5

Comparison of Other Regional Financial Arrangements with the CMI

The Chiang Mai Initiative is not by any means the first regional swap arrangement to be introduced. It is merely the latest in a series of regional and plurilateral financial facilities since the advent of international cooperation among central banks in the 1920s. This chapter examines three such arrangements: the bilateral swaps developed among the Group of Ten (G-10) countries during the 1960s to support the Bretton Woods regime; the facilities created in the context of European integration and then further developed during the 1970s and 1980s to support the European Monetary System (EMS); and the North American Framework Agreement (NAFA), a financial adjunct to the North American Free Trade Agreement. A fourth facility, the Exchange Stabilization Fund (ESF) of the United States, is examined separately in chapter 6.

These arrangements emerged under different exchange rate regimes, stages of development of international financial markets, and political circumstances. Comparing them nonetheless provides useful insights on the design and importance of the CMI and its relationship to the multilateral institutions.

Bilateral Swaps among the Group of Ten

As payments imbalances and market pressures on the fixed exchange rate regime emerged during the early 1960s, the governments of the industrial countries marshaled their financial resources to defend the regime. They constructed an elaborate array of financial instruments, at the

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center of which remained the International Monetary Fund but which added the General Arrangements to Borrow, Special Drawing Rights (SDRs), issuance of foreign-currency bonds by the United States, replenishment of the ESF, and a series of bilateral swap agreements.

The agreements between the United States and its partners in the G-10, plus four additional countries and the Bank for International Settlements (BIS), were the most important of the swaps.[1] The Federal Reserve was the US agency that served as party to most of these arrangements, which collectively grew to about $29.8 billion by 1978, and to $36.4 billion in the 1990s. The US Department of the Treasury concluded two such agreements, one with the Bank of Mexico in 1967 for $100 million, which was raised in stages to $3 billion eventually, and the other with the German Bundesbank in 1978 for $1 billion (see table 5.1).[2]

These were standing swap agreements. Agreements to exchange currencies with countries in this group in larger amounts, and agreements with countries beyond this group, could be negotiated on an ad hoc basis and were struck on several occasions.[3] European countries established a number of bilateral swaps among themselves, supplementing their lines with the United States. For example, the United Kingdom set up a series of swaps with 12 other central banks, through the BIS, to stabilize the pound in the mid-1960s.[4]

The terms and conditions attached to the bilateral swaps maintained by the United States changed over time. As of the early 1980s, the template presented in the appendix served as the model agreement. Either party could draw on the swap in principle, although most were actually activated only in one direction in practice. Neither party could activate the swap unilaterally. Drawings were for a period of 3 months and were subject to renewal an unspecified number of times with mutual agreement. Exchange rate risk was assigned differently depending on the country concerned and the date of the agreement. By the early 1980s, however, such risk was assigned to the initiator of the swap transaction.

The swaps were conceived as the first of a cascading series of facilities to which governments and central banks could resort during a prolonged crisis. If the initial use of the G-10 swaps proved to be insufficient in amount or duration to stem market pressures, the borrower would then turn to the IMF. With the proceeds of the (larger) IMF loan, the borrower could reverse the swap and finance medium-term payments imbalances.

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1. The group thus included the United States, Japan, Germany, France, United Kingdom, Italy, Canada, Belgium, the Netherlands, Sweden, Switzerland, Austria, Denmark, Norway, and Mexico, plus the BIS.

2. US Treasury, *ESF Annual Report*, 1991.

3. Henning (1999, table 1).

4. Rainoni (1973, 558-61).

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Table 5.1 Reciprocal currency arrangements of the United States (June 30, 1998; millions of dollars)

Institution	Amount
Federal Reserve arrangements	
Austrian National Bank	250
National Bank of Belgium	1,000
Bank of Canada	2,000
National Bank of Denmark	250
Bank of England	3,000
Bank of France	2,000
Deutsche Bundesbank	6,000
Bank of Italy	3,000
Bank of Japan	5,000
Bank of Mexico	3,000
Netherlands Bank	500
Bank of Norway	250
Bank of Sweden	300
Swiss National Bank	4,000
Bank for International Settlements	
Dollars against Swiss francs	600
Dollars against other authorized European currencies	1,250
Subtotal	**32,400**
Treasury arrangements	
Deutsche Bundesbank	1,000
Bank of Mexico	3,000
Subtotal	**4,000**
Total	**36,400**

Source: Federal Reserve Bulletin, September 1998, 721.

