Mechanism, *Guideline on Precautionary Assistance*, 2015.

<sup>64</sup> European Stability Mechanism, *Guideline on Precautionary Financial Assistance*, 2015.

<sup>65</sup> European Stability Mechanism, *Frequently Asked Questions on the European Stability Mechanism (ESM)*, 23 March 2015.

<sup>66</sup> European Stability Mechanism, *Guideline on the Secondary Market Support Facility*, 2015.

<sup>67</sup> European Stability Mechanism, *Frequently Asked Questions on the European Stability Mechanism (ESM)*, 23 March 2015.

<sup>68</sup> European Stability Mechanism, *Guideline on the Secondary Market Support Facility*, 2015.



or more systemic financial institutions whose instability could threaten the whole financial system of the recipient member state. Requesting countries should demonstrate the absence of financial institution recapitalisation alternatives.<sup>69</sup> There are no maturity limits for the loan. In 2012, Spain became the first country to activate this instrument—receiving a €41.30 billion loan (US\$45 billion) in two tranches with maturities of 12.5 and 12.2 years, respectively.<sup>70</sup> In 2015, Greece received a €10 billion loan (US\$10.89 billion) for recapitalisation purposes, to be followed by subsequent tranches if necessary.<sup>71</sup>

### *Borrowing conditions*

The CMIM and the ESM are more similar to each other with regards to borrowing conditions than in the instruments available to requesting members. The CMIM asks requesting economies to submit a formal swap activation request. Two countries are then appointed to coordinate the processing and activation of the request—these would be the co-chairs of the ASEAN+3 Finance Minister process, one from ASEAN and one from China, Japan or South Korea;<sup>72</sup> this process also includes central bank governors since 2012.<sup>73</sup>

Decisions on issues such as the total size of the financial package, contribution of each CMIM member economy, etc., are decided by consensus at ASEAN+3 finance minister level. Executive level decisions such as initial execution and drawing renewal or events of default is determined by 2/3 majority at the executive level comprising deputy-level representatives of ASEAN+3 finance ministries and central banks plus the Monetary Authority of Hong Kong.<sup>74</sup> These dispute-level representatives comprise the Executive Committee of AMRO—the highest management layer in this organisation.<sup>75</sup> AMRO, meanwhile, provides an analysis of the economic and financial situation of the requesting country.<sup>76</sup>

Requesting economies submitting a formal swap activation request would have to meet certain conditions before voting takes place. These include completion of an economic and financial situation review and no events of default. Requesting economies also have to comply with covenants such as periodic surveillance report submission and participation in the ASEAN+3

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<sup>69</sup> European Stability Mechanism, *Guideline on Recapitalisation of Financial Institutions*, 2015.

<sup>70</sup> 'Spain's Exit', *European Stability Mechanism* (2015), available at <<http://www.esm.europa.eu/assistance/spain/index.htm>> (accessed on 6 April 2015).

<sup>71</sup> European Council, *Eurogroup Statement on the ESM Programme for Greece*, 14 August 2015.

<sup>72</sup> *The Joint Ministerial Statement of the 13<sup>th</sup> ASEAN+3 Finance Ministers' Meeting – Annex 1*, Tashkent, 2 May 2010.

<sup>73</sup> *The Joint Ministerial Statement of the 15<sup>th</sup> ASEAN+3 Finance Ministers and Central Bank Governors' Meeting – Annex 1*, Manila, 3 May 2012.

<sup>74</sup> *The Joint Ministerial Statement of the 13<sup>th</sup> ASEAN+3 Finance Ministers' Meeting – Annex 1*, Tashkent, 2 May 2010.

<sup>75</sup> 'Organisational Structure', AMRO (2013), available at <<http://www.amro-asia.org/organisation/organisational-structure/>> (accessed on 6 April 2015).

<sup>76</sup> 'Organisational Structure', AMRO (2013), available at <<http://www.amro-asia.org/how-we-do/>> (accessed on 6 April 2015).

Economic Review and Policy Dialogue established in the aftermath of the AFC.<sup>77</sup> Presumably, the review would be carried out by AMRO, as just noted. Furthermore, the IMF linked portion of the agreed swap would only be disbursed with an IMF programme in place, as explained above.

CMIM members can borrow a multiplier of their financial contribution to the pool. The multipliers are 0.5 for China and Japan, 1 for South Korea, 2.5 for Hong Kong, Indonesia, Malaysia, Philippines, Singapore and Thailand, and 5 for Brunei, Cambodia, Lao, Myanmar and Vietnam. This means that the maximum swap amount ranges from US\$38.40 billion for Japan and South Korea to US\$0.30 billion for Brunei and Lao (see appendix 1).

Borrowing conditions for ESM countries are not very dissimilar to those of the CMIM. Requesting countries are asked to submit a request to activate one of the two loan mechanisms. The request is submitted to the Chairperson of the ESM Board of Governors. Once a request is received, the European Commission in liaison with the ECB and—wherever possible—the IMF assess the financing needs and public debt sustainability of the requesting country. The Managing Director will then prepare a proposal based on this assessment.<sup>78</sup> The Managing Director is in charge of managing the day-to-day operations of the ESM.

