Developing Financial Safety Net Framework-An Asian Perspective

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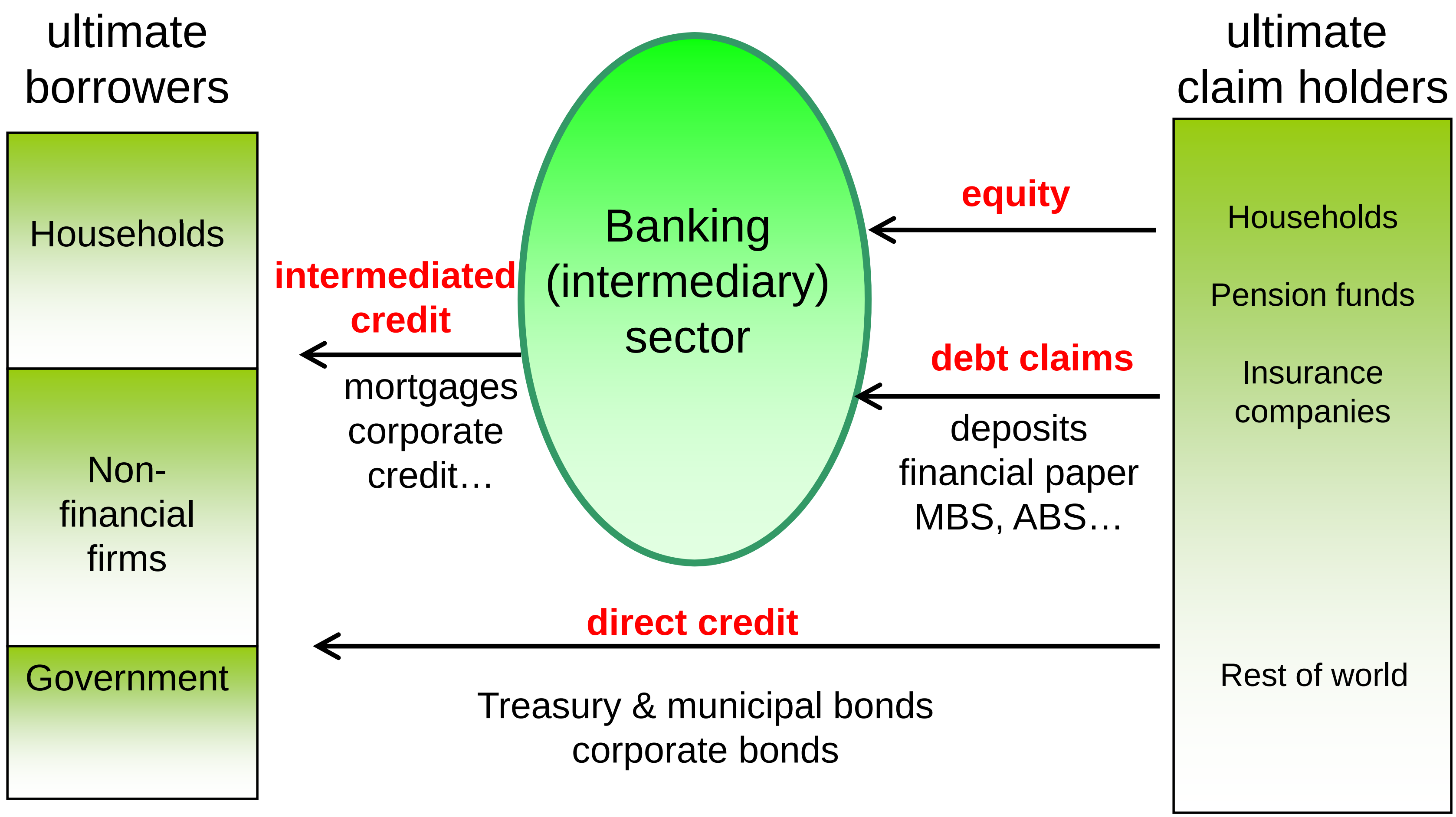
Developing FSN Framework: Issues and Challenges

- No commonly agreed/accepted arrangements, standard or framework for FSN
- For whom?-Banks & other financial institutions only?
- Need to establish an appropriate framework global financial safety at the global, regional and bilateral levels for preventing liquidity crises arising out of capital volatility and addressing contagion effects from crisis through pre-emptive provision of liquidity
- Adequacy and effectiveness of operation of financial safety nets and the structure of its components and their interrelations
- The framework should be able to balance between safety and soundness of the financial system; and tolerated risk level (moral hazard).

