

STRENGTHENING ASIA'S FINANCIAL SAFETY NET

DECEMBER 2019

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ISBN 978-92-9261-908-4 (print), 978-92-9261-909-1 (electronic)
Publication Stock No. TCS190563-2
DOI: <http://dx.doi.org/10.22617/TCS190563-2>

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Cover design by Mike Cortes.

Contents

Tables and Figures	iv
Foreword	v
Acknowledgments	vi
Executive Summary	vii
1. Introduction	1
2. The Role of Regional Financing Arrangements within the Global Financial Safety Net	4
• Comparing Existing Regional Financing Arrangements and Availability of Financial Safety Nets Regionally	8
• Evolution of Financial Safety Nets After the Global Financial Crisis	12
■ The European Stability Mechanism	12
■ The International Monetary Fund	14
3. ADB's Role in Regional Crisis Response	17
• ADB's Policy-Based Lending Instruments: Origins and Overview	17
• Evolution of ADB's Crisis Toolkit: Special Policy-Based Lending and the Countercyclical Support Facility	18
• Overview of Usage of ADB's Crisis Toolkit	20
• Assessing ADB's Role in Crisis Prevention and Support	21
4. Conclusions and Policy Considerations	28
References	31
Appendix: ADB Approved Policy-Based Lending by Subsector, Pre-Asian Financial Crisis to Present	33

Tables and Figures

Tables

1	Layers of the Global Financial Safety Net	4
2	Comparing the Main Elements of Chiang Mai Initiative Multilateralisation, European Stability Mechanism, and Latin American Reserve Fund	8
3	European Financial Stability Facility and European Stability Mechanism Financial Assistance	13
4	Overview of the IMF Toolkit	15
5	Overview of ADB Policy-Based Lending Instruments	18
6	ADB Crisis Response Instruments: Lending Terms	19
7	Crisis Program Lending, 1997–1999	23
	Appendix: ADB Approved Policy-Based Lending by Subsector, Pre-Asian Financial Crisis to Present	33

Figures

1	Foreign Exchange Reserves, ASEAN+3, 1990–2017	5
2	Availability of Financial Safety Nets: ASEAN+3	11
3	Availability of Financial Safety Nets: Euro Area and Latin America	11
4	Availability of Financial Safety Nets	12
5	Timeline of ADB Crisis Response Facilities	21
6	ADB Approved Policy-Based Lending, 1978–2017	22
7	ADB Approved Policy-Based Lending by Sector, before and during the Asian Financial Crisis	22
8	ADB Approved Policy-Based Lending by Sector, before and during the Global Financial Crisis	23
9	ADB Annual Approved Policy-Based Lending by Sector, Pre-Asian Financial Crisis to Present	24
10	ADB Approved Policy-Based Lending by Sector, Post-Global Financial Crisis to Latest	25
11	ADB Policy-Based Lending to Economies under IMF Conditionality, Disbursed 1992–2014	26

Foreword

Financial crises over the past 2 decades illustrated their transnational consequences and underscored the significance of cross-border coordination in crisis response and mitigation. At a time of growing financial interconnectedness, which can fuel financial volatility and contagion, the need for adequate arrangements to meet emergency financing needs and measures to ensure financial stability is rising.

The global financial safety net has evolved to encompass multiple levels, ranging from foreign exchange reserves nationally to an International Monetary Fund (IMF) rescue package globally. As previous financial episodes demonstrated, however, national crisis response mechanisms are limited and recourse to the IMF may prove politically challenging and time consuming in times of emergency. Consequently, regional structures to shore up market confidence and financial stability have become increasingly relevant. In particular, regional financing arrangements (including the Chiang Mai Initiative Multilateralisation) as well as assistance from regional development banks such as the Asian Development Bank (ADB) can complement other global financial safety net layers to make support more resilient and practical. Aside from providing an additional layer of needed liquidity, these arrangements also add response flexibility and greater familiarity with the regional context..

ADB's policy-based lending (PBL)—encompassing conventional policy-based lending and crisis response instruments such as the Countercyclical Support Facility and Special Policy-Based Lending—is central to its crisis preparedness and response arsenal, helping meet financing gaps triggered by financial volatility. PBLs serve both preventive and ameliorative functions. They seek to address the negative consequences of financial crises while enhancing the region's ability to weather future financial episodes. PBL support has been concentrated in public sector management programs to limit adverse effects emanating from financial crises, while supporting capital market development to strengthen financial resilience in the long run. This support underscores ADB's role in complementing both national and regional responses as part of the global financial safety net.

This report aims to provide a useful synthesis of the elements comprising Asia's financial safety net, their evolution, as well as the complementary role ADB plays in helping the region meet its financing needs. In doing so, I hope this publication will serve as a useful guide to policy makers in crafting effective strategies for crisis response, mitigation, and ultimately in safeguarding the region's financial stability.



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Acknowledgments

This report was prepared by the ADB Regional Cooperation and Integration (ERCI) Division of the Economic Research and Regional Cooperation Department under the supervision of Cyn-Young Park, director of ERCI.

The main authors of the report include Cyn-Young Park, Peter Rosenkranz, and James Villafuerte. Monica Melchor and Mara Claire Tayag provided excellent economic research and technical support.

The report greatly benefited from technical advice provided by Edimon Ginting, Satoru Yamadera, Joel Mangahas, and Josef Yap and comments received during the conference on Strengthening Regional Surveillance and Financial Safety Net Mechanisms in Asia on 14 August 2018 in Manila at the ADB Headquarters. Furthermore, it is greatly acknowledged that data on ADB's policy-based lending was generously made available by Joel Mangahas, Joanne Asquith, Setijo Boentaran, and Viliami Sefesi.

Peter Rosenkranz and James Villafuerte coordinated the production with support from Paulo Rodelio Halili.

Guy Sacerdoti and James Unwin edited the manuscript, while Michael Cortes did the cover design, graphics, and typesetting. Levi Lusterio proofread the report with assistance from Paulo Rodelio Halili and Monica Melchor, while Lawrence Casiraya handled the page proof checking. The Printing Services Unit of ADB's Office of Administrative Services and the Publishing Team of the Department of Communications supported printing and publishing.

Executive Summary

The 1997–1998 Asian financial crisis and the 2008–2009 global financial crisis emphasized the need for international cooperation in responding to systemic failure in an increasingly globalized financial system. As previous crises demonstrated, adequate financial safety net arrangements—globally, regionally, and nationally—are vital to safeguard financial stability and enhance resilience across Asia and the Pacific. They must be sufficiently complementary and comprehensive to create a prevention and response package that both stabilizes and buttresses needed liquidity, while working to correct the imbalances that originally led to the instability.

In response to these crises, the region's economies have taken considerable strides in laying a strong institutional framework for regional financing arrangements (RFAs)—to enhance regional macroeconomic and financial surveillance, strengthen crisis assistance and management, and bolster broader regional cooperation for financial stability and resilience. Regional initiatives including the ASEAN+3 Economic Review and Policy Dialogue (ERPD), the Chiang Mai Initiative Multilateralisation (CMIM), the Asian Bond Markets Initiative (ABMI), and the ASEAN+3 Macroeconomic Research Office (AMRO) have collectively strengthened the region's financial stability and capacity to respond to future crises. Multilateral development banks operating regionally—such as the Asian Development Bank (ADB), through its crisis response and lending facilities—likewise are an important complement to existing financial safety net arrangements, such as national foreign exchange reserves, bilateral swap arrangements, or International Monetary Fund (IMF) financial assistance.

The report highlights the central role RFAs play—and the contribution of ADB—in buttressing the multilayered global financial safety net. It examines the evolution of different RFAs—the European Stability Mechanism, the CMIM, and Latin American Reserve Fund—their key features, and salient differences that may affect their capacity for financial support during crises. It then focuses on ADB's complementary role within the global financial safety net and the evolution of its policy-based lending instruments. The report highlights several issues:

- The key advantages of RFAs and regional development bank assistance include local expertise and knowledge, their ability to increase the volume of available funds, and their greater flexibility in providing assistance relative to the IMF.
- ADB's policy-based lending plays an instrumental role in helping countries bridge financing gaps during periods of crisis, mitigating the adverse social and economic impacts of financial crises, and laying the foundations for greater long-term financial resilience.
- In response to crises, ADB's support in the form of conventional and crisis-specific policy-based lending consists primarily of support for the expansion of public sector management programs to mitigate the adverse social impact of crises; and support for financial sector and capital market development to promote crisis prevention and long-term financial stability.

- In particular, ADB support in a crisis situation would be typically provided jointly with a large international rescue package led by the IMF to help restore stability to the affected developing member countries under IMF programs and conditionalities, highlighting ADB's role in both contributing to a stronger regional financial safety net and complementing other layers—such as IMF assistance.

The report concludes with the following policy considerations:

- Given the increasing cross-border economic interdependence and financial transactions at the regional level, there is a need to better coordinate and regularly review, revisit, and realign (if need be) RFA and multilateral development bank instruments in response to regional and global economic and financial turmoil. This also applies to the important role ADB plays in the regional financial safety net architecture of the Asia and Pacific region.
- Regional dialogue and cooperation in strengthening ex ante crisis prevention measures—particularly AMRO's surveillance capacity—helps bolster Asia's financial safety net and resilience to financial crises. Policy cooperation is also needed to bolster ex post crisis support mechanisms, including enhancing the CMIM effectiveness and operability.
- Systemic and seamless coordination between the IMF, AMRO, and ADB policies is required to ensure crisis support and funding are most effective.

1. Introduction

Financial crises remind us that international cooperation is essential in responding to systemic failure; it is similarly requisite to ensure economic and financial stability in an increasingly globalized financial system. The Asian financial crisis in 1997/98 was a catalyst for regional financial cooperation and integration. However, the global financial crisis of 2008/09 sent another shockwave across Asia, highlighting the risks of increasingly interconnected financial markets and systems within and beyond the region. During previous financial crises, national mechanisms to stem the spread of financial panic proved largely inadequate, ineffective, and inefficient in the face of the large-scale and volatile cross-border capital flows. Given looming financial challenges—amid growing financial interconnectedness and associated regional and global financial risks and spillovers—the importance of multilateral financial safety net arrangements in containing the risks to financial stability continues to grow.

While discussions about creating a regional monetary fund started long before the Asian financial crisis, it was this crisis that triggered the establishment of strong regional financing arrangements. The idea of such a fund was first broached during the Asian Development Bank's (ADB) establishment in 1966 but failed to gain traction amid a lack of consensus on the role it would play. The idea resurfaced in 1995 within Japan's Ministry of Finance and Japanese officials presented a proposal during the Group of Seven and International Monetary Fund (IMF) meetings in Hong Kong, China in September 1997. In the wake of the Asian financial crisis, Japan proposed the establishment of a new regional monetary fund—the so-called Asian Monetary Fund—but the United States and the IMF expressed strong resistance on the grounds that this would duplicate assistance from the IMF, aside from the moral hazard associated with potential softening of aid conditionalities. In October 1998, the Government of Japan offered up to \$30 billion in loans and loan guarantees to help the five Asian economies most severely hit by the crisis—known as the New Miyazawa Initiative. A call for a more independent regional fund ultimately surfaced amid mounting concern over the crisis management of global financial institutions. In particular, this included the nature of the response to the unfolding crisis in Indonesia, a lack of specificity in IMF policy prescriptions, and worries over the social impact IMF-prescribed remedies would have on crisis-stricken countries in the region. Asian economies met to examine potential solutions. In December 1997, the first ASEAN+3 meeting was convened to discuss further regional economic and financial cooperation (Amyx 2002; McCawley 2017; Lim and Lim 2012).¹

Gradually, ASEAN+3 economies shaped an institutional framework for regional financing arrangements to promote stronger regional macroeconomic and financial surveillance, timely crisis assistance and management, and broader regional cooperation for financial stability and

¹ The Association of Southeast Asian Nations (ASEAN) includes Brunei Darussalam, Cambodia, Indonesia, the Lao People's Democratic Republic, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Viet Nam. The Plus-3 countries include the People's Republic of China, Japan, and the Republic of Korea.

resilience. The East and Southeast Asian experience during the Asian financial crisis highlighted the importance of regional financial cooperation as part of efforts to foster stability and prevent similar events in the future. After the crisis, the region's economies launched several regional cooperation initiatives to advance the regular exchange of information and dialogue on key issues. These initiatives together laid the foundation for a coordinated response to address the weaknesses behind the Asian financial crisis and helped build a line of defense to prevent future crises. The new regional initiatives helped to ensure economic stability through better management of vulnerabilities, greater availability of financial assistance facilities, and deeper and more interlinked capital markets.

Regional initiatives to bolster financial stability and resilience include the ASEAN+3 Economic Review and Policy Dialogue, the Chiang Mai Initiative Multilateralisation, and the ASEAN+3 Macroeconomic Research Office. First, the inception of the ASEAN Surveillance Process during the 2nd ASEAN Finance Ministers' Meeting in 1998 later evolved into the ASEAN+3 Economic Review and Policy Dialogue in 2001. Second, the Chiang Mai Initiative was conceived during the ASEAN+3 Finance Ministers Meeting in May 2000 as part of a framework for strengthening Asian financial cooperation by expanding an existing ASEAN swap agreement and establishing a network of bilateral currency swap arrangements to provide a regional buffer fund against future speculative currency attacks. This framework developed into a \$120 billion foreign currency reserve arrangement among the ASEAN+3 members in March 2010—the Chiang Mai Initiative Multilateralisation (CMIM). At the 15th ASEAN+3 Finance Ministers and Central Bank Governors Meeting in Manila on 3 May 2012, authorities enhanced the CMIM features by doubling its size to \$240 billion and introducing a crisis prevention function. Third, the ASEAN+3 Macroeconomic Research Office (AMRO) was established as an independent regional surveillance unit for the ASEAN+3 in April 2011 to (i) monitor macroeconomic and financial developments in ASEAN+3 economies and facilitate the early detection of risks, (ii) recommend remedial policy actions, and (iii) ensure effective decision-making under the CMIM. AMRO was converted to an international organization with full legal standing in February 2016. Further regional financial cooperation to enhance financial stability and resilience included the development of local currency bond markets through the Asian Bond Markets Initiative in 2002.