In extraordinary cases where the medium-term assistance of the IMF was also insufficient, longer-term assistance also might be made available on a bilateral or regional basis. (See the discussion of the European facilities below.) This concept of a "facilities sequence"—layered by maturity and to which countries would resort successively—continues to serve as the basis for official approaches to financial stabilization.

As a government moved progressively through the facilities sequence, it was subjected to increasingly stringent policy adjustments. Because speculative capital outflows that are not founded on underlying disequilibrium can reverse themselves in the short term, the theory went, policy adjustments would not be necessary to provide for repayment by the borrower over that time horizon in these instances. When borrowing is necessitated by current account deficits or capital outflows related to more persistent economic problems, however, correspondingly more fundamental adjustment of policies and more time to realize positive results

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are required. When countries resorted to their upper credit tranches of the IMF, therefore, they would also submit to its policy conditionality.

As the first step along this facilities sequence, the swaps came with no formal conditionality.[5] Drawings would take place on consultation about the use to which they would be put and policies being pursued by both parties. Yet because creditors retained the discretion to activate, they could extract from borrowers assurances beyond those consultations. Such assurances sometimes included a promise to turn to the IMF, if necessary, rather than request a swap renewal.

The first activation of one of the G-10 bilateral swap agreements took place in June 1962. Then, the Federal Reserve swapped dollars for Belgian francs and Dutch guilders, using the proceeds to buy surplus dollars in the hands of the National Bank of Belgium and Netherlands Bank, in an effort to dissuade those central banks from converting at the US Treasury's gold window.[6] Through the speculative episodes and parity adjustments of the 1960s, the switch to flexible rates in the early 1970s, and the management of floating currencies in the mid- and late 1970s, the swap arrangements were used, and enlarged, again and again.[7] The last drawing by a G-10 country took place in 1981 by Sweden. After more than 15 years of disuse, and on the eve of the introduction of the new currency in Europe, the Fed and Treasury decided to discontinue all of these arrangements except those with Canada and Mexico at the end of l998.[8]

These drawings represented a substantial source of funds for external financing and currency support. US policymakers conceived of them as the first of a series of "concentric defense lines" for the dollar, prior to reliance on the IMF.[9] At the outset, there was no deliberate effort to coordinate the G-10 swaps with the purposes of the IMF. As time went

5. Charles Coombs, who negotiated these arrangements from the New York Federal Reserve Bank, justified the absence of formal conditionality by saying that central bankers preferred instead to insist firmly on reversal of the swap as the primary safeguard against abuse (Coombs 1976, 87). This would leave to the subsequent creditor the responsibility of negotiating conditionality if an extension were needed. In the event, central bankers' insistence was often less than firm; many swap activations were in fact renewed several times. Officials gradually drew the lesson that such indulgence was often counterproductive, and always so in cases of fundamental disequilibrium.

6. Coombs (1976, 79-80).

7. For treatments of the use of the swaps, see Coombs (1976), Black (1977), Solomon (1977), Mayer (1980), Odell (1982), and Edwards (1985).

8. *Federal Reserve Bulletin*, March 1999, 182. After the September 11, 2001, attacks on the World Trade Center in New York City and the Pentagon, the Fed opened a temporary set of swap lines with the European Central Bank and the Bank of England, and temporarily enlarged its swap arrangement with the Bank of Canada under the North American Framework Agreement, to assure smooth operation of payments systems (Federal Reserve press releases, Washington, September 13 and 14, 2001).

9. Coombs (1976, 90).

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by, IMF and national officials increasingly appreciated the swaps' ramifications for IMF programs. The swaps bridged the gap in time between the onset of crises and the availability of IMF funds and supplemented the resources of the IMF.

However, by possibly delaying adjustment and giving creditor governments a larger stake in being "bought out" with IMF financing, the swaps also potentially constrained the IMF when its support was eventually requested. As a condition for activation of the swaps in 1976, the United States insisted that the United Kingdom negotiate a program with the IMF.[10] Nonetheless, the linkages between swaps and IMF activities remained ad hoc and informal.