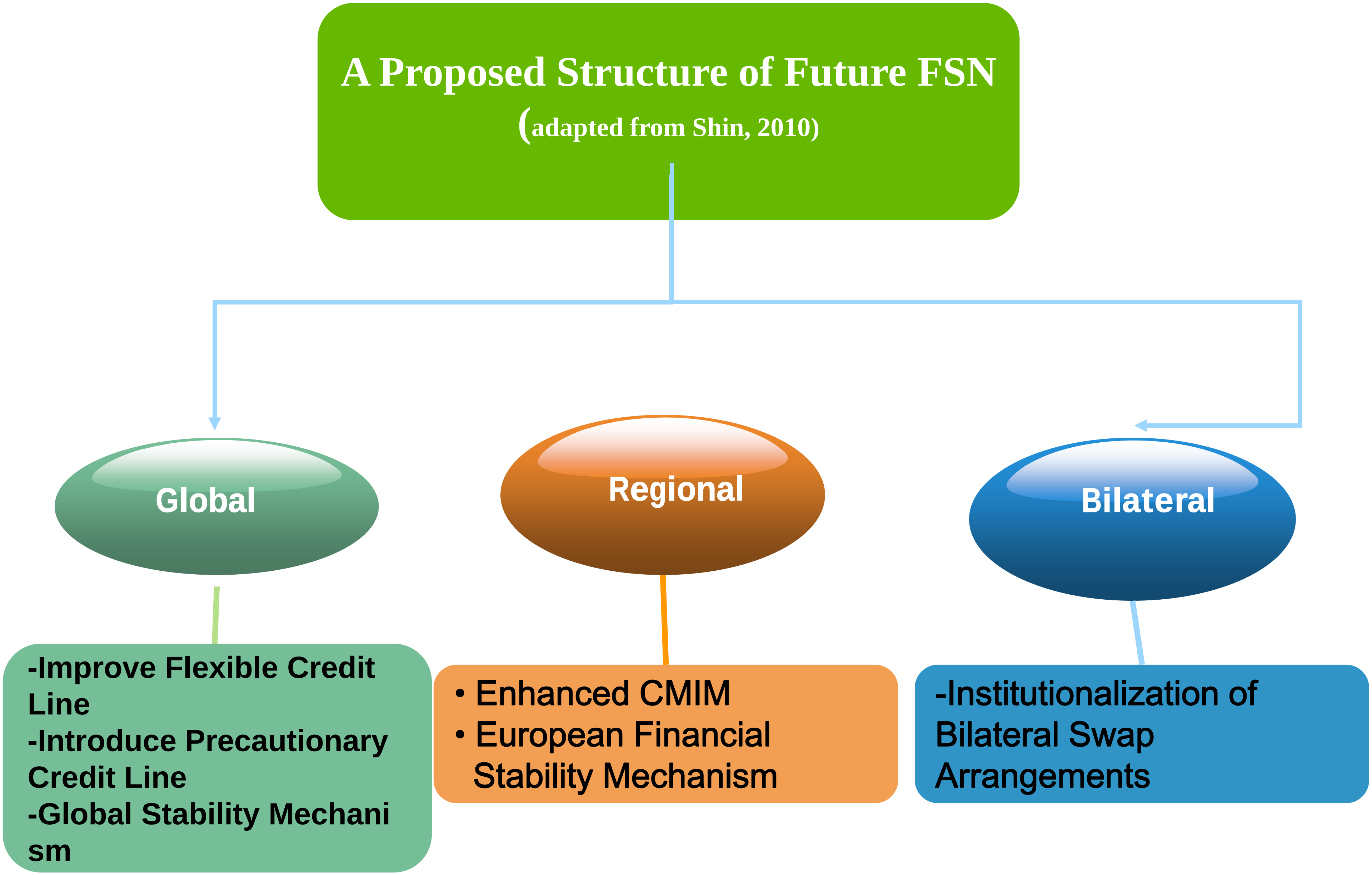
Components of FSN

- Lender of last resort-Monetary and Fiscal authorities
- Deposit Insurance-moral hazard for unlimited coverage
- Macro-prudential Regulation and Supervision-Prudential authorities
- Failure Resolution Mechanism-Monetary and Fiscal authorities (Schich, 2008)