Given the important role that regional initiatives and institutions play in safeguarding Asia's financial stability, this report examines RFAs and ADB's complementary role in bolstering the broader global financial safety net. The report analyzes the status of regional and global financial safety nets by comparing different regional financing arrangements (RFAs) and examining ADB's complementary role in the region's financial safety nets. The report finds that ADB's conventional policy-based lending and specific crisis response facilities can provide needed additional liquidity, supporting existing regional and global financial safety net arrangements. It can thus address the negative consequences of financial crises and enhance economies' crisis preparedness through financial sector development. As shown during past crises, ADB support does indeed complement IMF support.

RFAs have become a critical component for safeguarding financial stability and resilience in the region. In recent years, the scope of these arrangements has been growing beyond their initial aim of averting financial crises and safeguarding financial stability. RFAs are an important alternative—to supplement and complement IMF financial assistance—given their local expertise and knowledge, ability to enhance the volume of available funds, and greater flexibility in providing assistance. They also facilitate regional cooperation and policy dialogue, enhancing the effectiveness of crisis prevention mechanisms and contributing to a more balanced national, regional, and global economic surveillance architecture.

Regional financing arrangements have emerged in response to financial crises and have evolved to reflect changing economic developments and circumstances.

The architecture of RFAs has emerged largely in response to the shortage of adequate liquidity at the global level (Fritz and Mühlich 2019). The debt crises plaguing Latin America in the 1980s gave rise to the Latin American Reserve Fund. Similarly, the 1997/98 Asian financial crisis gave rise to the Chiang Mai Initiative and the global financial crisis which followed a decade later triggered its strengthening in capacity and institutional design, giving rise to the Chiang Mai Initiative Multilateralisation (Mühlich and Fritz 2016). The establishment of the European Stability Facility (later European Stability Mechanism) was likewise triggered by the global financial crisis and ensuing European sovereign debt crisis. And while efforts to secure financial stability were initially tied to crisis response efforts, the focus has shifted to crisis prevention and the need for macroeconomic surveillance. The crisis toolkits of RFAs have similarly evolved to reflect these changing economic circumstances. In this way, regional financing arrangements have continuously adapted to meet the necessary conditions for a meaningful and well-functioning regional financial safety net.

Multilateral development banks are likewise crucial in bridging gaps in country financing requirements and in safeguarding economic resilience.

As the Group of Twenty (G20) highlights, it is critical that multilateral development banks and the IMF coordinate to ensure effective financing (G20 2017). In particular, sound policy frameworks and country engagement with the IMF are prerequisite to successful multilateral development bank financing. Close coordination between these institutions and other layers of the global financial safety net can (i) ensure implementation of consistent policies, (ii) identify areas for cooperation, and (iii) enhance crisis response effectiveness and mitigate adverse social impacts during crisis episodes.

Multilateral development bank efforts to enhance the capacity for regional economic surveillance and strengthen the multilateral financial safety net are vital in achieving global development goals.

Economic crises undermine the hard-earned gains from sustainable development in the past few decades. The human costs of economic crises are large as evident from millions of jobs lost and millions of people falling into poverty. Economic crises moreover absorb substantial financial resources that could have been channeled to the attainment of the development goals. Therefore, the ADB and other such institutions can bolster collective efforts to meet the international Sustainable Development Goals by facilitating crisis prevention and response. Regional financing arrangements and economic surveillance are important components to advancing the international development agenda.

ADB is ready to provide crisis assistance and complement other global or regional financing arrangements.

In particular, ADB's crisis support instruments, such as for public sector management programs, aim to minimize the adverse social impacts of economic crises and are important in crisis response. Likewise, its support for financial sector and capital market development is important for enhancing financial resilience and crisis prevention in Asia's developing countries. In this way, ADB complements other layers of the global financial safety net.

2. The Role of Regional Financing Arrangements within the Global Financial Safety Net

The Asian and global financial crises made clear that a multilayered system of financial safety nets is needed to safeguard financial stability in the region. The past 2 decades have seen the growing internationalization and interconnectedness of Asian financial markets, with financial linkages increasing and strengthening across and beyond the region. But heightened volatility and vulnerability of financial markets accompanies such interconnectedness and requires international financial safety net arrangements—both globally and regionally—to safeguard financial stability and resilience.

Financial safety nets comprise the set of institutions and mechanisms that provide financial support to countries hard hit by a crisis. Financial safety nets should be guided by three main objectives: (i) provide crisis prevention mechanisms for members, (ii) supply financing when crises hit, and (iii) incentivize sound macroeconomic policies. The different layers of a wider financial safety net include foreign exchange reserves; central bank bilateral swap lines; RFAs; financial support provided by multilateral development banks such as ADB; and IMF financing (Table 1).

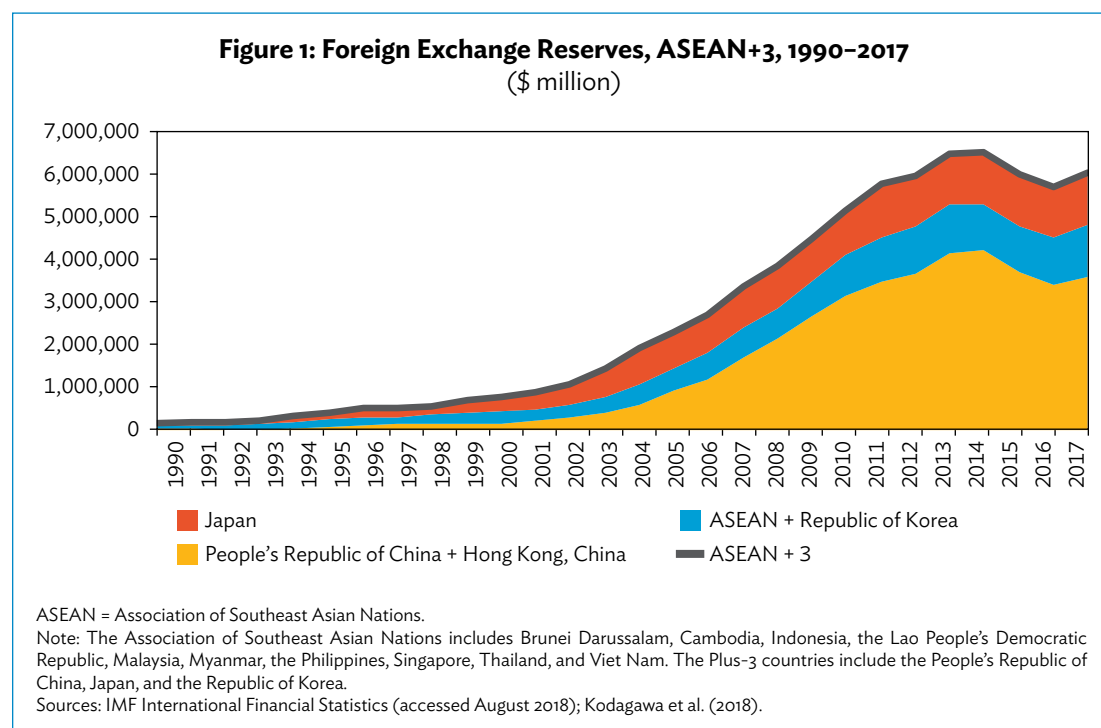
Table 1: Layers of the Global Financial Safety Net

Scope	Element	Conditionality	Availability and Key Factors for Access
National	Foreign exchange reserves	No	Past reserve accumulation, exchange rate regime
Bilateral	Central bank swap lines	Yes	Economic and political links with the reserve currency issuing country
Regional	RFA financing	For many RFAs	RFA forward commitment capacity; sometimes limited to a multiple of paid-in capital
	Asia and Pacific: ADB's crisis response and lending facilities	Yes	OCR-eligible and graduated developing member countries, capped at \$500 million per exogenous shock or crisis episode
Global	IMF financing	For most instruments	IMF forward commitment capacity, IMF quota, political factors

IMF = International Monetary Fund, OCR = ordinary capital resources, RFA = regional financing arrangement.
Source: ADB compilation based on Scheubel, Stracca, and Tille (2018).

Essentially, foreign exchange reserves are the first line of defense against sudden foreign currency liquidity shortfalls in a country. In the wake of the Asian financial crisis, reserves increased substantially across ASEAN+3, contributing to enhanced financial resilience in the region (Figure 1). Reserves are an important form of self-insurance against unexpected capital flow reversals and can help boost market confidence. But accumulating reserves also incurs opportunity costs; and

exchange rate movements can also affect the value of reserves. Reserves can furthermore quickly dissipate during an attack on a national currency under fixed and managed float currency regimes. Partly related to reserve accumulation, financial resilience can also be enhanced by accumulating fiscal buffers during good times through fiscal surplus—thus creating enough fiscal space to conduct countercyclical policies during bad times.



Currency swap arrangements among central banks—either bilaterally or multilaterally—can provide much needed access to foreign currency liquidity to the recipient in exchange for its domestic currency and have proven to be an effective line of defense during crises.

These arrangements have long been an instrument of the central bank policy toolkit and have been accessed several times during past crises, playing important roles in the Asian financial crisis, the global financial crisis, and the 2013 taper tantrum. However, political considerations can also drive these arrangements, along with economic fundamentals. Nonetheless, bilateral swap arrangements can buttress and complement financing from RFAs. As the 20th ASEAN+3 Finance Ministers and Central Bank Governors Meeting joint statement notes, bilateral swap arrangements above \$160 billion can help supplement the CMIM (ASEAN 2017). In addition, the ASEAN Swap Arrangement, amounting to \$2 billion allows member banks to swap local currencies with major international currencies (United States dollar, yen, and euro) for up to 6 months.

RFAs act as an important alternative, supplement, and complement to IMF financial assistance—constituting an essential layer of the global financial safety net. As noted, these arrangements have been growing in scope in recent years. Their pooled resources provide an important source of liquidity to members facing temporary liquidity or balance of payment difficulties during financial crises. They can also complement the function of the IMF as lenders of last resort to sovereigns. With their advantage of having greater local expertise and knowledge, they can effectively mobilize the regional fund, enhance the amount of available international funds, and offer greater flexibility in providing assistance.

While the ASEAN+3 has taken visible steps forward in strengthening the CMIM and its capacity as an RFA, further efforts to improve its efficiency and operability are needed.

The operability of the CMIM has yet to be tested. In the aftermath of the global financial crisis, the resources of the CMIM were not tapped and economies sought other means of assistance. After encountering liquidity problems in late 2008, for instance, the Republic of Korea and Singapore entered into currency swap arrangements amounting to \$30 billion with the United States Federal Reserve, instead of requesting assistance from the CMIM (Park 2017). Similarly, following the taper tantrum in 2013, Indonesia entered into bilateral swap agreements with the People's Republic of China (CNY100 billion) and the Republic of Korea (\$10 billion) in August; a bilateral swap arrangement with Japan (\$12 billion) was extended in October of the same year (IMF 2013b).² Limited familiarity with the operability of the CMIM or its processes have triggered regular test runs to ensure the facility's operational readiness—the 9th joint Test Run was successfully completed in early 2019 with a succeeding test run to be undertaken later in the year.

Multilateral development banks also play a key role in helping countries bridge financing gaps during times of crisis, mitigating the adverse social and economic impacts of financial crises, and strengthening financial resilience in the region. In Asia, ADB has provided substantial financial support to mitigate these negative effects and to help economies pursue policies to improve underlying macroeconomic conditions and financial resilience. Subsequent sections explore this in greater detail.

Regional economic surveillance has likewise strengthened as an important supplement to global surveillance. In response to the Asian financial crisis, the more traditional policy advice from the IMF was perceived as interfering with domestic economic management. Policy makers felt there was an imbalance between the financial assistance offered and the conditionalities put in place. The debate then—which resurfaced during the global financial crisis—centered on how fiscal belt-tightening can coexist with the need to maintain funding for social services.

To supplement multilateral supervision by global institutions like the IMF, regional economic surveillance emerged in the ASEAN+3 region based more on a peer review process. In an effort to shore up the regional capacity to respond to and monitor crises, the Manila Framework was established in November 1999, giving rise to a regional peer surveillance process that eventually evolved into regional economic surveillance. New regional surveillance focused on information gathering and dissemination, which helped countries identify any regional and national vulnerabilities that could affect financial stability early on. It also incorporated technical assistance and capacity building to members to increase surveillance capacity and improve the quality of national economic surveillance work. It further gave policy advice in critical areas needing further examination and analysis. This emphasis on dialogue helped countries evaluate assessments, compare practical experience and policy results, motivate the adoption of specific practices, and offered scope for collective action in helping design regional responses to regional issues—incorporating the views of as many as possible. As a process, this regional economic surveillance anchored the building of more effective cooperation across the ASEAN+3 region. As noted, it also helped improve national surveillance capacities and contributed to the creation of a more balanced global, regional, and national economic surveillance architecture.