The dollar rescue package of November 1, 1978, illustrates the importance of these swaps to the United States. After the dollar had depreciated through most of 1977 and 1978, the Carter administration organized a $30 billion package to halt the movement. The package consisted of $15 billion in the form of swap lines from three major central banks, issuance of up to $10 billion of Treasury securities denominated in foreign currency, $3 billion in drawings on the US reserve position at the IMF, and $2 billion in sales of SDRs. Although only part of this package was ever mobilized, its nominal size was probably important in reversing market expectations of further dollar depreciation.[11] Whether the United States would have been driven to the upper credit tranches at the IMF—where conditionality applies—in the absence of these swap arrangements is an intriguing counterfactual question.

European Facilities

The monetary authorities of the European Community developed and operated a comprehensive set of facilities to finance foreign exchange intervention in support of the European Monetary System. The set contained three main components: (1) the Very-Short-Term Financing facility (VSTF), (2) the Short-Term Monetary Support facility (STMS), and (3) the Medium-Term Financial Assistance facility (MTFA). These facilities, which were used heavily at times during the 1980s and 1990s, were the focus of nearly continuous bargaining and renegotiation over the life of the EMS. The VSTF and STMS were retired with the introduction of the euro and the creation of the European Monetary Union. Under the mechanism that is available to stabilize remaining European currencies against the euro—the ERM (Exchange Rate Mechanism) II—in which the

10 Stephen Fay and Hugo Young, "The Day the Pound Nearly Died," *Sunday Times* (London), 1978.

11. *Federal Reserve Bulletin*, March 1979, 201-20; Putnam and Henning (1989); S. Cohen and Meltzer (1982); de Vries (1985).

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Danish kroner is the only present member, such financing is potentially available directly from the European Central Bank.[12] Notwithstanding Economic and Monetary Union, the MTFA remains in place but is unused at the moment.

Short-Term Facilities

A central bank in need of deutsche mark reserves to defend its currency within the bands of the EMS could draw upon the VSTF. These credits were repayable within 45 days after the end of the month in which they were borrowed. The repayment period was extended, in the mid-1980s, to 75 days after the end of the month in which they were drawn. If a borrower was unable to replenish reserves before the repayment date, it could then resort to the STMS for a period of 3 months, renewable once. Drawings under these facilities by one central bank against another were recorded as transactions of each with the European Monetary Cooperation Fund (EMCF). The EMCF, which was established along with the VSTF in 1973, was made the rubric for the VSTF and STMS when the EMS was created in 1979.[13]

Under the rules of the EMS, in theory, central banks were required to intervene in unlimited quantities to maintain exchange rates within their designated bands. Thus, the amounts available through the VSTF were theoretically unlimited. But extensions of these drawings beyond the initial repayment date were constrained formally, in two ways.

First, extensions were limited by the quota system of the STMS. The size of debtor quotas was initially set at ECU7.9 billion (ECUs being European Currency Units), and creditor quotas were set at twice that amount. By unanimous agreement within the Committee of Central Bank Governors, the total figure for effective credits could be extended to ECU14 billion.[14] The amount that any one country could draw was similar to its IMF quota in 1979, but lagged behind subsequent overall increases in IMF quotas.[15]

12. "Agreement on the New Exchange Rate Mechanism (ERM II)," European Central Bank, *Annual Report 1998*, 72-74.

13. The main founding document of the EMS is "Resolution of the European Council of December 5, 1978 on the Establishment of the European Monetary System (EMS) and Related Matters" (European Council 1978). See, as well, "Conclusions of the Presidency of the European Council of July 6 and 7, 1978 in Bremen" (European Council Presidency 1978); and Committee of Governors of the Central Banks of the Member States of the European Economic Community, press communiqué, September 18, 1987. Analyses can be found in Gros and Thygesen (1992); Giavazzi and Giovannini (1989); Mastropasqua, Micossi, and Rinaldi (1988); Russo and Tullio (1988); and Edwards (1985).

14. These are provided for in the main founding document of the EMS (European Council 1978).

15. Gros and Thygesen (1992, 50); Giavazzi and Giovannini (1989, 37-39, n. 14). The IMF quotas for the members of the ERM totaled about ECU11.6 billion in 1979.