The proposal will then be presented to the Board of Governors. The board is comprised of the ministers of finance of ESM member countries, their appointed alternates, the president of the Eurogroup, and—when necessary and on an observer capacity only—the European commissioner responsible for economic and financial affairs and the president of the ECB. Representatives of other institutions including the IMF might be invited to join deliberations. The Board of Governors then takes a decision on whether to adopt or reject the proposal. If adopted, it will take the form of a financial assistance facility.<sup>79</sup> Adoption has to be made by mutual agreement—that is, unanimously by those countries participating in a vote and with abstentions not preventing unanimity.<sup>80</sup>

If adopted, the Board of Governors entrusts the European Commission—in liaison with the ECB and, wherever possible, the IMF—to negotiate a memorandum of understanding. This document will include the conditionality attached to the financial assistance facility. Concurrently, the Managing Director will prepare the financial assistance facility agreement. The Board of Governors shall approve the memorandum of understanding to be signed by the European Commission. Meanwhile, the Board of Directors shall approve the financial assistance facility agreement together with the disbursement of the first tranche of assistance. The Board of Directors is comprised of governor-appointed directors and their alternates—one of each per ESM

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<sup>77</sup> *The Joint Ministerial Statement of the 13<sup>th</sup> ASEAN+3 Finance Ministers' Meeting – Annex 1*, Tashkent, 2 May 2010.

<sup>78</sup> *Treaty Establishing the European Stability Mechanism*, Brussels, 2 February 2012.

<sup>79</sup> *Ibid.*

<sup>80</sup> European Central Bank, *The European Stability Mechanism*, Monthly Bulletin (July 2011), p. 76.

member state—as well as by the European commissioner responsible for economic and financial affairs and the president of the ECB—on an observer capacity only in these two cases.<sup>81</sup>

There is also an emergency voting procedure requiring a qualified majority of 85 per cent of the votes cast. This procedure is activated when both the European Commission and the ECB consider that delay in the granting or implementation of financial assistance could threaten the Euro area. Qualified majority would apply to the votes both in the Board of Governors and the Board of Directors.<sup>82</sup>

**Table 2. CMIM and ESM crisis management and resolution liquidity instruments and borrowing conditions**

	<b>CMIM</b>	<b>ESM</b>
<b>Instruments</b>	<ul style="list-style-type: none"> <li>• Loans</li> </ul>	<ul style="list-style-type: none"> <li>• Loans</li> <li>• Primary Market Support Facility (PMSF)</li> <li>• Secondary Market Support Facility (SMSF)</li> <li>• Financial institution recapitalisation loans</li> </ul>
<b>Available funds</b>	<ul style="list-style-type: none"> <li>• Member economy contribution multiplier</li> </ul>	<ul style="list-style-type: none"> <li>• ESM total funds (in theory)</li> </ul>
<b>Supporting period</b>	<ul style="list-style-type: none"> <li>• Two years (IMF delinked portion)</li> <li>• Three years (IMF linked portion)</li> </ul>	<ul style="list-style-type: none"> <li>• Unlimited (in theory)</li> </ul>
<b>Maturity</b>	<ul style="list-style-type: none"> <li>• Six months with three rollovers up to two years (IMF delinked portion)</li> <li>• One year with two rollovers up to three years (IMF linked option)</li> </ul>	<ul style="list-style-type: none"> <li>• Decided on a case-by-case basis</li> </ul>
<b>Financial assistance granting final decision modality</b>	<ul style="list-style-type: none"> <li>• ASEAN+3 ministers of finance by consensus (intergovernmental)</li> </ul>	<ul style="list-style-type: none"> <li>• Eurozone member ministers of finance grouped in the Board of Governors by mutual agreement or by qualified majority of 85 per cent in emergency situations (intergovernmental)</li> </ul>
<b>Other body involvement in financial assistance decision-making</b>	<ul style="list-style-type: none"> <li>• AMRO</li> <li>• IMF for the linked portion</li> </ul>	<ul style="list-style-type: none"> <li>• Eurogroup</li> <li>• European Commission</li> <li>• ECB</li> <li>• IMF wherever possible</li> </ul>
<b>Attached conditionality</b>	<ul style="list-style-type: none"> <li>• For the IMF linked portion</li> </ul>	<ul style="list-style-type: none"> <li>• For the whole programme</li> </ul>

Source: Compiled by the author from different sources

In principle, requesting countries are not limited in the amount that they can borrow.<sup>83</sup> Nonetheless, loans might be provided in one or more tranches and each of them may consist of one or more disbursements. Failure to comply

<sup>81</sup> *Treaty Establishing the European Stability Mechanism*, Brussels, 2 February 2012.

<sup>82</sup> *Ibid.*

<sup>83</sup> *Ibid.*

with the conditionality approved through the memorandum of understanding can result in interruption or a halt to disbursements.<sup>84</sup>

#### 4. Financial assistance programme monitoring

In this section, the focus will be on the technical aspects of regional liquidity provision arrangements post-financial assistance programme launch. As explained in the previous section, conditionality is attached to CMIM and ESM programmes. Thus, both mechanisms operate compliance monitoring instruments to check compliance with said conditionality. In principle in the case of the ESM and presumably for the CMIM, non-compliance can lead to interruption or even halt of disbursements. This underscores the importance of proper monitoring.