² These bilateral swap arrangements between Japan and/or the People's Republic of China and the CMIM members are of considerable volume—such as the \$22.76 million arrangement between Japan and Indonesia, which is almost as much as Indonesia's maximum borrowing capacity under the CMIM. Hence, they offer viable alternatives beyond the scope of IMF and the CMIM institutional arrangements (Kring and Grimes 2019; Saputro 2017; Grimes 2015).

Regional economic surveillance, grounded in the peer review process, can help strengthen macroeconomic and financial stability among member economies. In Asia, the ASEAN+3 Economic Review and Policy Dialogue surveillance process encompasses knowledge exchange on economic developments concerning the region, a peer review among member countries, and due diligence constituting the highest level of surveillance (Park 2017). In Europe, general surveillance of EU countries is undertaken by the European Commission while the European Stability Mechanism is charged with monitoring developments in countries granted financial assistance.³ And while the Latin American Reserve Fund is not formally mandated to conduct country surveillance, it does undertake monitoring of the economic outlook and financial and banking stability conditions of its member countries over the short and medium term (Titelman et al. 2014; Rhee, Sumulong, and Vallée 2013).

Globally, the IMF remains a primary institution ensuring the stability of the international monetary system. IMF support comprises surveillance of the global economic climate, financial support to economies experiencing balance of payments problems, and capacity development to help economies implement policies to foster financial stability and growth. It is the largest provider of liquidity insurance and crisis support in the global financial safety net.

Regional financial safety nets can add agility and flexibility in crisis management while mitigating the political “stigma” that accompanies access to IMF funds in the region. Recourse to IMF funding carries a high political cost (stigma) for members—in some cases, a request for IMF financing can hurt financial markets and trigger capital outflows, as took place in South America during various crisis episodes and in the region during the Asian financial crisis, among others. This stigma effect remains an issue, and alongside other considerations, helps drive greater regional dialogue, cooperation and even coordination in crisis response—as a growing part of the global financial safety net.

Regional and bilateral arrangements can play an important and complementary role to the IMF. The IMF should continue to examine how it can better coordinate with these arrangements by setting up guidelines to help steer how cooperation would take place when a crisis erupts. This is critical to the safety net’s ability to respond quickly, flexibly, and consistently to crises. And it is key to promoting market confidence that the safety net works.

Coordination across different layers of the global financial safety net should help circumvent moral hazard problems, reduce the risk of fragmentation, and prevent excessive competition among safety net providers. Strong coordination is moreover key to reducing fragmentation or competition among RFAs. Assistance from RFAs or multilateral development banks needs to be coordinated with the IMF in order to mitigate these risks. RFAs should act in concert in complementing IMF assistance and should avoid competition in extending assistance to member economies. Appropriate conditionalities linked to a country program, as well as strong surveillance capacities, are moreover key to containing the possible risk of moral hazard. For the case of the CMIM, the IMF-linked portion can also help mitigate concerns of moral hazard.

³ Currently, there are discussions at the EU level on revisiting the European Stability Mechanism’s role. One consideration is to allow the ESM to join the European Commission for economic surveillance of euro area member states (Cheng, forthcoming).

Comparing Existing Regional Financing Arrangements and Availability of Financial Safety Nets Regionally

Regional financing arrangements can leverage their local expertise and knowledge of regional and country conditions and their relative flexibility to supplement the volume of available funds. In addition to their role as a liquidity backstop, they can provide a platform for regional cross-country coordination in risk identification, mitigation, and response. This is even more evident given increasing financial integration regionally and globally.

Examination of the CMIM, European Stability Mechanism, and the Latin American Reserve Fund reveals salient differences in characteristics and design. The European Stability Mechanism (ESM) emerged from the European Financial Stability Facility, which was established as a temporary liquidity backstop for euro area economies during the global financial crisis. The ESM has a lending volume of €500 billion (\$551 billion). In contrast, the CMIM, which succeeded the Chiang Mai Initiative in 2010, has a lending capacity of \$240 billion (€218 billion). Meanwhile, the Latin American Reserve Fund (FLAR) was established in 1978 in the wake of volatile boom–bust cycles in external financing in the region and has a lending capacity of \$4.8 billion (€4.4 billion) (Table 2).

Regional financing arrangements also differ in the instruments contained in their respective toolkits and in the availability of funds. In contrast to the ESM and FLAR, which are grounded on established international organizations managing actual funds, the CMIM is a contractual agreement among ASEAN+3 finance ministries and central banks and the Hong Kong Monetary Authority without paid-in capital (i.e., by commitments only). While the ESM and FLAR have paid-in capital as part of their capital stock, which is leveraged on financial markets to increase their available resources through market financing,⁴ the CMIM disbursements would depend on the timely adherence of members to their commitments. The roster of available lending instruments also varies. While the CMIM allows for two facilities that member economies can access, the ESM toolkit also allows for intervention in capital markets through primary and secondary purchases as well as bank recapitalization during times of financial distress. The FLAR also provides instruments for external debt restructuring of central banks as well as treasury operations. In terms of surveillance capabilities, both the CMIM (through AMRO) and the FLAR have surveillance and monitoring functions over all member economies. For euro area economies, ESM surveillance is limited to countries granted financial assistance. General surveillance of euro area economies is tasked to the European Commission.

Table 2: Comparing the Main Elements of Chiang Mai Initiative Multilateralisation, European Stability Mechanism, and Latin American Reserve Fund

Features	CMIM	ESM	FLAR
Establishment	Established in March 2010, replacing the Chiang Mai Initiative, which was established in May 2000	Inaugurated in October 2012, following the European Financial Stability Facility, established in June 2010 as a temporary backstop in response to the European debt crisis	Created in 1991 following the accession of countries to the Andean Reserve Fund, which was created in 1978 in response to external imbalances facing Andean economies and to facilitate regional integration
Members	All 13 ASEAN+3 member countries and HKMA	All 19 euro area countries	8 Latin American countries

continued on next page

⁴ The ESM applies a strict separation of funds. That is, paid-in capital cannot be used for financial assistance; program financing comes exclusively from funds raised from financial markets. The FLAR can disburse both paid-in capital and funds from market financing. See Cheng and Lennkh (2019) for further discussion.

Table 2 continued

Features	CMIM	ESM	FLAR
Objectives	(i) Address balance of payments and short-term liquidity difficulties in the ASEAN+3 region; (ii) supplement international financing arrangements	Help euro area countries undergoing severe financial distress	(i) Support the member countries' balance of payments; (ii) improve conditions of members' reserve investments; and (iii) help harmonize members' exchange rates and monetary and financial policies
Type	Multilateral currency swap arrangement	Fund	Fund
Capital stock	\$240 billion callable capital	€700 billion (€80 billion paid-in, €620 billion callable capital)	\$3.9 billion subscribed capital (of which \$2.9 billion is paid-in)
Lending capacity	\$240 billion (€218 billion)	€500 billion (\$551 billion)	\$4.8 billion (€4.4 billion)
Lending instruments	(i) Crisis prevention facility (ii) Crisis resolution facility	(i) Loans within macroeconomic adjustment program (ii) Primary and secondary market purchases (iii) Precautionary credit line (iv) Loans for indirect and direct recapitalization of financial institutions	(i) Balance of payments credit (ii) Liquidity credit (iii) External debt restructuring of central banks (iv) Contingency credit (v) Treasury operations
Governance and decision-making	A request for activation of swap transactions can be submitted to the CMIM Coordinating Countries (2 Chairs—1 from ASEAN, 1 from +3 countries) and is subject to the approval of the Executive Level Decision Making Body.	Most important decisions, including those on granting financial assistance to member states, are made by mutual agreement by the ESM board of governors (19 finance ministers, and EC and ECB as observers).	Lending decisions are made by the Board of Directors (central bank governors and the Executive President). Each member country has the same voting power irrespective of their paid-in capital. Most decisions are made by a three-quarter qualified majority; lending decisions for Liquidity, Contingency, and Treasury credit are made by the Executive President.
Conditionalities	(i) IMF de-linked portion: 30% of maximum drawable amount (ii) Portion linked to IMF conditionalities: 70%	Financial assistance is linked to policy conditions specified in a memorandum of understanding between beneficiary member state and the EC, ECB, and the IMF	Central bank of requesting member state must provide a report on monetary, credit, exchange, fiscal and trade policies to be implemented, subject to approval of FLAR's Board
Surveillance	Yes, through AMRO	Only countries with financial assistance	Yes
Usage	Never been used	(i) Loans within a macroeconomic adjustment program: Greece (EFSF, ESM), Cyprus (ESM), Portugal (EFSF), Ireland (EFSF) (ii) Loans for indirect bank capitalization: Spain (ESM) (iii) All other instruments have not been used.	Historically, FLAR has been relevant for its member countries, especially those of smaller relative size. It currently has \$1,485 million in outstanding loans to central banks (\$1,000 million to Costa Rica and \$485 million to Venezuela).

AMRO = ASEAN+3 Macroeconomic Research Office, ASEAN = Association of Southeast Asian Nations, CMIM = Chiang Mai Initiative Multilateralisation, EC = European Commission, ECB = European Central Bank, EFSF = European Financial Stability Facility, ESM = European Stability Mechanism, FLAR = Latin American Reserve Fund (Fondo Latinoamericano de Reservas), HKMA = Monetary Authority of Hong Kong, China, IMF = International Monetary Fund.

Notes: ASEAN includes Brunei Darussalam, Cambodia, Indonesia, the Lao People's Democratic Republic, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Viet Nam. The Plus-3 countries include the People's Republic of China, Japan, and the Republic of Korea. The euro area includes Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Portugal, Slovak Republic, Slovenia, and Spain. The FLAR member economies include Bolivia, Colombia, Costa Rica, Ecuador, Paraguay, Peru, Uruguay, and Venezuela.

Sources: IMF (2013a, 12; 2017a; 2017b, 13); AMRO, ESM, FLAR, and IMF official websites.

The financial structures of RFAs differ. These arrangements vary in composition of funding sources—whether they rely more heavily on financial markets for funding (e.g., through issuance of bonds) or whether they are financed more heavily by member contributions. The ESM relies more heavily on the former,⁵ allowing the RFA to leverage financing from markets to a level above the normal and exceptional access limit of the IMF (Cheng and Lennkh 2019). Without paid-in capital, the CMIM relies solely on the latter, with member contribution commitments taking the form of a commitment letter rather than a direct transfer of funds. The FLAR falls in the middle of this spectrum, having recourse to both member state contributions and, to a lesser extent, market-based instruments (e.g., bond issuance or deposits) to finance financial assistance programs.

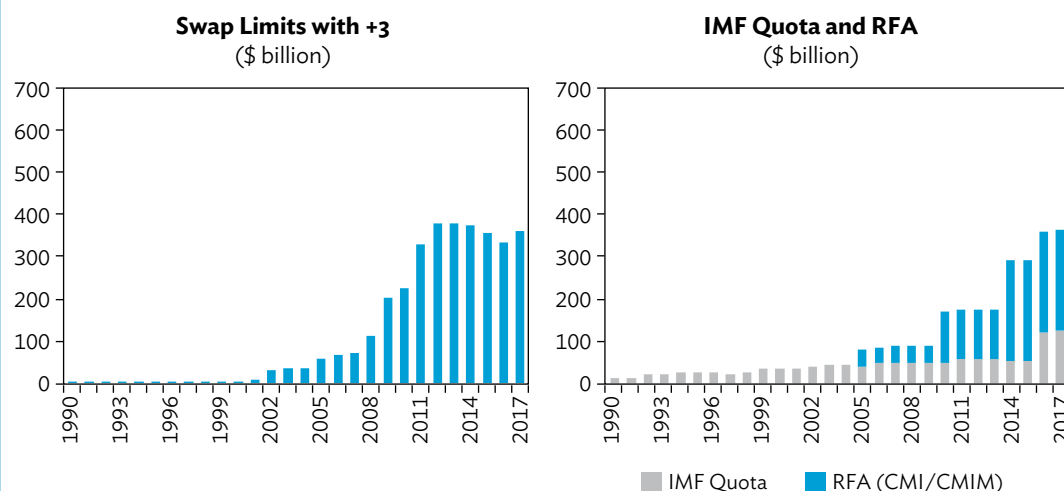
These different funding structures, in turn, have implications for RFAs' lending capacities. The capacity of an RFA depends on its ability to borrow from financial markets, its credit rating, or on the equity that member states have provided or committed. Thus, maintaining high creditworthiness and a strong capital or guarantee structure is critical to ensuring sustained funding for a more heavily market financed RFA (Cheng and Lennkh 2019). Such a structure may, however, more heavily subject an RFA to financial cycles and volatility. In case one solely relied on committed callable capital from member economies, as in the CMIM, a smooth and timely activation of these funds is crucial if a member economy seeks financial assistance. Furthermore, only 30% of the CMIM's maximum drawable amount can be disbursed in the absence of an associated IMF program with conditionalities. This in turn could result in a lack of available firepower or a delay in activating funds going beyond the IMF de-linked portion during times of urgent need. It is worth noting that the instruments embedded in the CMIM have not been used to date.