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Second, if a central bank sought to renew the original drawing beyond 6 months, the extension could be subject to conditionality.[16] A tightening of monetary policy was usually the logical candidate for such policy adjustments in the short term.

In addition to these formal limitations on the size and automaticity of these credits, there were also an important set of informal, but nonetheless effective, constraints. Because the EMS imposed greater burdens of adjustment and intervention on countries with weak currencies than on those with strong ones, and because the Bundesbank issued the strongest currency in the system, the German central bank played a particularly important role in shaping the European system.

First, the Bundesbank reserved the right to suspend interventions, and credits, when such operations threatened to raise domestic liquidity to the point of endangering German price stability.[17] The threat to use this option—a point of continuing controversy throughout the life of the EMS—was exercised by the Bundesbank on more than one occasion to induce governments to negotiate realignments within the system.

Second, in deference to the preferences of the Bundesbank, access to the financing facilities was originally limited to instances when the exchange rate reached the outer margins of the band. Later, this rule was relaxed to facilitate "intramarginal" interventions. Nonetheless, the Bundesbank adroitly employed these economic and institutional advantages to guide EMS members toward low inflation.

In formal accounting terms, the resources behind the short-term facilities were pooled in the EMCF from the gold and US dollar reserves of the participating central banks. These central banks in return received a claim on the EMCF denominated in ECUs. Because the EMCF was an accounting construction, central banks retained possession and control of their reserves. During crises, the Bundesbank would contribute deutsche marks to the EMCF and counterparts would draw deutsche marks from it. Because borrowers could repay a portion of their drawings in ECUs rather than deutsche marks—and this proportion increased over time—the accounting convention distributed exchange rate risk to both creditors and debtors.[18]

Table 5.2 summarizes the pattern of foreign exchange intervention by European central banks from the creation of the EMS through the late 1980s. The last row summarizes the extent of recourse to the VSTF during this period, showing that the amounts were quite large. The shorter-term facilities continued to play a central role in currency management in the early 1990s, particularly during the EMS crises of 1992-93.

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16. Micossi (1985, 329); Eichengreen (1997, 202).

17. Emminger (1986); Henning (1994, 185-89); Eichengreen (1997, 202-06).

18. Van Ypersele and Koeune (1985, 59).

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Table 5.2 Foreign exchange market intervention in the European Monetary System (sum of purchases and sales, in billions of US dollars)

Intervention	1979-82	1983-85	1986-87	1988-89
All ERM currencies				
Inside EMS				
At the margin	20.5	15.4	22.3	0.9
Intramarginal	29.2	48.6	113.7	32.4
US dollar interventions	139.4	78.4	53.7	29.5
Deutsche Bundesbank				
Inside EMS				
At the margin	3.1	1.7	3.3	0
Intramarginal	0	0	0	0
US dollar interventions	25.4	18.9	5.4	12.4
Recourse to VSTF	17.1	15.3	34.3	—

EMS = European Monetary System
ERM = Exchange Rate Mechanism
VSTF = Very-Short-Term Financing Facility

Sources: Gros and Thygesen (1992); Bini-Smaghi and Micossi (1989); and Deutsche Bundesbank data.

During the failed bid to prevent the devaluation of the Italian lira and Spanish peseta and the ejection of the British pound in September 1992, the Bundesbank lent about DM47 billion to its partner central banks, in addition to a similar amount of direct intervention.[19] During the unsuccessful attempt to maintain the narrow bands in July 1993, the Bundesbank lent DM25 billion, again in addition to roughly similar amounts of direct intervention. As in the case of the September crisis, a very large share of these loans was extended, as the interventions were executed, in a single day. These loans were unprecedented in size and would not have been available from any alternative source, including the IMF, let alone within the very short time frame of the operations.

Balance of Payments Finance

The Medium-Term Financial Assistance facility provided loans to member states to finance payments imbalances. The MTFA combined two other facilities that had been established in the 1970s, thus predating the EMS. The first of these predecessors was financed from the treasuries of the European Community's member states, its total size being set at ECU11 billion at the advent of the EMS. The Ecofin Council (composed

19. Deutsche Bundesbank (1993, 19-42, 14*).

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of the finance ministers of the EC member states), rather than central banks, made decisions on loans. Each member state would then lend directly to the borrower, with take-out provisions for creditors that were themselves experiencing balance of payments difficulties.[20]

The second predecessor facility was created to alleviate problems associated specifically with oil price increases and was financed with borrowing by the European Community on the private financial markets. When the Ecofin Council combined the two into the MTFA in 1988, it also increased the size to ECU16 billion and shifted its source of funding predominantly to the financial markets.