##### *CMIM monitoring*

AMRO is entrusted with the monitoring of CMIM financial assistance programmes.<sup>85</sup> Monitoring has to be conducted on a bi-annual basis—as is the case with the Precautionary Line also offered by the CMIM.<sup>86</sup> Indeed, one of the reasons behind the setting up of AMRO was for ASEAN+3 to have an independent monitoring body.<sup>87</sup> No other institution or country has financial assistance programme monitoring responsibilities.

Notwithstanding the above, it seems likely that an understaffed AMRO would need to make use of IMF monitoring capabilities were the CMIM to be activated. At present, AMRO does not possess sufficient human and monitoring resources. These will take time to build, thus the need to cooperate with the IMF.<sup>88</sup> The need is further compounded by the fact that the conditionality attached to CMIM programmes operates in relation to the linked portion—not necessarily to the delinked portion in the current technical configuration of this mechanism. It would make sense for the institution determining conditionality to support monitoring of compliance with it.

Presumably, non-compliance would prevent a loan from being rolled over—or, if disbursements were provided in tranches, from subsequent tranches to be made available. Nonetheless, this is only speculation at the moment. ASEAN+3 is yet to make public its revised Operational Guidelines, which should provide more detail. According to the joint statement of the May 2014 ASEAN+3 Finance Ministers and Central Bank Governors' Meeting, the guidelines revision process including detailed CMIM operationalisation

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<sup>84</sup> European Stability Mechanism, *Frequently Asked Questions on the European Stability Mechanism (ESM)*, 23 March 2015, p. 11.

<sup>85</sup> 'Organisational Structure', AMRO (2013), available at <<http://www.amro-asia.org/how-we-do/>> (accessed on 6 April 2015).

<sup>86</sup> *The Joint Ministerial Statement of the 15<sup>th</sup> ASEAN+3 Finance Ministers and Central Bank Governors' Meeting – Annex 1*, Manila, 3 May 2012.

<sup>87</sup> 'Message from AMRO Director', AMRO (2013), available at <<http://www.amro-asia.org/about-amro/overview/message-from-amro-director/>> (accessed on 6 April 2015).

<sup>88</sup> Rhee, Sumulong and Vallee, op. cit., pp. 229-230.

arrangements has concluded.<sup>89</sup> Meanwhile, the statement following the last meeting—held in May 2015—confirmed that CMIM test runs under different scenarios are being conducted.<sup>90</sup>

In any case, leading East Asian economists with experience of working with AMRO, in international institutions, and/or with their home country governments have pointed out that building the independent monitoring capabilities of AMRO is crucial for the CMIM,<sup>91</sup> and that independent monitoring can even be considered the primary task of AMRO.<sup>92</sup> Since no country has activated the CMIM yet, its monitoring capabilities should be built up to ensure they are ready if/when a CMIM member economy does.

### *ESM monitoring*

Monitoring of ESM programme policy conditionality adherence is the responsibility of the European Commission, in liaison with the ECB and—wherever possible—the IMF;<sup>93</sup> this is the aforementioned ‘Troika’. Monitoring compliance reports produced by the European Commission are necessary for the Board of Directors to approve disbursement of tranches of financial assistance following the initial payment and at the proposal of the Managing Director.<sup>94</sup>

Borrowing countries are legally required to provide all the necessary information for the effective monitoring of compliance. Failure to comply with ‘Troika’ monitoring requests or to meet the conditions agreed may result in interruption of subsequent disbursements by the Board of Directors.<sup>95</sup> This gives financial assistance recipient countries a clear incentive to facilitate monitoring.

Regarding SMSF-related disbursements, monitoring involves the European Commission and the ECB. Monitoring involves checking compliance with the agreed memorandum of understanding. There is no provision for the IMF to be part of SMSF reimbursement. Together with the monitoring process, a technical sub-committee approved by the Board of Directors at the proposal of the Managing Director shall report to the Board of Directors on a monthly basis. In parallel, the Managing Director shall forward a report to the Board of Governors on a monthly basis as well. If monitoring assessments or reports indicate that the SMSF has ceased to serve its purpose, its adequacy will be reconsidered.<sup>96</sup>

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<sup>89</sup> *The Joint Ministerial Statement of the 17<sup>th</sup> ASEAN+3 Finance Ministers and Central Bank Governors’ Meeting*, Astana, 3 May 2014.

<sup>90</sup> *The Joint Ministerial Statement of the 18<sup>th</sup> ASEAN+3 Finance Ministers and Central Bank Governors’ Meeting*, Baku, 3 May 2015.

<sup>91</sup> Sussangkarn, *op. cit.*

<sup>92</sup> Wei Benhua, ‘The ‘Chiang Mai Initiative Multilateralization (CMIM)’ Should Be Better Equipped for Crisis Prevention’, *Boao Review*, 6 December 2013.