Financial System



Source: Hyun Song Shin, 2010

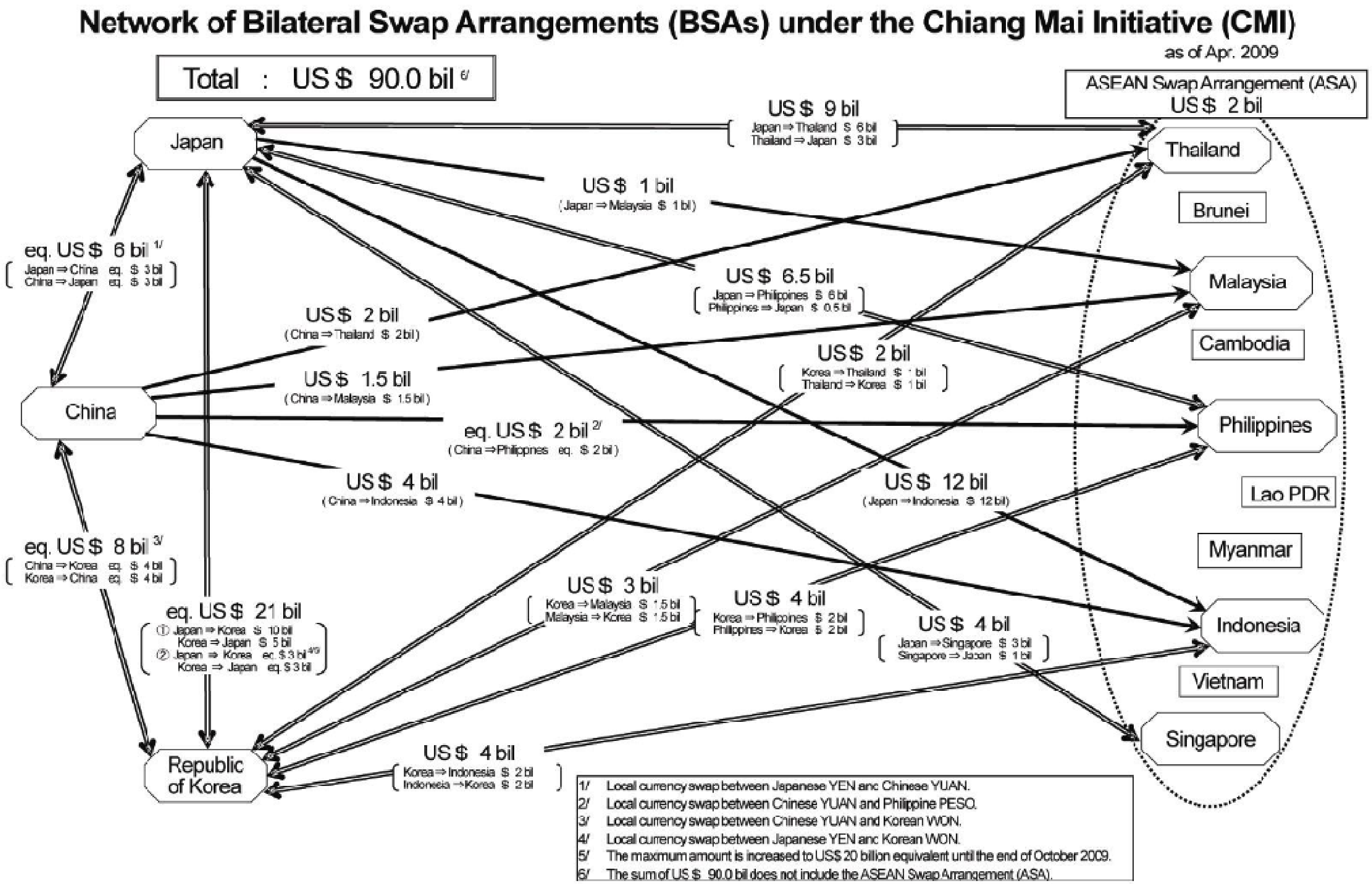

A Proposed Structure of Future FSN
(adapted from Shin, 2010)
Global
Regional
Bilateral
-Improve Flexible Credit Line
-Introduce Precautionary Credit Line
-Global Stability Mechanism
• Enhanced CMIM
• European Financial Stability Mechanism
-Institutionalization of Bilateral Swap Arrangements

Bilateral Currency Swap Arrangements

- Bilateral agreements between central banks of an economy and a reserve currency central bank can provide FX liquidity to local financial institutions in need.
- Federal Reserve provided dollar swap arrangements with Brazil, Korea, Mexico, and Singapore (as well as with 10 advanced countries), and European Central Bank and Swiss National Bank each extended Euro liquidity to Hungary and Poland.
- These bilateral swaps have been effective, however, liquidity receiving economies do not have control for timely provision.
- Need for formalization and institutionalization of bilateral swaps

Source: Ishi et. al, 2009

Structure of the Chiang Mai Initiative



Source: Ministry of Finance, Japan.