Loans under the MFTA were for terms of 2 to 5 years. The Ecofin Council set the exact maturity and interest rate on such loans with each decision. By qualified majority vote, Ecofin also determined the policy conditions to accompany the loan, including numerical performance targets, and when doing so was supposed to take into account the medium-term guidelines for economic policy set by the European Community.

The general decision governing the facility provided for disbursement in successive installments, with each installment contingent on a favorable performance review and with Ecofin deciding on each disbursement.[21] European Community conditionality and disbursements were not formally coordinated with the IMF. European governments could draw on information gleaned through IMF surveillance, and European IMF executive directors were in a position to coordinate such programs informally. By and large, however, European balance of payments lending was fairly independent from the IMF.

As table 5.3 shows, the MTFA extended eight loans between 1974 and 1993.[22] The first loan to Italy carried market rates of interest and quantified performance targets for credit expansion and government expenditure and debt. Italy failed to meet some of these targets, prompting the introduction of disbursement by installment. Because it was experiencing balance of payments difficulties of its own, the United Kingdom was allowed to opt out of the Italian loan.[23] Also during the mid-1970s, Italy activated its G-10 swap arrangements and agreed to an IMF program.

With the formation of the European Monetary Union in 1999, individual EU member states that have adopted the euro are no longer eligible

20. Edwards (1985, 335-39).

21. Edwards (1985, 337).

22. See Council Regulation 1969/88 (European Council 1988, 1993; Gros and Thygesen 1992). In most cases, these loans exceeded the borrower's quota in the IMF; those of 1985 and 1991 were 330 and 500 percent of Greece's IMF quota, respectively (Polak 1997, table 1, 506).

23. Edwards (1985, 339).

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Table 5.3 EU balance of payments loans

Year	Borrower	Amount (in millions)	Mechanism
1974	Italy	$1,391	Medium-term Financial Assistance of 1971
1976	Italy (October 13)	$1,100	Community Loan Mechanism
	Ireland (March13)	DM500	Community Loan Mechanism
1977	Italy	$500	Community Loan Mechanism
1983	France	ECU4,000	Community Loan Mechanism
1985	Greece	ECU1,750	Community Loan Mechanism
1991	Greece	ECU2,200[a]	Medium-Term Financial Assistance of 1988 (Single Facility)
1993	Italy	ECU8,000[b]	Medium-Term Financial Assistance of 1988 (Single Facility)

DM = deutsche mark
ECU = European Currency Unit

a. In three installments; only the first installment of ECU1,000 million was disbursed, in April 1991.
b. In four installments; only the first two installments of ECU2,000 million each were disbursed, in March and November 1993.

Source: European Commission data.

for medium-term financial assistance from the European Union.[24] Nevertheless, three current EU member states have opted out of the euro area, and EU enlargement is expected to increase the number of non-euro member states substantially. In early 2002, the European Union thus decided to renew the medium-term facility, with certain changes. Any drawings under the facility will be financed by European Community borrowing from the financial markets and limited, in the case of multiple drawings, to a total of 12 billion euros.[25]

The European Monetary Fund

In 1978, the European Council declared that the heads of government "remain firmly resolved" to create a European Monetary Fund no later than 2 years after the creation of the EMS. As part of the launch of the new exchange rate system, the motives behind this proposal seemed to include bolstering regional currency stability and monetary cooperation by expanding and consolidating the European financial facilities and perhaps further developing regional macroeconomic surveillance.

European leaders do not appear to have been fundamentally dissatisfied with IMF lending practices or their response to currency crises, as

24. Papaspyrou (1993). That adoption of the euro actually obviates the need for balance of payments financing is challenged by Polak (1997).