<sup>93</sup> *Treaty Establishing the European Stability Mechanism*, Brussels, 2 February 2012.

<sup>94</sup> European Stability Mechanism, *Guideline on Loans*, 2015.

<sup>95</sup> *Ibid.*

<sup>96</sup> European Stability Mechanism, *Guideline on the Secondary Market Support Facility*, 2015.

In the case of financial institution indirect recapitalisation assistance, monitoring in relation to conditionality related to EU state aid rules is the remit of the European Commission. Compliance with other policy conditions is the responsibility of the Commission in liaison with the ECB and the relevant European Supervisory Authority (ESA).<sup>97</sup> In this case, the relevant ESA would be the European Banking Authority—established in 2011 to regulate banks across the EU.<sup>98</sup> The financial assistance beneficiary member state is also encouraged to request additional assessment from the IMF.<sup>99</sup>

**Table 3. Monitoring conditions under the CMIM and the ESM**

	<b>CMIM</b>	<b>ESM</b>
<b>De jure monitoring bodies</b>	• AMRO	• European Commission • ECB
<b>De facto monitoring bodies</b>	• IMF (presumably)	• IMF (wherever possible and not for SMSF instrument)
<b>Conditionality non-compliance consequences</b>	• TBC, but probably financial assistance programme interruption	• Financial assistance programme interruption, and presumably halting if compliance is not restored
<b>Monitoring periodicity</b>	• Six-monthly	• Unspecified, but tri-monthly has become the norm

Source: Compiled by the author from different sources

The regularity and duration of visits varies, since it has not been established by law. Nonetheless, the experience of ESM—and EFSF—borrowers suggests that relatively lengthy and frequent visits are possible. An EFSF programme-related visit to Greece lasted five months, for example.<sup>100</sup> While this is not the norm, visits of a few days every three months have been common. EFSF programme and ESM programmes visits to Cyprus, Ireland, Portugal and Spain seem to have followed this pattern.

## **5. IMF and regional liquidity provision arrangements: Complementarity and competition?**

There is a policy and academic debate regarding the relationship between the global and regional layers of the GFSN. The debate has regained prominence in the aftermath of the GFC and subsequent strengthening or creation of second generation RFSNs—of which the CMIM and the ESM are part. This debate boils down to one issue: do RFSNs complement or compete against the GFSN?

In the case of post-crisis liquidity provision, the IMF itself has engaged in this debate. Not surprisingly, the Washington-based institution has advocated the

<sup>97</sup> European Stability Mechanism, *Guideline on Recapitalisation of Financial Institutions*, 2015.

<sup>98</sup> 'About Us', *European Banking Authority* (2015), available at <<http://www.eba.europa.eu/about-us;jsessionid=36B961189CC1A5B2E002BF72584536AB>> (accessed on 6 April 2015).

<sup>99</sup> European Stability Mechanism, *Guideline on Recapitalisation of Financial Institutions*, 2015.

<sup>100</sup> Giorgos Christides, 'Stalling for Time: Greek Reform Efforts Slows to a Crawl', *Der Spiegel*, 27 February 2013.

complementarity between regional mechanisms and itself.<sup>101</sup> The IMF has even admitted the possibility that dissatisfaction with its conditionality—and also with its governance—may have been a trigger for the development of RFSNs.<sup>102</sup> Regardless of the rationale behind RFSNs, the IMF believes that coordination is possible—as also called for by the G20.<sup>103</sup>

Meanwhile, most contributors to the debate have sought to focus on how to promote cooperation, given that inter-layer competition in times of crisis would be highly undesirable. There seems to be a consensus that a multi-layered GFSN is necessary.<sup>104</sup> Hence, proposals have been made to organise IMF-RFSN cooperation *ex ante* to be activated as soon as a crisis strikes,<sup>105</sup> to clearly delineate the responsibilities of RFSNs to ensure they complement the IMF,<sup>106</sup> to use IMF resources to supplement those of RFSNs,<sup>107</sup> or to have RFSNs engage with the IMF in its areas of strength such as understating the implications for a region of an extra-regional crisis.<sup>108</sup>

These and other proposals seem to show that the debate about the complementary or competitive nature of the relationship between the IMF and regional liquidity provision arrangements remains unsolved. In this context, the case of the relationship between the IMF on the one hand and the CMIM and ESM on the other suggests that complementarity and competition co-exist.

#### *Complementary and competition between the IMF and the CMIM and ESM*

The clearest case of IMF-RFSN complementarity is institutionalised cooperation. In the case of the CMIM, there is a high degree of this type of complementarity. Insofar disbursement of 70 per cent of agreed financial assistance is linked to an IMF programme which comes with a longer maturity and supporting period,<sup>109</sup> requesting countries have very strong incentives to enter in a formal agreement with the IMF. It can be said that ASEAN+3

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<sup>101</sup> IMF, *Stocktaking the Fund's Engagement with Regional Financing Arrangement* (11 April 2013).

<sup>102</sup> *Ibid.*, p. 1.