The difference in these funding structures may also affect the speed and effectiveness of liquidity provision by financial safety net providers. For example, the CMIM is large compared to other RFAs in the size of committed funds, but the lack of paid-in capital makes it difficult to leverage the fund to expand the lending capacity and limits its effective interventions. Moreover, a potentially lengthy domestic (often political) approval process behind the release of committed funds could lead to delays in disbursement during times of crisis.

The availability of safety net arrangements has historically varied across regions. In Asia, the size of RFA financing has increased markedly over the past decade. More generally, financial safety nets in ASEAN+3 have been growing, due to a rise in available bilateral swap lines in the region and available RFA and IMF financing (Figure 2). RFA financing has likewise seen a steady increase in the euro area and Latin America, with the amount of available funding in the euro area far exceeding that of the other regions (Figure 3). In ASEAN+3, political costs tied to accessing IMF resources underscore the importance of bolstering RFAs.

The availability of financing relative to the size of short-term external debt or to the IMF quota has likewise varied across regions. The availability of regional financing (measured in terms of IMF quota and available RFA financing) relative to outstanding short-term external debt is higher for FLAR member countries than for euro area or ASEAN+3 economies. The availability of RFA funding relative to IMF funding is highest in the euro area, followed by ASEAN+3. These ratios have increased substantially since the global financial crisis, highlighting the increased regional component of the available financial backstop in the two regions. Among FLAR economies, the IMF quota exceeds the availability of RFA financing, underscoring the continued prominent role IMF funding plays in these Latin American economies (Figure 4).

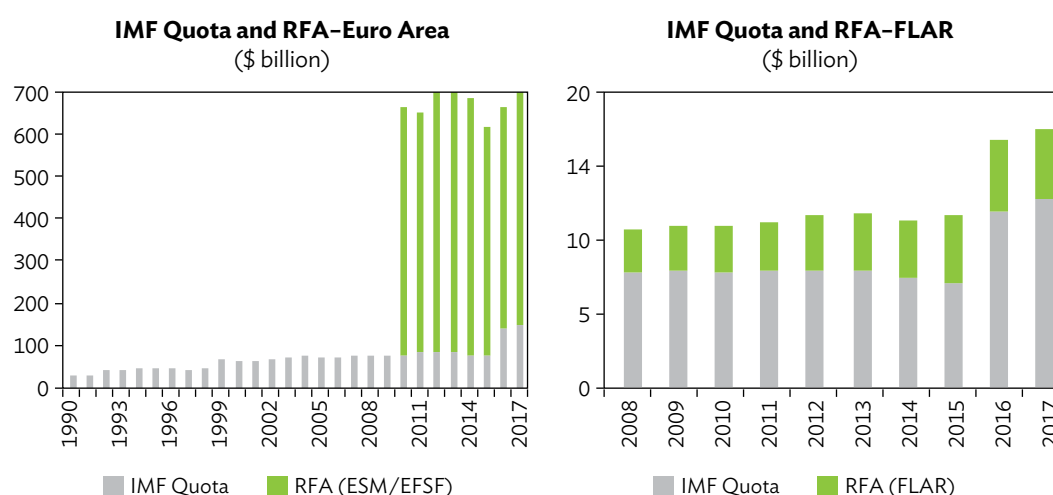
⁵ Cheng and Lennkh (2019) moreover note that the ESM enjoys favorable ratings from credit rating agencies and that this, in turn, translates to more favorable rates.

Figure 2: Availability of Financial Safety Nets: ASEAN+3

ASEAN = Association of Southeast Asian Nations, CMI = Chiang Mai Initiative, CMIM = Chiang Mai Initiative Multilateralisation, IMF = International Monetary Fund, RFA = regional financing arrangement. Plus-3 includes the Bank of Japan, Bank of Korea, and the People's Bank of China.

Notes: Data on swap limits include only swap arrangements published by the central banks and finance ministries. Swap limit calculations include one-way and two-way swaps and the ASEAN Swap Agreement. Starting in 2008, renewed or newly established swap lines with the People's Bank of China used the local currency. End-of-period exchange rates were used in converting amounts to United States dollars. A currency swap-financed liquidity facility with the Republic of Korea was introduced in Malaysia (2014) and the People's Bank of China (2015).

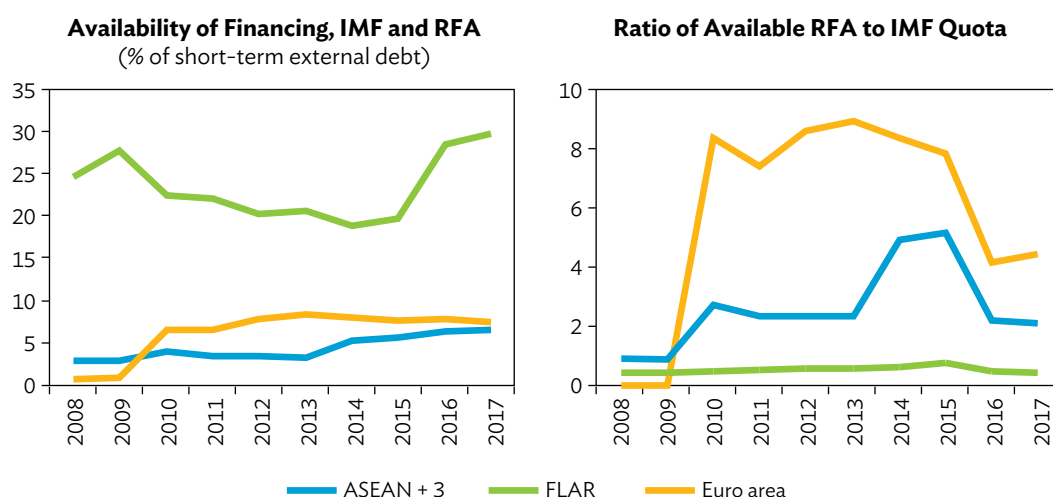
Sources: Bank of Japan; Bank of Korea; People's Bank of China; IMF; Haver Analytics; and Global Financial Safety Nets database (accessed May 2018).

Figure 3: Availability of Financial Safety Nets: Euro Area and Latin America

EFSS = European Financial Stability Facility, ESM = European Stability Mechanism, FLAR = Latin American Reserve Fund (Fondo Latinoamericano de Reservas), IMF = International Monetary Fund, RFA = regional financing arrangement.

Notes: The euro area is composed of the following countries: Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Portugal, Slovak Republic, Slovenia, and Spain. Financing from the European Financial Stability Facility was made available starting 2010 and from the ESM (which replaced the European Financial Stability Facility) starting 2012. The amount of ESM loans available was converted from euro to United States dollars using end-of-period exchange rates. FLAR member countries include Bolivia, Colombia, Costa Rica, Ecuador, Paraguay, Peru, Uruguay, and Venezuela. RFA data refer to maximum credit disbursement capacity for FLAR member countries; data prior to 2008 not available.

Sources: ESM; IMF; Haver Analytics and Global Financial Safety Nets database (accessed May 2018); and Giraldo (2017).

Figure 4: Availability of Financial Safety Nets

ASEAN = Association of Southeast Asian Nations, FLAR = Latin American Reserve Fund (Fondo Latinoamericano de Reservas), IMF = International Monetary Fund, RFA = regional financing arrangement.

Notes:

1. FLAR excludes Uruguay as data on short-term external debt are not available. FLAR includes Bolivia, Colombia, Costa Rica, Ecuador, Paraguay, Peru, and Venezuela.

2. ASEAN+3 includes ASEAN (Brunei Darussalam, Cambodia, Indonesia, the Lao People's Democratic Republic, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Viet Nam) and Plus-3 countries (Japan, the People's Republic of China, and the Republic of Korea)

Sources: ESM; IMF; Haver Analytics; Global Financial Safety Nets database (accessed May 2018); and Giraldo (2017).

Evolution of Financial Safety Nets After the Global Financial Crisis

The global financial crisis triggered a revisiting of regional and global financial safety net components, resulting in the establishment of the ESM and a revision of the IMF toolkit. Both the severity and nature of the crisis prompted a wide array of policy reforms in the global financial safety net architecture. While the crisis originated in the United States, it quickly spread across borders, heavily hitting other regions, including Europe. As history has demonstrated, due to reasons of political economy, it is mostly crisis periods that prompt policy makers to take necessary action. The following discusses how the global financial crisis has shaped the origins of the ESM as well as the IMF's efforts to finetune its toolkit. The subsequent section details the evolution of ADB's crisis response toolkit, which was also heavily influenced by past crisis episodes.

The European Stability Mechanism

The global financial crisis and subsequent European sovereign debt crisis triggered the creation of the European Financial Stability Facility and later the ESM to safeguard financial stability in the region. At the onset of the European sovereign debt crisis in 2010, Greece was shut out of financial markets after amassing excessive public debt. In the absence of available institutional instruments to provide balance of payments support, the Greek Loan Facility was created to provide bilateral loans from euro area members to supplement IMF support (Korhonen 2018; IMF 2017a; Rhee, Sumulong, and Vallée 2013). To ensure timely and sufficient financial stability support and to signal the region's commitment to the integrity of the common currency area, the European Financial Stability Facility was created as a temporary crisis mechanism (ESM 2017; Korhonen 2018). The

European Financial Stability Facility was later adapted by member countries to increase its lending capacity, enhance its operational flexibility, and improve its funding strategy. In October 2010, the region's policy makers agreed on the need for a permanent entity to safeguard the stability of the common currency area as part of a broader comprehensive policy response, culminating in the establishment of the European Stability Mechanism (ESM 2017; Korhonen 2018).

Accompanying the establishment of the European Financial Stability Facility and the ESM was the creation of the European Banking Union. The European Banking Union was built on institutions ensuring the centralization of banking supervision, uniform deposit insurance arrangements, and centralization of crisis resolution. The Banking Union had three pillars: (i) the Single Supervisory Mechanism, as part of the European Central Bank, as the supervisor of significant banks in the euro area; (ii) the Single Resolution Mechanism consisting of the Single Resolution Board and Fund; and (iii) the still to be established European Deposit Insurance Scheme.

Financial assistance from the ESM and European Financial Stability Facility has served as an important complement to IMF assistance. The two European institutions have approved €383 billion in assistance to euro area economies, with €279 billion disbursed in mainly front-loaded programs (Table 3). This has been an important complement to the IMF, with loans offered at lower rates and with longer maturities than those issued by the IMF (Korhonen 2018).

**Table 3: European Financial Stability Facility and European Stability Mechanism
Financial Assistance**

Country	Financing Institution	Formal Request	Facility Agreement Entered into	Program Completion	Amount Approved (€ billion)	Amount Disbursed (€ billion)	Financing Partners
Ireland	EFSF	20 Nov 2010	22 Dec 2010	8 Dec 2013	17.7	17.7	EFSM, IMF, bilaterals
Portugal	EFSF	7 Apr 2011	27 May 2011	18 May 2014	26.0	26.0	EFSM, IMF
Greece	EFSF	8 Feb 2012	15 Mar 2012	30 Jun 2015 ^a	144.6	141.8	IMF
Spain	ESM	25 Jun 2012	25 Jul 2012	31 Dec 2013	100.0	41.3	-
Cyprus	ESM	25 Jun 2012	8 May 2013	31 Mar 2016	9.0	6.3	IMF
Greece	ESM	8 Jul 2015	19 Aug 2015	28 Aug 2018 ^b	86.0	45.9 ^c	-

EFSF = European Financial Stability Facility, EFSM = European Financial Stabilisation Mechanism, ESM = European Stability Mechanism, IMF = International Monetary Fund.

Notes: ^a Expired; ^b End of availability period; ^c Disbursed at end-March 2018.

Source: Korhonen (2018, 70).

An evaluation of the performance of the ESM highlighted several measures to strengthen its operations. The EFSF/ESM Financial Assistance Evaluation Report released by the Independent Evaluator in 2017 laid out several recommendations to enhance the institutional capacity of the ESM. These include improvements to program credibility and ownership by integrating stakeholder objectives early on; clear definition of objectives and priorities; further refinements of the ESM governance framework to be undertaken by the Board of Governors; and enhancements to program transparency and accountability. In addition, it was emphasized that further review of the ESM's role and strengthening of its crisis prevention capacity should be considered. In particular, the need for a firewall in the euro area was raised; and the limitations of the institution's early warning mandate were underlined (ESM 2017).⁶

⁶ For more on the issues relating to the institutional set-up in the euro area, see Martin (2018) and Vives (2018).

The International Monetary Fund

In the aftermath of the global financial crisis, policy makers from emerging and industrialized economies advocated reforms to expand and strengthen the global financial safety net. These reforms centered on expanding IMF resources—IMF lending capacity has tripled, its toolbox has been enhanced with the introduction of new precautionary instruments, the allocation of Special Drawing Rights has increased substantially, and the number of structural conditions has decreased (Cheng 2016; Marino and Volz 2012). An additional \$750 billion of funding was added to the IMF emergency lending arsenal, with \$250 billion available via bilateral loans and \$500 billion accruing from the enhanced New Arrangements to Borrow.⁷ Moreover, a \$250 billion equivalent new general allocation in Special Drawing Rights was implemented by the IMF in August 2009 when the Fourth Amendment to the Articles of Agreement came into effect in order to inject additional liquidity into the international monetary system (Cheng 2016).