25. Council Regulation (EC) 332/2002 (European Council 2002).

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Asian leaders have been more recently. German chancellor Helmut Schmidt was deeply unhappy with US policy, however, pressed for the EMS in part to deflect US pressures for policy adjustment, and would certainly have seen benefits in creating a forum that was more insulated from US influence than the IMF. The proposal nonetheless foundered on a number of legal, political, and economic obstacles, and the European monetary authorities instead chose to enhance the existing facilities.[26]

The North American Framework Agreement

As the North American Free Trade Agreement entered into force, the monetary authorities of the United States, Mexico, and Canada negotiated the formation of a parallel financial agreement, the North American Framework Agreement, which was established in April 1994. The NAFA brought together and enlarged three prior bilateral swap agreements between the United States and Mexico, the United States and Canada, and Canada and Mexico.[27]

The new US-Mexico facility was in the amount of $6 billion, with the Federal Reserve and the Treasury each participating up to $3 billion.[28] The Canada-Mexico swap was expanded to CAN$1 billion, and the swap agreement between the Federal Reserve and Bank of Canada was renewed at $2 billion. Each party has reciprocal privileges to draw on the other's currency in these amounts. These trilateral swaps were introduced in connection with a new consultative mechanism, the North American Financial Group, which brings Treasury and central bank officials together for annual meetings on macroeconomic and financial matters.[29]

The NAFA swaps are activated with the approval of both parties, which enables US authorities to stipulate conditions for disbursement. On the US side, the principals are the Federal Open Market Committee of the Federal Reserve, which formally controls the activation of all Fed swaps, and the secretary of the treasury.[30]

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26. Gros and Thygesen (1992, 54-56), and Thygesen (1997).

27. As a "framework agreement," NAFA serves as the rubric for the separate bilateral agreements.

28. On March 23, 1994, after NAFA was effectively negotiated, but before it could be approved, Mexico was plunged into a political crisis by the assassination of Luis Donaldo Colosio, the leading candidate for the presidency. US authorities opened a special, temporary swap facility with the Bank of Mexico in the amount of $6 billion the next day. Although it was identical to the US swaps under NAFA, with the exception of the dates at which it would take effect and expire, the special facility was distinct. In the event, no drawings were made under the facility, which lapsed after the introduction of NAFA (GAO 1996, 80-82).

29. GAO (1996, 82-83); *Federal Reserve Bulletin*, July 1994, 586-87.

30. The US authorities review and renew their swaps with the Bank of Mexico annually.

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Whereas the two US agencies formally participate independently, the Treasury swap negotiations normally establish the conditions for activation, and the two agencies usually participate in equal amounts. In drawing on its Exchange Stabilization Fund (described in the next chapter), Treasury requires that an assured source of repayment be identified and that the IMF managing director provide a letter stating his confidence in the economic policies of the borrower. The NAFA swaps can be activated bilaterally or trilaterally.[31]

These arrangements were activated during the initial stage of the peso crisis that began in December 1994. In January 1995, the Fed and Treasury each lent Mexico $500 million, followed by $1 billion (each) in February. The Bank of Canada also activated its swap agreement with the Bank of Mexico in January. On a temporary basis, in addition, the US-Mexico and Canada-Mexico swaps under NAFA were augmented by 50 percent.[32] These short-term swap operations—which nonetheless were quickly overwhelmed by capital outflows from Mexico—were replaced by much larger medium-term loans from the US Treasury's ESF and the IMF.[33] Proceeds from those loans were used to redeem the borrowing under the swaps, which were fully reversed by January 1996.

The CMI in Comparative Perspective

This review and comparison suggests five observations. First, regional and plurilateral financial cooperation was a common feature of international financial relations in the last half of the twentieth century. The United States, European governments, and Japan all participated in regional, plurilateral, or bilateral arrangements that were separate from the IMF. Each of these governments determined that the IMF alone was not sufficient to provide financial stability.

31. Federal Reserve Board of Governors, "Transcript: Federal Open Market Committee Meeting, March 22, 1994," and "Transcript: Federal Open Market Committee Conference Call, March 24, 1994."

32. US Department of the Treasury and the Government of the United Mexican States, "Temporary Exchange Stabilization Agreement," February 21, 1995, Washington. Like the special facility introduced after the Colosio assassination, the additional borrowing privileges were not exercised, and the Temporary Exchange Stabilization Agreement, as the augmentation agreement was named, expired on April 3, 1995.