<sup>103</sup> *G20 Cannes Summit Final Declaration – Building Our Common Future: Renewed Collective Action for the Benefit of All*, Cannes, 4 November 2011; *G20 Meeting of Finance Ministers and Central Bank Governors Communique – Global Economy and G20 Framework for Strong, Sustainable and Balanced Growth*, 19 April 2013.

<sup>104</sup> See Pradumna B. Rana, *The Evolving Multi-layered Global Financial Safety Net: Role of Asia*, RSIS Working Paper Series No. 238 (May 2012), and Pradumna B. Rana and Ramon Pacheco Pardo, 'ASEAN+3 and the IMF: The Need for a Marriage of Convenience', *Global Asia* 10: 1 (2015), pp. 64-71.

<sup>105</sup> C. Randall Henning, *Coordinating Regional and Multilateral Financial Institutions*, Peterson Institute for International Economics Working Paper Series No. 11-9 (March 2011).

<sup>106</sup> Ulrich Volz, *The Need and Scope for Strengthening Co-operation between Regional Financing Arrangements and the IMF*, German Development Institute Discussion Paper No. 15/2012 (2012).

<sup>107</sup> Ravi Menon, *Regional Safety Nets to Complement Global Safety Nets*, Singapore, 31 January 2012.

<sup>108</sup> Iwan J. Azis, *Inadequate Regional Financial Safety Nets Reflect Complacency*, ADBI Working Paper Series No. 411 (March 2013).

<sup>109</sup> *The Joint Ministerial Statement of the 15<sup>th</sup> ASEAN+3 Finance Ministers and Central Bank Governors' Meeting – Annex 1*, Manila, 3 May 2012.

economies have taken the decision to institutionalise cooperation with the IMF from the moment the CMIM is activated. To an extent, this is probably linked to lingering mistrust within ASEAN+3 and the moral hazard associated with lending to a country that has mismanaged its economy. IMF involvement helps to address these issues. Also, the IMF has over 3.5 times the financial capability of the CMIM, a non-negligible amount.

Complementarity with the IMF is more ambiguous in the case of the ESM. Eurozone countries have made provision for involvement of the IMF in the negotiation and monitoring of ESM programmes “wherever possible”,<sup>110</sup> which strongly suggests that IMF exclusion is a possibility. Furthermore, this applies to loan instruments but not to PMSF and SMSF instruments (see tables 2 and 3). The experience of the three ESM programmes activated thus far shows that institutionalised complementarity with the IMF is not straightforward. The Cyprus programme involved the IMF—as did the EFSF programmes with Greece, Ireland and Portugal. Yet, the IMF had a junior role in the Spain programme (see below). In any case, IMF involvement also serves to address the abovementioned issue of moral hazard, in this case at the Eurozone level.

This ambiguity, however, became clear during negotiations for a new programme for Greece during 2015. The IMF was involved in the negotiation process and invited to be part of its monitoring.<sup>111</sup> However, the Washington-based institution criticised the agreement reached in July. In a press release issued on the same day that EU institutions and the Greek government signed a memorandum of understanding, the IMF publicly called for debt relief to be offered to Greece.<sup>112</sup> This had become a point of contention between several EU member states and the IMF.<sup>113</sup> At the time of writing, the IMF is yet to decide whether it will contribute to the programme were debt relief not to be part of it. In other words, formal complementarity between the ESM and the IMF might have its limits.

Notwithstanding the possibility of disagreements, in addition to formal complementarity there is also informal complementarity. This could refer to a division of labour between the IMF and a RFSN in which each of them conducts activities which support those of the other. Information sharing would be an area in which this type of complementarity could exist. By their own nature, the CMIM and the ESM have better knowledge about regional issues and member-specific information than the IMF. Meanwhile, the latter has unmatched global perspective and technical expertise that can be deployed for crisis management.<sup>114</sup> The ‘Troika’ has not made public details of the information sharing during its visits to Cyprus and other Eurozone members. Yet, it would make sense to have said information sharing.

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<sup>110</sup> *Treaty Establishing the European Stability Mechanism*, Brussels, 2 February 2012.

<sup>111</sup> European Council, *Eurogroup Statement on the ESM Programme for Greece*, 14 August 2015.

<sup>112</sup> International Monetary Fund, *Statement by IMF Managing Director Christine Lagarde on Greece*, Press Release No. 15/381, 14 August 2015.

<sup>113</sup> Shawn Donnan, ‘IMF: Lagarde Eyes New Act in Greek Drama’, *Financial Times*, 13 August 2015.

<sup>114</sup> Manuela Goretti, Sergi Lanau and Uma Ramakrishnan, ‘IMF, Regional Financial Safety Nets to Create Stronger Links’, *IMF Survey Magazine* (26 October 2010).