The IMF lending toolkit was enhanced with the introduction of new precautionary instruments following the global financial crisis. Historically, IMF assistance has involved crisis resolution rather than crisis prevention. And while discussions centering on the establishment of crisis prevention instruments emerged in the 1990s, decisive action did not take place until after the onset of the Asian financial crisis and subsequent global financial crisis (Marino and Volz 2012; Henning 2015).⁸ In April 2009, the IMF introduced the Flexible Credit Line (FCL) to provide large access to IMF resources to economies with very strong fundamentals in order to boost crisis prevention; this was later enhanced in August 2010. The Precautionary Credit Line (PCL) was introduced in October 2010 for crisis bystander economies with solid economic fundamentals, but with some vulnerabilities that preclude them from accessing the FCL; this was later expanded into the Precautionary and Liquidity Line (PLL) in 2011 as a means to extend short-term liquidity support over the course of 6 months (Marino and Volz 2012). As of March 2018, the PLL has been used by Macedonia and Morocco (IMF 2018b). Requests to use the FCL have come from Mexico, Colombia, and Poland, although no drawings have been made as of March 2018.⁹ In contrast to the IMF's earlier lending instrument—Stand-By Arrangements—the FCL and PLL have more stringent requirements for qualification, but allow greater access limits without strict conditionality (Cheng 2016). A brief overview of lending instruments and different kinds of facilities is provided in Table 4.

Applications to IMF precautionary facilities have been relatively limited. Although the IMF's precautionary facilities were designed to better insulate economies with sound fundamentals from sharp capital flow reversals, their uptake has been relatively low. Reasons for the relatively low usage include high qualification criteria to access the facilities, reservations stemming from fear of failure to qualify and the potential negative implications this might have on confidence and financial market stability, aside from potential stigma concerns (Henning 2015).

The number of structural conditionalities imposed on crisis-affected economies declined in the post-global financial crisis period. To further enhance funding access for economies in

⁷ In addition to the quota, the IMF has recourse to bilateral borrowing from its members, the most important of which is the New Arrangements to Borrow, which was intended as an additional financial backstop should quota resources be insufficient (Bretton Woods Project 2012).

⁸ Marino and Volz (2012) note that discussions centering on the creation of a Short-Term Financing Facility began in 1993 but that this failed to translate into a concrete facility. At the root of the reservations behind the creation of the Short-Term Financing Facility were concerns over the eligibility of economies, the absence of conditionalities, and the sufficiency of Fund resources, in addition to reservations concerning moral hazard.

⁹ Poland exited from its FCL arrangement in November 2017 (IMF 2018a).

need of crisis assistance, conditions attached to loans were streamlined and reduced. For instance, structural conditions accompanying Stand-By Arrangements approved in post-global financial crisis years declined significantly from pre-global financial crisis periods (Cheng 2016). This is a major improvement from the criticism of the IMF after the Asian financial crisis.

Table 4: Overview of the IMF Toolkit

Facility	Purpose	Eligibility	Duration	Access	Conditionality (ex ante/ex post) and Reviews
Poverty Reduction and Growth Trust Supported Program					
Extended Credit Facility	Sustained medium- to long-term engagement in case of protracted balance of payments problems	Available to all PRGT-eligible member countries facing protracted balance of payments problems	3–4 months initial duration; maximum of 5 years	75% of quota per year and total outstanding concessional credit to 225% of quota; with exceptions	Semiannual reviews; standard benchmarks, quantitative conditions
Standby Credit Facility	Financing for low-income countries with actual or potential short-term balance of payments and adjustment needs caused by domestic or external shocks or policy slippages	Available to all PRGT-eligible member countries facing immediate or potential short-term balance of payments problems	12–24 months; limited to 2.5 out of any 5 years	75% of quota per year and total outstanding concessional credit to 225% of quota; with exceptions	Semiannual reviews; quantitative conditions, standard benchmarks
Rapid Credit Facility	Rapid financial support as a single up-front payout for low-income countries facing urgent balance of payments needs	Available to all PRGT-eligible member countries facing urgent balance of payments problems, where full-fledged economic program not necessary or feasible	Single disbursement, with scope for repeated use within 3 year period for exogenous shocks	18.75% of quota per year and 75% on cumulative basis; annual access limit of 60% of quota	No ex post conditionality
Policy Support Instrument Supported Program					
Policy Support Instrument	Provision of advice and support without a borrowing arrangement for low-income countries not in need of financial support	Available to all PRGT-eligible member countries without current or prospective balance of payments problems but that may benefit from structural reforms	Initial duration of 12–48 months; maximum of 5 years	--	Semiannual review
General Resources Account Supported Program					
Stand-By Arrangement	Quick financial support for countries facing external financing needs	All member countries facing external financing needs	12–24 months; no more than 36 months	No cap. Exceptional access criteria may apply beyond normal circumstances	Normally semiannual reviews; quantitative conditions, performance criteria, standard benchmarks, and prior actions.

continued on the next page

Table 4 continued

Facility	Purpose	Eligibility	Duration	Access	Conditionality (ex ante/ex post) and Reviews
Flexible Credit Line	Financial support to countries facing actual, prospective, or potential balance of payments needs	Compliance with qualification criteria: very strong ex ante macroeconomic fundamentals, economic policy framework, and policy track record	12–24 months arrangement	No preset limit	No ex post conditionality. Only ex ante (qualification criteria); annual reviews for 2-year FCL arrangements
Rapid Financing Instrument	Rapid financial support to countries facing urgent balance of payments needs where full-fledged economic program not necessary or feasible	Available to all member countries	Outright purchases	Outright purchase 37.5% of quota; 75% of quota cumulative	No Fund-supported program; no ex post conditionality or reviews but prior actions possible
Precautionary and Liquidity Line	Flexible instrument to meet liquidity needs of member countries with sound economic fundamentals but facing limited remaining vulnerabilities precluding them from using FCL	Compliance with qualification criteria: sound policy frameworks, external position, and market access, including financial sector soundness	6 months arrangement (liquidity window)	125% per arrangement; 250% cumulative (latter due to exogenous shock heightened stress)	Semiannual reviews; standard continuous performance criteria, prior actions. Ex ante conditionality (qualification criteria)
			12–24 months arrangement	250% - first year upon approval; 500% - cumulative	Ex ante conditionality (qualification criteria). Semiannual reviews; indicative targets and continuous performance criteria; other performance criteria, standard benchmarks and prior actions, as warranted
Extended Fund Facility	Support for countries facing serious medium-term balance of payments problems due to structural weaknesses	All member countries facing external financing needs	12–48 months arrangement	No cap. Exceptional access criteria apply beyond normal access	Normally semiannual reviews; performance criteria, standard benchmarks, and prior actions, focusing on structural reform

FCL = Flexible Credit Line, IMF = International Monetary Fund, PRGT = Poverty Reduction and Growth Trust.
Sources: IMF (2017, 13; 2018a; 2018b).

While great strides have been taken in expanding the financial capacity of the IMF, reforms relating to governance have had mixed success; and challenges surrounding its resolution toolkit remain. The limited representation of emerging market economies relative to their contribution to global economic growth is one issue. Notably, however, recent steps have been taken to enhance representation while increasing quotas, with a greater voice allocated to emerging market economies (Cheng 2016).¹⁰

¹⁰ The 2008 Quota and Voice Reform of March 2011 was a significant step forward in institutional reform. Further steps to broaden representation include the 2010 Reform of Quotas and Governance, which included a doubling of quotas translating to a 6% shift in quota share to emerging economies, and improvements to the representation of the Executive Board. The conditions for the effectiveness of quota increases were met on 26 January 2016 (IMF 2018c).

3. ADB's Role in Regional Crisis Response

ADB has played an important role in stabilizing the regional economies during times of crisis and strengthening economic and financial resilience. Such assistance initially emerged as budgetary or balance of payments support through policy-based lending (PBL) to economies in the wake of the global oil crisis in the 1970s. Gradually, in response to crises such as the Asian financial crisis and global financial crisis, instruments better tailored to specific crisis episodes—the Countercyclical Support Facility (CSF) and Special Policy-Based Lending (SPBL)—were introduced. In broad strokes, ADB support to economies is grounded in the recognition that financial crises and recessions have a long-lasting negative impact on economies and that fiscal support can help stabilize economies and protect socially vulnerable groups while maintaining the momentum of reforms in the medium term to build economic and financial resilience.

Economic and financial crises originating abroad can disrupt growth in developing countries in the region, partly jeopardizing ADB's goals and thus reinforcing the need to mitigate the potential negative impacts. Recent experiences have illustrated the disruptive potential of a variety of exogenous shocks to the growth of developing member countries in Asia and the Pacific. These include sharp swings in global commodity prices, spillover effects from monetary policy changes in reserve currency economies, economic slowdowns of major trading partners, rising protectionist trade measures, and increased uncertainty from geopolitical events. The following details ADB's instruments for enhancing economic and financial resilience in those countries, emphasizing crisis response measures. Figure 5 provides a timeline of ADB's crisis response and crisis facilities.

ADB's Policy-Based Lending Instruments: Origins and Overview

Policy-based lending encompasses general budgetary or balance of payments support to borrowing developing member countries and is provided in conjunction with the adoption of policy reforms by borrowing economies. ADB program lending originated as balance of payments support in the aftermath of the global oil crisis in the 1970s. Since its initial inception in 1978, ADB has continually adapted policy-based lending to reflect the changing context and evolving needs of international development. Policy-based lending can broadly be categorized into conventional policy-based lending and crisis response instruments (Table 5).

Table 5: Overview of ADB Policy-Based Lending Instruments

Conventional Policy-Based Lending	Crisis Response Instruments
<p>1. <u>Stand-alone Policy-Based Lending</u> Multi or single-tranche loan approved by the Board at once; progress report to the Board upon compliance with ex post conditionalities needed for subsequent tranches</p>	<p>1. <u>Countercyclical Support Facility</u> Budget support provided against exogenous shocks at the time of the economic crisis, in conjunction with DMC authority's fiscal stimulus package to restore growth</p>
<p>2. <u>Programmatic Approach</u> Series of single-tranche loans, each approved by the Board</p>	<p>2. <u>Special Policy-Based Lending</u> Balance of payments support with flexible conditionalities provided at the time of balance of payments crisis, as part of the IMF-led bailout package</p>

DMC = developing member country, IMF = International Monetary Fund.
Source: Asian Development Bank.

Conventional policy-based lending is grounded in the recognition of the country context and recognizes the need for country ownership in designing and implementing reforms rather than one-size-fits-all policies. Conventional program—or non-project—lending initially began as a means to support the economic growth of developing member countries by financing the importation of goods essential to realizing a developing economy's full productive capacity. In the 1980s, the scope of the program was broadened to include a wide range of policy reforms in developing and transitioning economies. Underlying this trend was the growing recognition that capital investments to developing economies needed to be accompanied by stable macroeconomic conditions and sound policies in order to generate lasting benefits. By the 1990s, the experience with structural adjustment programs underscored the role of country ownership as a vital element for successful reform programs. Policy-based lending was shown to be most effective when it reflected the country context rather than being unilaterally imposed by international finance institutions. This gave way to a programmatic approach for budgetary support that placed emphasis on the identification of a limited number of binding constraints, which gave consideration to unique country contexts, as opposed to lengthy one-size-fits-all policy prescriptions and recognized the importance of a phased approach in designing and implementing reforms.

Evolution of ADB's Crisis Toolkit: Special Policy-Based Lending and the Countercyclical Support Facility

The limitations of conventional policy-based lending in adequately responding to financial crises prompted the development of instruments tailored to crisis response. In the aftermath of the financial crises of the late 1990s and succeeding 2 decades, the limitations of conventional policy-based lending in adequately responding to financial episodes paved the way for the introduction of tailored crisis response instruments. After the Asian financial crisis and the global financial crisis, there was growing recognition that conventional policy-based lending with structural reform conditionality may be best suited to support reforms under normal circumstances, and not necessarily during crises. Consequently, new instruments were established to address unique crisis situations. These include Special Policy-Based Lending, introduced in 1999 after the Asian financial crisis, and the Countercyclical Support Facility, established as a time-bound instrument during the 2008/2009 global financial crisis and mainstreamed in 2011. Table 6 briefly summarizes lending terms.

Table 6: ADB Crisis Response Instruments: Lending Terms

Lending Terms	Crisis Response Instruments	
	Countercyclical Support Facility	Special Policy-Based Lending
Conditionality	Fiscal policy (countercyclical expenditures/fiscal stimulus)	Guided by crisis-specific contexts: not all structural reforms beneficial in the long run should be undertaken in the midst of a crisis
Ceiling/cap	Capped at \$500 million per exogenous shock or crisis episode, within ADB's risk-bearing capacity. Not counted in ceiling	None, albeit within Asian Development Bank's risk-bearing capacity. Not counted in ceiling
Eligibility	Ordinary capital resources-eligible developing member countries, graduates	
Rate	Minimum spread of 200 basis points over LIBOR, a rebate or surcharge reflecting the cost of funds	
Maturity	5–8 years including a grace period of up to 3 years, and commitment charge at 75 basis points per year	

LIBOR = London interbank offered rate.

Source: Asian Development Bank (2011).

Special Policy-Based Lending was established to provide large-scale financing to crisis-affected economies. Its introduction formalized ADB's participation in the collaboration arrangement led by the IMF to address balance of payments crises. Although ADB provided financial support to the Republic of Korea as part of an IMF-led international rescue package in the wake of the Asian financial crisis, this was a special arrangement and not part of the special PBL. In December 2019, ADB approved Special Policy-Based Lending of \$1 billion to Pakistan—the first ever SPBL provided by ADB since the establishment of the lending modality—to shore up the country's public finances and facilitate a multi-donor economic reform program supported by the IMF.