33. The Temporary Exchange Stabilization Agreement was thus one of three instruments offered by the United States during the crisis, the other two being the "Medium-Term Exchange Stabilization Agreement" and the "Guarantee Agreement." The Mexican rescue operation is described, among other places, in GAO (1996); Lustig (1998); and Henning (1999, 61-74). Pastor (2001, 116) is critical of the smallness of the standing NAFA arrangements relative to Mexican external capital flows and borrowing requirements in crises.

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Second, these arrangements were created in the context of the IMF and had important ramifications for its role and operations. Although the IMF would welcome the additional liquidity provided by the G-10 swaps, for example, the availability of these funds could delay the initiation by deficit countries of serious discussions with the IMF, and thus also delay policy adjustment. The European facilities effectively exempted the IMF from financing intra-European exchange rate stabilization and eased the burden of financing medium-term imbalances of payments. Ramifications such as these thus carried both benefits and costs for the IMF.

Third, the Chiang Mai Initiative is more sensitive to preserving the central position of the IMF and not undercutting the IMF in negotiations with borrowing countries than these other arrangements. Except for the 10 percent tranche, almost all of the BSAs are *explicitly* linked to the use of IMF facilities. Of the four sets of arrangements reviewed here, the ASEAN+3 swaps are unique in the formality of their connection to the IMF, which effectively ties the activation of the BSAs to IMF conditionality. (See table 5.4 for a side-by-side comparison.)

Fourth, BSAs under the CMI are potentially medium-term credits, with substantially longer maturities than the European short-term facilities and NAFA. The G-10 swaps and the ESF were used for 2 years only in quite exceptional cases. The term structure of the BSAs approaches that of the European balance of payments facility; the term "swap" might thus understate the support provided through the CMI.

Fifth, and fundamentally, these four sets of facilities were deployed over a variety of exchange rate regimes and different levels of capital mobility. It is noteworthy that the shift to floating exchange rates did not make swaps obsolete in the eyes of governments and central banks. Although the United States, Europe, and Japan disbanded their bilateral arrangements dating from the 1960s, the three North American countries maintain a standing arrangement, even in the presence of floating exchange rates. The European Union renewed and updated its medium-term facility as recently as February 2002.

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Table 5.4 Comparison of swap arrangements and facilities

Arrangement or facility	Origin	Size	Terms	Decision on activation	Condition-ality	Surveillance	Relationship to IMF	Network or bilateral
Group of Ten swaps	Efforts to stabilize the Bretton Woods regime in the early 1960s	Grew to $36.4 billion	3 months, renewable, at short-term T-bill interest rate	Two-key	None	Informal, through OECD WP3 and IMF	No formal link	Bilateral
European short-term facilities	Stabilization of intra-European exchange rates, 1972; creation of the EMS, 1979	Potentially unlimited in the very short term, but effectively subject to Bundesbank's acquiescence. Renewals were limited by quotas, initially ECU7.9 billion.	75 days, renewable twice for 3 months, at market interest rates	Automatic when the exchange rate reached the margin	None at initial drawing; but potential conditions on renewals beyond 6 months. Moreover, Germany exercised pressure for convergence toward low inflation.	Originally, EC surveillance was weak, then was strengthened in the 1990s	No formal link	Bilateral, with some network features
European medium-term facility	Community obligations and Werner Plan, 1971	ECU16 billion; now reduced to 12 billion	2 to 5 years, set by Ecofin Council, as was interest rate	Ecofin Council decision	Yes; set by Ecofin Council	See above	No formal link	Bilateral loans with strong network coordination
North American Framework Agreement	NAFTA implementation in 1994	About $8.6 billion total	3 months, renewable at least up to 1 year; 91-day T-bill rate	Two-key	Informal and indirect	Through IMF and NAFG	US Treasury requires a letter from managing director	Bilateral and trilateral
Chiang Mai Initiative	Reaction to Asian financial crisis, 2000	Expected to exceed $25 billion when completed	3 months; renewable up to 2 years; CCL interest rates	Two-key	Applied through IMF link	Regional mechanism in early stages of development; mainly through IMF	Explicit formal link for 90 percent of swaps	Bilateral, with common principles and joint activation

CCL = Contingent Credit Line; EC = European Community; ECU = European Currency Unit; EMS = European Monetary System; NAFG = North American Financial Group; NAFTA = North American Free Trade Agreement; OECD WP3 = Organization for Economic Cooperation and Development, Working Party No. 3