Complementarity could also take the form of ex-ante capacity building and information sharing to strengthen cooperation and understanding in crisis management and resolution situations. To this end, the IMF and representatives of four regional liquidity provision arrangements—including the CMIM and the ESM—held a seminar in April 2013. Issues such as swift regional liquidity arrangement activation prior to the IMF putting together a programme, conditionality divergences or the strengthening of regional arrangement capabilities were discussed.<sup>115</sup> In January 2014, the IMF and AMRO held their own joint seminar for the first time. The dollarization of East Asian economies and macroprudential policies were discussed.<sup>116</sup> Regular AMRO-IMF exchanges are now part of the relationship between both institutions.<sup>117</sup>

Notwithstanding existing and potential areas for cooperation, there are also areas of possible competition between the IMF on the one hand and the CMIM and ESM on the other. Most notably, there is no legal requirement or even provision for IMF liquidity provision and monitoring of CMIM programmes (see above). As for the ESM, IMF liquidity provision is not necessarily part of its programmes and IMF involvement in the negotiation and monitoring of said programmes is only considered “wherever possible” (see above). The IMF is therefore excluded or only granted a junior role in essential areas of CMIM and ESM programmes. This suggests that CMIM member economies and ESM member countries might consider their liquidity provision mechanisms as a protection against dependence on IMF programmes.

A degree of competition seems to have been present in the three ESM programmes activated so far. This was obvious in the case of the Spain programme, in which the IMF was confined to an advisory—when determining the financial institutions to receive funds—and monitoring role.<sup>118</sup> In the Cyprus programme the IMF seems to have a junior role as well. It has committed to provide €1 billion out of a €10 billion programme (US\$1.09 and US\$10.97 billion, respectively).<sup>119</sup> In the case of the 2015 Greece programme, the IMF has not even agreed to provide funds at the time of writing because of disagreements in relation to debt relief. Notwithstanding this, the programme has been approved and activated.<sup>120</sup> In contrast, the IMF provided around a third of the funds received by Greece, Ireland and Portugal under the EFSF/EFSM framework—and even larger shares to the programmes of non-

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<sup>115</sup> ‘Overview of the G20-IMF Seminar: Regional Financing Arrangements—Their Role in the International Financial Architecture and Cooperation with the IMF’, *G20 Russia* (17 April 2013).

<sup>116</sup> ‘Press Release – First AMRO-IMF Joint Seminar’, *AMRO* (23 January 2014).

<sup>117</sup> *The Joint Ministerial Statement of the 18<sup>th</sup> ASEAN+3 Finance Ministers and Central Bank Governors’ Meeting*, Baku, 3 May 2015.

<sup>118</sup> European Stability Mechanism, *Frequently Asked Questions on the European Stability Mechanism (ESM)*, 23 March 2015, pp. 23-24.

<sup>119</sup> ‘ESM Financial Assistance for Cyprus’, *European Stability Mechanism* (2015), available at <<http://www.esm.europa.eu/assistance/cyprus/index.htm>> (accessed on 6 April 2015).

<sup>120</sup> European Council, *Eurogroup Statement on the ESM Programme for Greece*, 14 August 2015.

Eurozone members Hungary, Latvia and Romania.<sup>121</sup> This suggests that the ESM has reduced the role of the IMF in Eurozone programmes.

**Table 4. Relationship between the IMF and the CMIM and ESM**

	<b>CMIM</b>	<b>ESM</b>
<b>Formal cooperation provision</b>	• Yes	• Yes
<b>Formal cooperation</b>	• 70 per cent IMF linked disbursement	• Programme negotiation (“whenever possible”) • Monitoring (“whenever possible”)
<b>Informal cooperation</b>	• Information sharing	• Information sharing
<b>Other cooperation</b>	• Ex-ante capacity building and information sharing	• Ex-ante capacity building and information sharing
<b>Possible competition areas</b>	• Liquidity provision • Monitoring • “Facility shopping” <sup>122</sup>	• Liquidity provision • Programme negotiation • Monitoring • “Facility shopping”

Source: Compiled by the author from different sources

Finally, the mere existence of regional liquidity provision arrangements can lead to “facility shopping”, which has been recognised as a threat by both the IMF and regional facilities.<sup>123</sup> This occurs when crisis-hit countries seek to play one mechanism against another to obtain the best programme with the less onerous conditions. It could lead to competition among institutions seeking to strengthen their legitimacy.

## 6. Conclusion

The main objective of this paper is to provide a comparative analysis of the evolution and current state of the regulatory basis which underpins the regional liquidity provision arrangements of ASEAN+3 and the Eurozone: the CMIM and the ESM, respectively. These are the two biggest regional arrangements, two of the most recently created, and the only—together with the EFSM—with formal links to the IMF. In short, the CMIM and the ESM are the two best-developed mechanisms among those that currently exist.

The arrangements have several similarities. To begin with, they are second generation agreements launched in the aftermath of the GFC. The CMIM was established in 2010 as an evolution of the CMI launched in 2000, following the AFC. Meanwhile, the ESM only entered into force in 2012—following from the EFSF created two years before. Their very recent creation suggests the inadequacy of the previous, IMF-centred liquidity provision mechanisms. As

<sup>121</sup> See European Stability Mechanism, *Frequently Asked Questions on the European Stability Mechanism (ESM)*, 23 March 2015, and ‘Balance of Payments’, *European Commission* (21 August 2014), available at <[http://ec.europa.eu/economy\\_finance/eu\\_borrower/balance\\_of\\_payments/index\\_en.htm](http://ec.europa.eu/economy_finance/eu_borrower/balance_of_payments/index_en.htm)> (accessed on 6 April 2015).