ADB introduced the Countercyclical Support Facility to supplement IMF resources in 2009 and mainstreamed the facility in 2011. The global financial crisis triggered international calls for fiscal stimulus. The G20 urged multilateral development banks to provide countercyclical lending within their risk-bearing capacity to supplement IMF resources. The Countercyclical Support Facility was introduced to assist developing member countries in borrowing from ordinary capital resources to mitigate the adverse impact of the global economic crisis and support specific countercyclical development expenditures. The facility provides incremental support on top of regular development financing and avoids crowding out any planned support. Unlike crisis instruments of other financial institutions, the facility requires fiscal stimulus rather than austerity measures at the macro level without strictly imposing structural reform conditionality at the micro level. The instrument is reserved for addressing severe crises and adverse impacts resulting from exogenous shocks.

In 2009, the Countercyclical Support Facility of ADB had three main access criteria. These were (i) adverse impacts of global economic crisis, (ii) planned countercyclical development of expenditure for poverty reduction, and (iii) sound macroeconomic management. By 2011, an updated policy formally acknowledged a precautionary financing option, which allowed approval of a Countercyclical Support Facility loan in anticipation of an adverse event with disbursements withheld until the impacts of a crisis are felt by a borrowing country. In 2016, following a review of ADB's crisis lending toolkit, the access criteria were adjusted and broadened to include adverse impacts to exogenous shocks (as opposed to global economic crises). This allows the usage of the facility

under conditions such as a global deterioration of commodity prices or a slowdown in a major trading partner that causes adverse economic impacts.

The introduction of Special Policy-Based Lending and the Countercyclical Support Facility enhanced ADB's crisis response toolkit. In the event of a balance of payments crisis requiring IMF intervention, the Special Policy-Based Lending may be mobilized by ADB under IMF leadership. Should the impact of a crisis be primarily limited to slower growth, however, the Countercyclical Support Facility would be the more appropriate instrument.

Overview of Usage of ADB's Crisis Toolkit

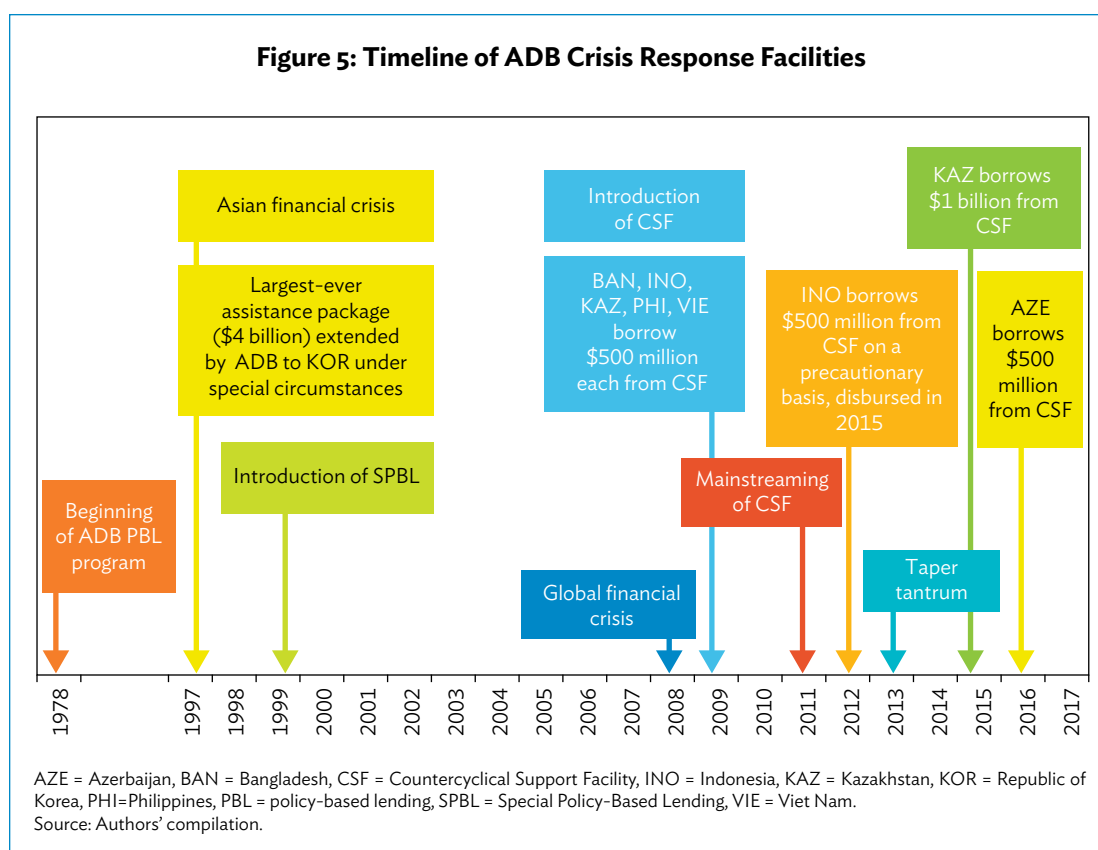
The Countercyclical Support Facility has been used multiple times since its introduction.

In 2009, as a result of financial turmoil following the global financial crisis, Bangladesh, Indonesia, Kazakhstan, the Philippines, and Viet Nam each borrowed \$500 million from the facility. The combined \$2.5 billion loans were provided to mobilize countercyclical development expenditure programs. In Bangladesh, the facility supported higher spending for expanded social safety net programs, as well as a new public-private partnership, and a larger allocation for annual development program infrastructure projects. The Countercyclical Support Facility loan for Indonesia enhanced predictability in the government's budget financing and supported the country's public expenditure program. In Kazakhstan, the loan supported implementation of employment generation and anti-crisis plans. The facility in the Philippines sought to provide support to the Economic Resiliency Plan of the government and further aid key development efforts during time of limited liquidity in global financial markets. In Viet Nam, the fiscal stimulus package was designed to limit the adverse effects of the global financial crisis.

The mainstreamed Countercyclical Support Facility was first used for a precautionary loan to Indonesia during the European sovereign debt crisis in 2012, but the disbursement was not made until after a major change in the facility in 2015. The precautionary financing facility for Indonesia emerged in the context of financial turbulence and a volatile global economic outlook. As such, the Countercyclical Support Facility to Indonesia with a precautionary financing option was proposed to help the Indonesian government mitigate the negative impact of financial volatility. In 2015, given adverse economic developments combined with a tightening of bond markets, the government of Indonesia asked ADB to allow it to withdraw the loan proceeds. The major change to the loan amounting to \$500 million was to apply disbursement-linked repayment terms for the facility in place of the original commitment-linked repayment terms.

In 2015, a Countercyclical Support Facility loan amounting to \$1 billion was granted to Kazakhstan to help counter an economic slowdown and mitigate the adverse impacts of the steep decline in world oil prices and an economic slowdown in neighboring economies. The ADB Board granted the waiver to exceed the policy's country ceiling of \$500 million. The loan was divided into two \$500 million tranches, and a number of policy reforms were designated as conditions for release of the second tranche, in part to address Board concerns over Kazakhstan's Countercyclical Support Facility eligibility. The loan was granted to facilitate the government's infrastructure modernization program and maintain spending programs for job creation, social services, support to low-income households, and private sector development, particularly for small and medium-sized enterprises.

In 2016, a Countercyclical Support Facility loan amounting to \$500 million was granted to Azerbaijan. This loan intended to help the economy maintain social spending, create jobs, diversify

Figure 5: Timeline of ADB Crisis Response Facilities

its economy and mitigate the adverse impact of a crash in oil prices. A 55% drop in oil prices from 2014 to 2016 hurt the Azerbaijan economy, as oil and gas revenues accounted for 30% of gross domestic product, 60% of budget revenues, and over 90% of export revenues.

ADB resource mobilization from 2008 to 2009 rapidly increased in close alignment with the unfolding crisis. Policy-based lending—including Countercyclical Support Facility loans—amounted to \$7.7 billion and comprised over a fifth of overall ADB assistance from 2009 to 2010 and nearly 45% of total sovereign operations in 2009, roughly double the ceiling for policy-based lending. Response and the extension of loans through the Countercyclical Support Facility was concentrated on efforts to mitigate the adverse social impacts of the crisis, hasten the recovery of economies, and facilitate more sustained and resilient growth moving forward.

Assessing ADB's Role in Crisis Prevention and Support

ADB provides support to enhance financial resilience and to secure stability in Asia and the Pacific. The bank extends loans, technical assistance, grants and equity investments to promote social and economic development in its developing member countries. In particular, ADB provides low cost loans to governments and businesses and offers knowledge and technical assistance to make funding more effective. It facilitates policy dialogue, provides advisory services, and mobilizes financial resources to strengthen resilience and economic stability. It provides direct crisis support to mitigate adverse economic and social impacts in crisis-affected economies. These efforts are complemented by loans to support structural reforms—such as financial sector development—aiming to increase financial and economic resilience in the longer term.

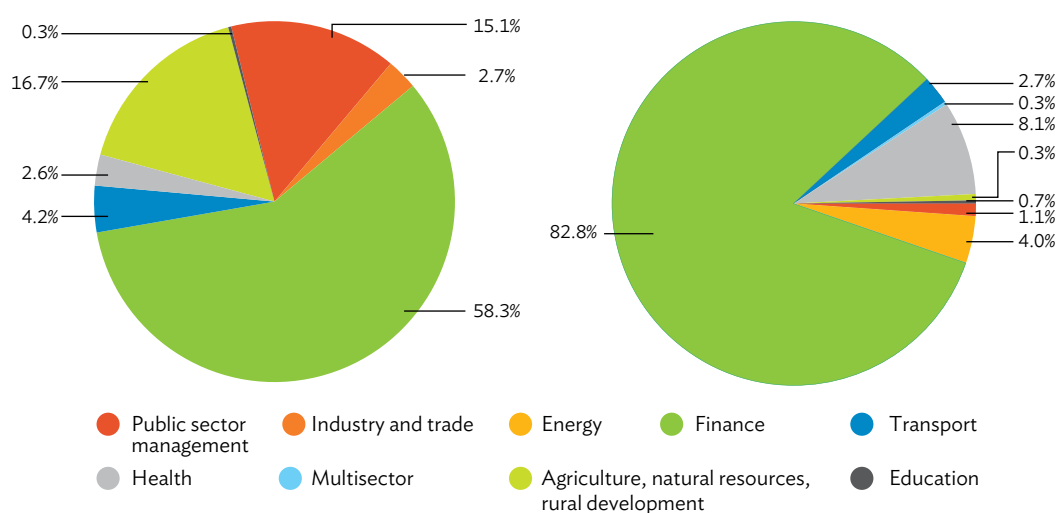
Figure 6: ADB Approved Policy-Based Lending, 1978–2017
(\$ million)



Source: Asian Development Bank Independent Evaluation Policy-Based Lending Approvals Database (accessed September 2018).

ADB's support helped economies bridge financing gaps after the onset of the Asian financial crisis. Crisis program loans amounted to \$7.28 billion (Table 7), accounting for half of program lending during that time (ADB 2001). More broadly, overall program lending spiked sharply during the outbreak of the crisis (Figure 6). Annual policy-based lending rose dramatically from \$343 million prior to the crisis to \$4.9 billion after its onset. Lending to the finance sector accounted for a substantial proportion of this increase (Figure 7).

Figure 7: ADB Approved Policy-Based Lending by Sector, before and during the Asian Financial Crisis
(% shares)



Notes:

1. Data include policy-based lending financed from Asian Development Fund/concessional assistance and regular ordinary capital resources and are based on gross approved amounts.
2. Pre-Asian financial crisis corresponds to 1 January 1992–1 July 1997. Asian financial crisis corresponds to 2 July 1997–31 December 1998.

Sources: Asian Development Bank Independent Evaluation Policy-Based Lending Approvals Database (accessed September 2018).

Table 7: Crisis Program Lending, 1997–1999

Country	Approval Year	Program Name	Amount (\$ million)
Thailand	1997	Financial Markets Reform Program	300
Thailand	1998	Social Sector Program	500
Thailand	1999	Agriculture Sector Program	300 ^a
Republic of Korea	1997	Financial Sector Program	4,000 ^b
Indonesia	1998	Financial Governance Reform Sector Development Program	1,400
Indonesia	1998	Social Protection Sector Development Program	100 ^c
Indonesia	1999	Power Sector Restructuring Program	380
Indonesia	1999	Health and Nutrition Sector Development Program	100 ^c
Indonesia	1999	Community and Local Government Support Sector Development Program	200 ^d
Total			7,280

^a An additional \$300 million was made available through cofinancing with the Overseas Economic Cooperation Fund (now the Japan Bank for International Cooperation).

^b An additional \$15 million loan provided support for institutional strengthening of the financial sector.