CMIM Contributions and Borrowing Multipliers

Country	Contribution (US$ Billion)		Borrowing Multiplier
Brunei	0.01		5
Cambodia	0.12		5
PRC	38.40	PRC , Excluding Hong Kong, China 34.2	0.5
		Hong Kong, China 4.2	2.5*
Indonesia	4.77		2.5
Japan	38.40		0.5
Korea	19.20		1
Lao PDR	0.03		5
Malaysia	4.77		2.5
Myanmar	0.06		5
Philippines	3.68		2.5
Singapore	4.77		2.5
Thailand	4.77		2.5
Viet Nam	1.00		5

* Hong Kong, China's borrowing is limited to IMF delinked portion because Hong Kong, China is not a member of the IMF

Source: The Joint Media Statement of The 12th ASEAN+3 Finance Ministers' Meeting, 3 May 2009, Bali, Indonesia.

Gross Official Foreign Reserves (in Billion US$)

-By the end of 2008, East Asia accumulated more than US $ 4 trillion accounting for 55% of world reserve

Year	1997	2000	2003	2006	2008
PRC	146.4	171.8	416.2	1,080.8	1,946.0
HK, China	92.8	107.6	118.4	133.2	182.5
Indonesia	17.5	29.4	36.3	42.6	51.6
Japan	226.7	361.6	673.6	895.3	1,030.8
Korea	20.5	96.3	155.5	239.1	201.5
Malaysia	21.5	28.7	44.3	82.9	92.2
Philippines	8.7	15.1	17.1	23.0	37.5
Singapore	71.4	80.2	96.2	136.3	174.2
Thailand	26.9	32.7	42.2	67.0	111.0

Source: Sussangkarn, 2010

A Framework of Asian FSN

- Asian economies witnessed a series of crises/shocks due to sudden withdrawal of capital flows and hence maintained very large reserve with a large cost
- Asia needs a regional financial safety nets to prevent these crisis or shocks with the support of major economies
- Enhanced Chiang Mai Initiative Multilateralization (CMIM) could be a suitable part of Asian FSN as the liquidity support mechanism
- Need to explore how to secure a sufficient size of resources for regional safety nets
- CMIM of ASEAN, Japan, Korea and China (ASEAN +3) can be expanded to include other major economies such as Australia, New Zealand and India (ASEAN +6) in the form of "contributing partners".
- CMIM resources can be supplemented by additional country contributions or to use the CMIM for swap agreements.
- CMIM can introduce pre-cautionary (non-crisis) facilities like FCL and offer flexible products for external shocks such as 2008 crisis without conditionality and IMF links

Source: Kawai, 2010 and Sussangkarn, 2010

Regional Macroeconomic-Financial Surveillance

- For de-linking CMIM structurally from IMF, current regional macroeconomic-financial surveillance mechanisms and financial cooperation process of ASEAN + 3 need to be strengthened significantly.
- Currently, technical and financial resources for surveillance have been very limited. Officials undertake the tasks on a part-time basis in addition to many other regular jobs. The success of a surveillance mechanism depends on a strong professional secretariat.
- The newly established ASEAN + 3 Macroeconomic Research Office (AMRO) should be strengthened with adequate resources and proper mandates. East Asia's surveillance activities cannot simply be an internal surveillance of the region. The region also needs mechanisms for surveillance of the more advanced economies that have the potential to negatively affect the region indirectly.

Source: Kawai, 2010 and Sussangkarn, 2010

Conclusion

- European debt crisis shows the need for a concerted global, regional and bilateral efforts
- How to strengthen CMIM to create an appropriate Asian FSN with right size, power and capacity?
- What should be the appropriate FSN framework interlinking global, regional and bilateral arrangements?
- What should be the relationship between an independent CMIM and IMF as well as institutionalized bilateral arrangements