<sup>122</sup> Of course this can be positive for the (potential) borrower. This paper does not deal with this matter though.

<sup>123</sup> ‘Overview of the G20-IMF Seminar: Regional Financing Arrangements—Their Role in the International Financial Architecture and Cooperation with the IMF’, *G20 Russia* (17 April 2013).

this paper has mentioned, rejection of IMF conditionality has been a key driving force behind the CMIM and the ESM.

In terms of the actual regulatory basis of these two arrangements, there are several similarities in terms of available instruments and applicable borrowing conditions. Regarding instruments at the disposal of recipient countries, loans are the only instrument available in the case of the CMIM and the only used hitherto by ESM borrowers. The use of loans has two clear advantages from the lenders' perspective. Firstly, they limit moral hazard insofar loan maturity and interest payable are clearly stipulated in the contract signed with the creditors. Borrowers therefore have to comply with a clear repayment programme. Secondly, loans remain in the balance sheets of borrowing members—even in the case of ESM indirect financial sector recapitalisation programmes. This should incentivise borrowers to swiftly resolve their financial crisis in order to resume economic growth and reduce the debt-to-GDP ratio resultant from the loans.

Borrowing conditions for CMIM and ESM borrowers are also similar. To begin with, requesting economies or countries have to submit a proposal that ultimately needs to be approved by the ministers of finance of either ASEAN+3 or the Eurozone. This means that the decision to grant financial assistance is intergovernmental in nature. Other, supranational institutions are also involved in the approval process. These include the IMF, even though only “wherever possible” in the case of the ESM. Approval will only be granted if the proposal meets certain conditionality—albeit only for the IMF linked portion in the case of the CMIM—which therefore needs to be agreed prior to the launch of financial assistance programme.

The similarities regarding borrowing conditions are explained by two factors. Most importantly, CMIM and ESM funding comes from their member economies or countries. In the case of the CMIM, there is a commitment by the member economies to make funding available—but it remains with member economy central banks until activation of the arrangement. As for the ESM, almost 90 per cent of the capital remains with member country central banks. Since funding comes from CMIM and ESM members, it is logical for them to make the final decision on programme approval. Especially since the reason for a request—a financial crisis—might affect other economies or countries in the region as well.

Closely related, limiting moral hazard is a second factor explaining borrowing condition similarities. Since programme funding originates from CMIM and ESM members, they will seek to impose conditions ensuring that economic growth will resume and interest-bearing disbursements will be repaid. Otherwise, borrowers would basically be receiving a ‘free lunch’. Even in the case of the 30 per cent portion of CMIM programmes delinked from IMF conditionality, requesting countries have to comply with covenants that reduce moral hazard.

CMIM-ESM similarities also exist in the area of monitoring. Most notably, monitoring is the remit of regional supranational organisations: AMRO in the

case of the CMIM and the European Commission and ECB in the case of the ESM. In both cases the IMF would generally be part of programme monitoring as well. In sharp contrast to the intergovernmental programme approval process, monitoring is supranational. This is sensible when considering that governments and their ministries of finance need to attend domestic issues and cannot be expected to provide regular attention to foreign matters. Supranational bodies specialised in financial affairs are better placed to conduct monitoring. Also, involvement of the IMF makes sense insofar it provides expertise on global-level and cross-regional matters that regional bodies do not necessarily have.

Despite cooperation with the IMF as just summarised, the CMIM and the ESM are also alike in that they confer the IMF a junior role in their programmes. Liquidity provision approval, programme negotiation, and implementation monitoring are led by the regional arrangements. The IMF is invited to participate in them, but it seems that only under the terms indicated by the CMIM or the ESM. This is reflective of a key reason behind the launch of second generation arrangements—displeasure with IMF conditionality. Even though there have been calls and meetings to ensure the complementarity of the IMF and RFSNs, the latter seem to have the upper hand in ASEAN+3 and the Eurozone.

This comprehensive list of similarities should not hide the fact that there are also differences between the CMIM and the ESM. These differences can be summarised by saying that the ESM is more institutionalised. The Eurozone liquidity provision facility has more instruments at the disposal of requesting countries, a more detailed and clearly defined programme approval process, a clearer conditionality setting process, a more thorough and better explained monitoring process, and well laid out programme non-compliance penalties. Furthermore, the ESM is around three times as big as the CMIM and is more independent from the IMF. Meanwhile, the CMIM still is at a developmental stage.

To explain these differences, it is necessary to understand the wider context. The ESM is an institution of the Eurozone, a currency union which needs better institutionalisation as demonstrated by the ESDC. It could be argued that the ESM provides the liquidity to the Eurozone in times of crisis that central banks provide elsewhere—including in ASEAN+3 economies. Indeed, there are ongoing discussions about the need for a fiscal union in the Eurozone. This further shows the need for the Eurozone to formally integrate, which is not essential for the independent economies of ASEAN+3.