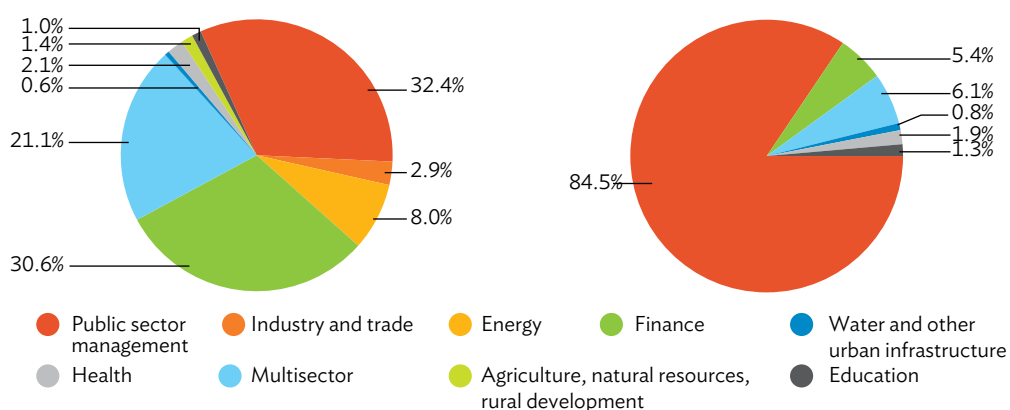
^c There was an additional \$200 million investment component.

^d There was an additional \$120 million investment component.

Sources: ADB (2001), McCawley (2017).

ADB's PBL rose substantially in response to the global financial crisis. After the global financial crisis, ADB provided financial assistance to governments and the private sector and policy advice and advocacy. Its response comprised primarily of sovereign investment lending geared toward sustaining development momentum in the region. It also provided fast-disbursing funding for fiscal stimulus (through the Countercyclical Support Facility), program lending tied to structural reforms, and pursued the expansion of trade facilitation (through the Trade Finance Program). Conventional policy-based lending increased sharply during the crisis period, before declining gradually (Figure 6). Annual policy-based lending rose substantially from \$1.7 billion before the crisis to \$5.7 billion during the crisis, with a substantial portion of the increase allocated for lending to public sector management (Figure 8).

Figure 8: ADB Approved Policy-Based Lending by Sector, before and during the Global Financial Crisis
(% shares)



Notes:

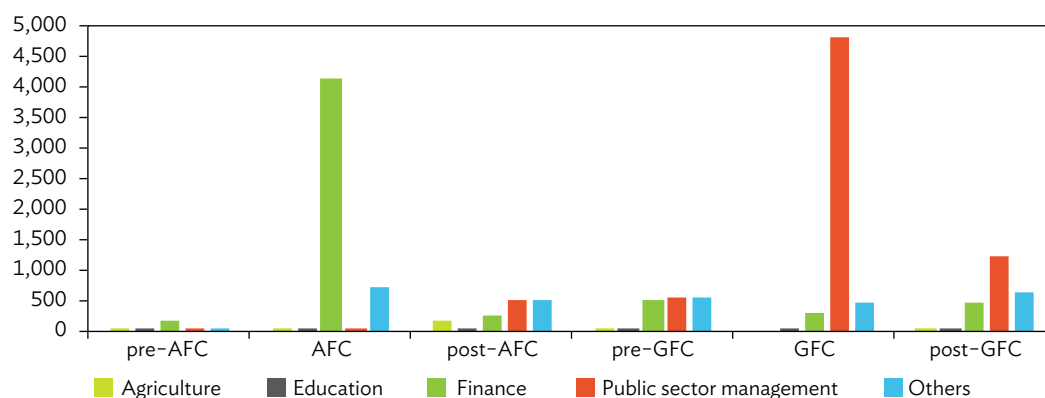
1. Data include policy-based lending financed from Asian Development Fund/concessional assistance and regular ordinary capital resources and are based on gross approved amounts.

2. Pre-global financial crisis corresponds to 1 January 2003–14 September 2008 and global financial crisis to 15 September 2008–31 March 2010.

Source: Asian Development Bank Independent Evaluation Policy-Based Lending Approvals Database (accessed September 2018).

In response to crises, ADB support comprising conventional and crisis-specific policy-based lending consists primarily of (i) support for the expansion of public sector management programs to mitigate the adverse social impact of crises; and (ii) support for financial sector and capital market development to further promote crisis prevention and long-term financial stability. In the aftermath of a crisis, assistance is provided in support of public sector management programs to relieve budgetary pressure on public finances, mitigating possible adverse social effects. At the same time, ADB efforts to prevent the future onset of crises and enhance financial stability constitute support for the provision of resources critical to sustaining long-term growth through the development of the financial sector and capital markets. During the Asian financial crisis, annual policy-based lending to the finance sector rose to \$4.1 billion from \$200 million prior to the crisis (rising from 58% to 83% of total policy-based lending during the time). Annual lending for public sector management likewise picked up, from \$51.8 million before the crisis to \$56.7 million during the crisis. A decade later, annual lending for public sector management dramatically increased during the global financial crisis (from \$542 million in the lead-up to the crisis to \$4.8 billion after its onset). At the same time, annual policy-based lending to the finance sector fell from \$511.6 million pre-global financial crisis to \$305 million during the crisis (Figure 9).¹¹

Figure 9: ADB Annual Approved Policy-Based Lending by Sector, Pre Asian Financial Crisis to Present
(\$ million)



AFC = Asian financial crisis, GFC = global financial crisis.

Notes:

1. Data include policy-based lending financed from Asian Development Fund/concessional assistance and regular ordinary capital resources and are based on gross approved amounts.
2. Pre-Asian financial crisis corresponds to 1 January 1992–1 July 1997. Asian financial crisis corresponds to 2 July 1997–31 December 1998. Post-Asian financial crisis corresponds to 1 January 1999–31 December 2002. Pre-global financial crisis corresponds to 1 January 2003–14 September 2008. Global financial crisis corresponds to 15 September 2008–31 March 2010. Post-global financial crisis to latest corresponds to 1 April 2010–30 December 2017.
3. Others includes energy, health, industry and trade, multisector, transport, and water and other urban infrastructure and services.

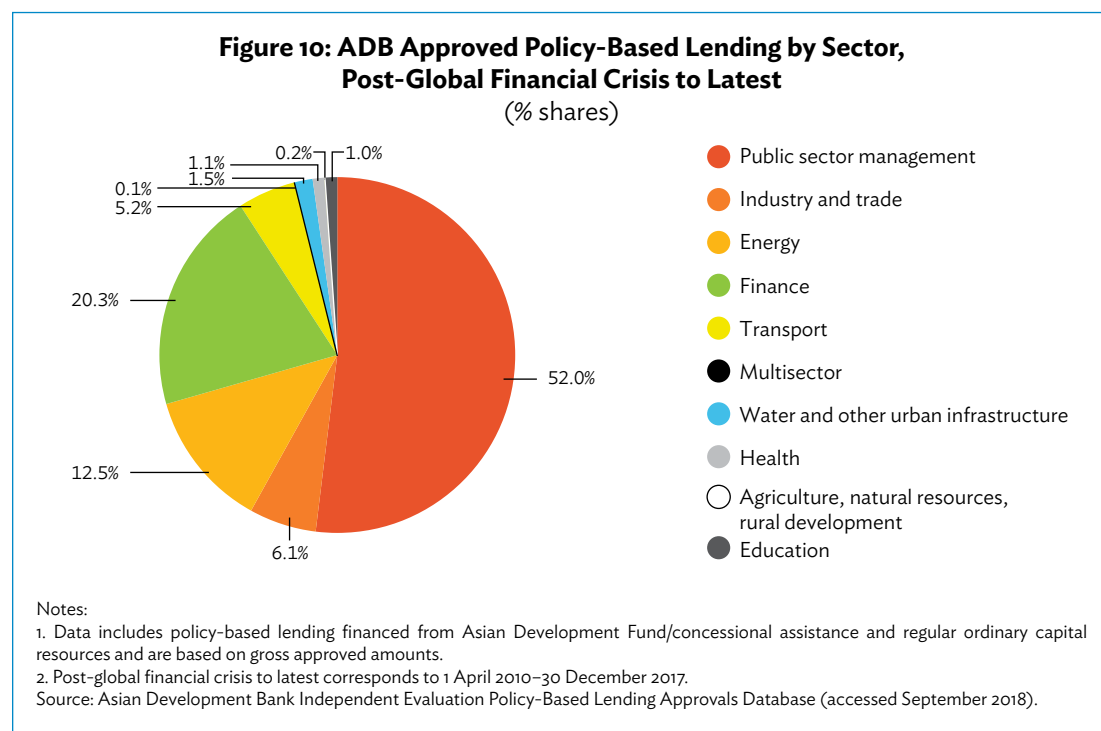
Source: Asian Development Bank Independent Evaluation Policy-Based Lending Approvals Database (accessed September 2018).

The success of policy-based lending—particularly crisis-related lending—increased from 2008 to 2017. In their 2018 evaluation of the development performance of ADB's policy-based lending, the Independent Evaluation Department (IED) note the doubling in the project success rate of policy-based lending from 2008 to 2017, increasing from 43% to 80%. Crisis lending, in particular, performed strongly during this period. The combined success rate of the fourteen crisis-related policy-based loans approved from 2008 to 2017 was 93%, in spite of disbursement delays that may have

¹¹ For a breakdown of ADB approved policy-based lending by sector and subsector before and during the Asian financial crisis and before, during, and after the global financial crisis, see the Annex.

impeded their overall effectiveness. By sectoral composition, the IED cites a dramatic improvement in the performance of loans supporting public sector management—rising from a success rate of 37% from 1999 to 2007 to an 88% rating from 2008 to 2017.¹² More broadly, the IED points to the positive results accompanying lending in capital market development and public sector management and characterizes overall policy-based lending support as highly relevant to developing member countries adversely affected by crises (ADB 2018).

In the post-global financial crisis period from 2010 to the present, ADB policy-based lending remains heavily concentrated in finance and public sector management. Annual policy-based lending from April 2010 to December 2017 amounted to \$2.4 billion. Of this, 52% (or \$1.2 billion annually) is accounted for by public sector management, encompassing funding for public administration, economic affairs management, public expenditure and fiscal management, and social protection initiatives. Such programs are geared toward building resilience to future economic shocks by improving public financial management systems, thereby enhancing social outcomes, strengthening poverty reduction, and achieving sustained economic growth. Policy-based lending in the financial sector accounts for the second highest share, comprising 20% (or \$479 million annually) of policy-based lending over the same time period (Figure 10). Efforts in the financial sector likewise reflect ADB's commitment to enhancing financial stability in the region.



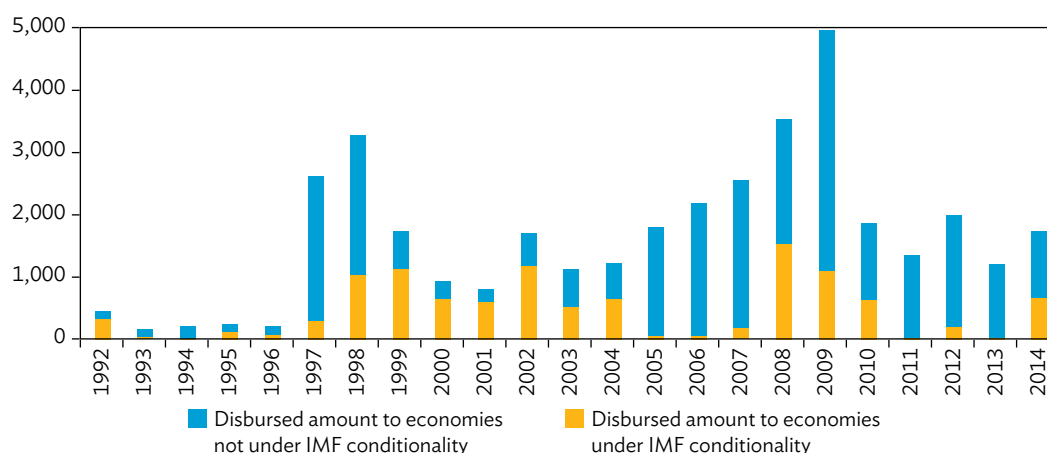
Despite successfully advancing the design and implementation of ADB's policy-based lending, important challenges remain. On the strategic design of ADB's policy-based loans, the IED identifies several potential areas for improvement. First, conventional PBL is primarily directed to developing member countries (DMCs) with comparably higher income per capita. Expanding

¹² The IED report cites two reasons for this sharp improvement: (i) increasing focus on public expenditure and financial management with policy actions within the direct control of finance ministries (the primary stakeholder in policy-based lending design); and (ii) reforms centering on finance ministries' technical areas of expertise (ADB 2018).

access of these loans to lower income countries could yield possible gains. Moreover, concessional assistance-only DMCs do not have access to emergency assistance instruments (i.e., CSF and SPBL), although these economies may potentially be in most need of support during crises. Second, there is a need to bring in line possibly competing short-term and longer-term objectives of conventional PBL. IED points to the possible incompatibility of pursuing longer-term structural reforms while also meeting urgent financing needs during crisis episodes under conventional PBL, which are also of longer maturity than crisis response instruments (ADB 2018).¹³

ADB has also played an important role in assisting economies subject to IMF conditionalities, illustrating the complementarity between ADB and IMF financing. Figure 11 highlights that a considerable amount of ADB disbursements of policy-based lending went to these member economies. This is especially evident during and after crises. In particular, after the outbreak of the Asian financial crisis in 1997, the proportion of policy-based lending disbursements targeted to economies under IMF conditionality rose from 11.3% in 1997 to 31.7% in 1998, before climbing to 65% in 1999, 69.6% in 2000, and 75.8% in 2001. Similarly, disbursed policy-based lending to economies under IMF conditionality increased following the onset of the global financial crisis, climbing from 7.5% in 2007 to 43.5% in 2008, 22.2% in 2009, and 33.9% in 2010.