Besides the need for greater integration, Eurozone countries also have a far longer history of integration, cooperation and institutionalisation. Formally it dates back to 1957, when the EU was created as the EEC. By the time that the euro was launched as an accounting currency in 1999, EU member states had already been cooperating on a wide range of economic, political and security issues for over forty years. Thereafter cooperation intensified for Eurozone member countries. ASEAN+3 does not have a comparable history,

even if free trade agreements, policy dialogues or the soon-to-be-launched ASEAN Economic Community have intensified cooperation.

There also seems to be a degree of lingering mistrust among ASEAN+3 economies. This would help to explain why 70 per cent of any CMIM disbursement would be contingent on the borrower having signed an IMF programme. Despite the stigma attached to IMF bailout packages as a result of its behaviour during the AFC, ASEAN+3 economies still prefer to have this institution set the conditionality to be met by CMIM programme recipients. Mistrust is also present in the Eurozone, as regular discussions around the Greece programme have shown. Nevertheless, this mistrust can be overcome through the need to cooperate and the existence of strong supranational institutions.

To summarise, ASEAN+3 and the Eurozone have developed the two most sophisticated second generation regional financial liquidity provision arrangements. The CMIM and the ESM were established in the aftermath of the GFC, to an extent to avoid future dependence on IMF bailout packages. When compared with each other, it becomes apparent that the Eurozone mechanism is better institutionalised. Yet, both liquidity provision arrangements are similar in terms of instruments, borrowing conditions, and monitoring, as well as in the relationship that each of them has with the IMF.

## Annex 1. Chiang Mai Initiative Multilateralization information

### CMIM Contributions, Purchasing Multiple, Maximum Swap Amount and Voting-Power Distribution

(After doubling the size and increasing the IMF de-linked portion to 30%)

Countries	Financial Contribution (billion USD)		Share(%)	Purchasing Multiple	Maximum Swap Amount (billion USD)	Basic Votes	Votes Based on Contribution	Total Voting Power	
									%
Plus Three	192.00		80.00		117.30	9.60	192.00	201.60	71.59
China	China (Excluding Hong Kong)	68.40	32.00	0.5	34.20	3.20	68.40	71.60	25.43
	Hong Kong China	8.40		2.5	6.30	0.00	8.40	8.40	2.98
Japan	76.80		32.00	0.5	38.40	3.20	76.80	80.00	28.41
Korea	38.40		16.00	1	38.40	3.20	38.40	41.60	14.77
ASEAN	48.00		20.00		126.20	32.00	48.000	80.00	28.41
Indonesia	9.104		3.793	2.5	22.76	3.20	9.104	12.304	4.369
Thailand	9.104		3.793	2.5	22.76	3.20	9.104	12.304	4.369
Malaysia	9.104		3.793	2.5	22.76	3.20	9.104	12.304	4.369
Singapore	9.104		3.793	2.5	22.76	3.20	9.104	12.304	4.369
Philippines	9.104		3.793	2.5	22.76	3.20	9.104	12.304	4.369
Vietnam	2.00		0.833	5	10.00	3.20	2.00	5.20	1.847
Cambodia	0.24		0.100	5	1.20	3.20	0.24	3.44	1.222
Myanmar	0.12		0.050	5	0.60	3.20	0.12	3.32	1.179
Brunei	0.06		0.025	5	0.30	3.20	0.06	3.26	1.158
Lao PDR	0.06		0.025	5	0.30	3.20	0.06	3.26	1.158
Total	240.00		100.00		243.50	41.60	240.00	281.60	100.00

Source: *The Joint Ministerial Statement of the 15<sup>th</sup> ASEAN+3 Finance Ministers and Central Bank Governors' Meeting – Annex 1, Manila, 3 May 2012.*

## Annex 2: European Stability Mechanism information

### Contribution Key of the ESM

<i>ESM Member</i>	<i>ESM key (%)</i>
<i>Kingdom of Belgium</i>	<i>3.4534</i>
<i>Federal Republic of Germany</i>	<i>26.9616</i>
<i>Republic of Estonia</i>	<i>0.1847</i>
<i>Ireland</i>	<i>1.5814</i>
<i>Hellenic Republic</i>	<i>2.7975</i>
<i>Kingdom of Spain</i>	<i>11.8227</i>
<i>French Republic</i>	<i>20.2471</i>
<i>Italian Republic</i>	<i>17.7917</i>
<i>Republic of Cyprus</i>	<i>0.1949</i>
<i>Republic of Latvia</i>	<i>0.2746</i>
<i>Republic of Lithuania</i>	<i>0.4063</i>
<i>Grand Duchy of Luxembourg</i>	<i>0.2487</i>
<i>Malta</i>	<i>0.0726</i>
<i>Kingdom of the Netherlands</i>	<i>5.6781</i>
<i>Republic of Austria</i>	<i>2.7644</i>
<i>Portuguese Republic</i>	<i>2.4921</i>
<i>Republic of Slovenia</i>	<i>0.4247</i>
<i>Slovak Republic</i>	<i>0.8184</i>
<i>Republic of Finland</i>	<i>1.7852</i>
<i>Total</i>	<i>100.0</i>

The above figures are rounded to four decimals.

Source: *Treaty Establishing the European Stability Mechanism*, Brussels, 2 February 2012.