Figure 11: ADB Policy-Based Lending to Economies under IMF Conditionality, Disbursed 1992–2014
(\$ million)



IMF = International Monetary Fund.

Sources: Asian Development Bank Controller's Department Database on Policy-Based Lending Disbursements (accessed December 2018); data from IMF Conditionality, 1980–2014 database published by Kentikelenis, Stubbs, and King (2016).

Consequently, ADB has become a crucial provider of complementary support to members experiencing crisis, mitigating potential negative social outcomes that put ADB's goals at risk. This underlines how ADB's assistance to crisis-affected economies both contributes to strengthening the regional financial safety net, and complements other layers, such as IMF global assistance. Empirical analysis of the effectiveness of IMF programs (and their associated conditionalities) has produced mixed results. Studies that assessed the impact of IMF funding on

¹³ While the Countercyclical Support Facility and special PBL have a maturity of 5–8 years including a grace period of up to 3 years, conventional PBL has a maturity of 24–25 years with a grace period of 5–8 years for concessional assistance and 15 years with a grace period of 3 years for non-concessional assistance.

economic growth found no significant impact—and in some cases, a negative impact—on later economic performance (Rittberger, Zangl, and Kruck 2012). And while the IMF (2017c) and Clements, Gupta, and Nozaki (2013) found that IMF programs have promoted social protection systems and improved public social spending, Stubbs and Kentikelenis (2017) found that IMF conditionalities decreased health expenditure—and more generally, that IMF fiscal adjustment policies are associated with a decline in social spending. Through its commitment to poverty reduction—and equipped with the necessary expertise—ADB can help fill this gap by providing complementary assistance to countries in need and by helping to mitigate adverse social effects stemming from crises (and possibly associated with implementing IMF conditionalities).

Since the Asian financial crisis, ADB has also actively supported regional economic surveillance through various initiatives. In the aftermath of the Asian financial crisis, ADB established the Regional Economic Monitoring Unit to support the ASEAN surveillance process. The unit was viewed as a key part of broader regional monetary and financial cooperation in East Asia and worked as an information exchange and surveillance system. It became the focal point for research on regional monetary and financial cooperation, with the policy and research focus centered on issues arising from cross-country regional contagion, shocks to the availability of international liquidity, the undeveloped nature of financial markets in the region, and the volatility of exchange rates and capital flows. In addition, ADB has highlighted the importance of strengthening the regional financial surveillance capabilities of AMRO.

ADB provides support to strengthen regional economic monitoring and surveillance in a broader effort to bolster the existing layers of global and bilateral surveillance. This allows:

- (i) frank information exchange and dialogue, which is better managed within a regional body where members have greater control than within global institutions such as the IMF;
- (ii) a well-synchronized exchange of information between the producer and user of data;
- (iii) greater specialization in regional economic conditions and development issues;
- (iv) greater willingness to pass information between countries that share common regional analytical filters; and
- (v) greater confidence in a regional analytical perspective that is deemed more congenial, credible, and useful (de Brouwer 2004).

ADB has shared these views as it participates regularly in ASEAN and ASEAN+3 surveillance processes.

Overall, ADB's support is complementary to other elements of the global financial safety net and plays a significant role in mitigating crisis impact on the economy, particularly for socially vulnerable groups, providing budget support for economic stabilization, and facilitating the needed reforms for long-term development. In the aftermath of financial crises and the lead-up to them, ADB has continuously demonstrated its commitment to supporting public sector management programs to mitigate the negative impacts of crises and to financial sector and capital market development efforts that lay the foundation for long-term financial growth and stability in the region.

4. Conclusions and Policy Considerations

A multilayered financial safety net system is increasingly vital to safeguard the region's financial stability and resilience amid increasingly integrated financial markets, regionally and globally. The Asian and global financial crises have underlined the risks of financial contagion that accompany greater financial interconnectedness and have highlighted the need for multilateral financial safety net arrangements. Most importantly, financial safety nets can provide additional liquidity in the face of a severe crisis. Financial safety nets can also help incentivize the adoption of good policies that could simultaneously mitigate the adverse impacts of financial volatility and prevent the occurrence of future crises.

Regional dialogue and cooperation in strengthening ex ante crisis prevention measures and ex post crisis support mechanisms is needed to bolster Asia's financial safety net and resilience to financial crises. In peacetime, supporting the surveillance function and capacity of the ASEAN+3 Macroeconomic Research Office is a key priority to more effectively monitor potential liquidity risks and prevent the outbreak of financial volatility—and therefore strengthen ex ante crisis prevention measures. In the aftermath of financial crises, the enhanced operability of the CMIM can translate into a more effective response to financial instability and thus serve as a powerful ex post crisis support mechanism. In particular, several options can be considered to strengthen the operability of the CMIM and bolster financial safety nets: (i) an increase in the CMIM's capacity (e.g., through paid-in capital and, subsequently, the possible leveraging of this through bond issuance); (ii) possible widening of the CMIM's mandate such as the recapitalization of systemically important financial institutions especially in light of the emergence of regional systemically important banks; and (iii) an increase in the CMIM's efficacy through an increase in the IMF de-linked portion, in line with AMRO's surveillance capacities. While the operability of the CMIM has yet to be tested, AMRO's surveillance function might have positively influenced and improved financial stability and resilience in its member economies.

Growing cross-border banking activities and the rise of big regional financial institutions—of potentially systemic importance—underline the need for greater regional cooperation and the widening of the CMIM's mandate to safeguard financial stability. In line with increasing financial integration, the cross-border activities of financial institutions are on the rise. In such a highly interconnected financial environment, the failure of a regional systemically important financial institution (SIFI) could have significant repercussions across Asia's economies. Regional policy dialogue and cooperation would be essential to address the potential impact and possible financial contagion incurred by a failure of a regional SIFI. In this context, an expansion of the mandate of the CMIM could also be considered. For example, the member economies need to discuss if the CMIM resources can be used to facilitate the resolution or recapitalization of a regional SIFI facing bankruptcy or a liquidity crisis. Supervisory colleges for regionally active foreign banks represent a viable option for promoting cross-border supervision in Asia.

Regional economic surveillance has come a long way but still needs to evolve with changing times. Within the context of the CMIM, it is essential that the focus of regional economic surveillance be narrowed so that it delivers a clear message to policy makers. In this regard, improvement of the data and methodologies and the use of objective indicators is essential. The scope of surveillance has to be expanded, as well, to not only cover the detection of vulnerabilities but also incorporate the preparation of crisis programs that can be triggered should a crisis occur. The CMIM should also move slowly into a due diligence exercise that can evaluate the request for financial assistance. In parallel, effective regional monitoring and surveillance mechanisms need to be in place to enhance the crisis prevention capacity of regional financing arrangements, in coordination with other global and multilateral surveillance bodies. Such coordination can build complementarity, avoid duplication, and build institutional mechanisms to carry out their surveillance mandate. The governance structure should also be built to protect candor and impartiality in conducting surveillance.

Amid growing financial interconnectedness and its associated financial spillovers and financial volatility, Asia also needs to cooperate better to boost financial resilience. To the extent global and regional integration bring negative spillover effects, a need exists to reinforce regional cooperation for monitoring macrofinancial conditions and improving financial sector regulations and policies to mitigate these spillovers. Large banks that are active internationally manage their assets and liabilities in multiple currencies and jurisdictions. As a result, new financial techniques are emerging to help them manage international collateral and liquidity. As collateral plays an important role in securing credit from central banks, the use of cross-border collateral arrangements can help them to deal with liquidity issues. Cross-border collateral arrangements in the region can allow regional central banks to accept foreign assets as collateral, so that banks can use collateral in one currency to obtain liquidity in another. This will help mitigate counterparty risks in financial market transactions for Asian banks.

Regional financing arrangements are an increasingly important layer of the global financial safety net given their local expertise and relative flexibility. The role of RFAs is evolving, and today not only entails the function of crisis mitigation, but also more generally the role of enhancing long-term financial stability. RFAs have become a more important complement within the global financial safety net, strengthening financial resilience and stability, not only in Asia, but also in other regions such as Europe or Latin America. The design of RFAs and their instruments should frequently be revisited to conform with recent trends, such as ever-growing financial integration, both regionally and globally.

However, considerable differences exist across subregions, even within Asia, in the establishment of RFAs. While there has been considerable progress in the ASEAN+3 region in establishing, developing, and strengthening regional financial safety net arrangements and regional efforts since the Asian financial crisis, this has not necessarily been achieved to the same extent in other subregions in Asia. Consequently, these differences point to an even more important role for ADB's support as part of the regional financial safety net across Asia.

ADB's crisis response facilities can complement existing regional and global financial safety net arrangements as they focus on mitigating the adverse social impact of financial crises. Through its policy-based lending to countries in times of need, ADB assistance represents an important layer of the region's financial safety net. As demonstrated during past crises, ADB support complements the IMF's, aiming to mitigate adverse social impacts during crises; and any potential negative effects accompanying IMF conditionalities.

Loans that address any negative social impact of a crisis and/or support postcrisis financial and capital market development are critical—this is reflected in ADB's policy-based lending, which increased substantially during past crisis periods. ADB provides support to economies

facing a crisis, mitigating the possible negative social impacts during times of volatility. This is primarily done through policy-based lending for public sector management. ADB's support also lays the foundations for enhancing long-term financial resilience, for example, through financial sector and capital market development programs.

Smooth coordination among IMF, ADB, and RFAs can mitigate the risks of moral hazard and ensure that crisis support and funding are most effective. In line with *G20 Principles for Effective Coordination Between the IMF and Multilateral Development Banks in Case of Countries Requesting Financing While Facing Macroeconomic Vulnerabilities* laid out in 2017, regular dialogue and close coordination between ADB and the IMF can help to ensure consistent policy signaling and can highlight potential areas for cooperation. More generally, the linkage of RFA and ADB lending with the IMF can help reduce moral hazard risks, and contribute to a more effective financial safety net, thereby enhancing financial stability and resilience in the region.

ADB needs to continuously develop and adjust its toolbox to changing circumstances surrounding the region. Given the role ADB plays in ensuring macroeconomic growth and financial stability in the region, it is critical that the technical, programmatic, and financial support it provides remains relevant to country needs and adapts to changing circumstances. In this regard, it needs to regularly review, revisit—and realign when needed—its instruments in line with regional and global developments.

Considerations to enhance the effectiveness of ADB's policy-based lending include the revisiting of access criteria for crisis support, especially for small low-income economies, and balancing the focus between long-term and short-term needs. For instance, member economies requesting assistance need to be at least ordinary capital resource-eligible to access emergency assistance, thereby potentially excluding economies most in need of support. Scope therefore exists to reconsider the means by which ADB can extend support to concessional assistance-only countries and more broadly ensure that proper safety nets are in place, including extending access to a countercyclical facility to concessional assistance-only DMCs. A recent evaluation (ADB 2018) also points to the fact that policy-based lending tends to be concentrated in economies with higher income per capita and stronger institutional policies. This in turn may undercut policy-based lending's ability to advance overall development in the region. Moreover, it is important to strike the right balance between longer-term structural reforms and urgent financing needs through policy-based lending.

ADB's role in crisis prevention and support during the crisis and postcrisis recovery can help advance the international Sustainable Development Goals. Given its commitment to the global partnership for sustainable development, ADB's crisis support facilities can play an important role in mitigating adverse social outcomes stemming from economic or financial crises, helping achieve the Sustainable Development Goals.

Emerging technological disruptions and innovations present new challenges to financial security and stability, calling for deeper regional policy dialogue and cooperation. Against the backdrop of continued and rapid technological advancement and the emergence of financial technology (fintech), digital assets like Bitcoin, blockchain, artificial intelligence, and the like, new challenges to financial stability and security are on the rise. Coordination and discussion among the region's policy makers are therefore needed to navigate the risks to financial security at present and prepare for challenges which may arise in the future. Regional development banks can moreover lead these policy discussions and knowledge exchange and help strengthen the region's capacity to secure financial stability.

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Appendix: ADB Approved Policy-Based Lending by Subsector, Pre-Asian Financial Crisis to Present

Sector	Subsector	Pre-Asian Financial Crisis		Asian Financial Crisis		Pre-Global Financial Crisis		Global Financial Crisis		Post-Global Financial Crisis to Present	
		Value (\$ million)	% of sector spending	Value (\$ million)	% of sector spending	Value (\$ million)	% of sector spending	Value (\$ million)	% of sector spending	Value (\$ million)	% of sector spending
Agriculture, natural resources, and rural development	Agricultural policy, institutional and capacity development	205	65	50	100	105	81				
	Agricultural production and markets	110	35			25	19				
	Land-based natural resources management									24	55
	Rural water policy, institutional and capacity development									20	45
Sector Total		315		50		130				44	
Education	Sector Lending as % of Total Policy-Based Lending		17		1		1				0.2
	Education sector development	7	100	19	100	58	60	115	100	140	76
	Secondary					39	40			25	14
	Technical and vocational education and training									19	10
	Sector Total	7		19		97		115		184	
Energy	Sector Lending as % of Total Policy-Based Lending		0.3		0.3		1		1		1
	Conventional energy generation										
	Electricity transmission and distribution					60	8				
	Energy sector development					100	13			400	17
	Energy sector development and institutional reform			300	100	600	79			1,800	78
	Renewable energy									100	4
Sector Total				300		760				2,300	
Sector Lending as % of Total Policy-Based Lending					4		8				13

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Table continued

Sector	Subsector	Pre-Asian Financial Crisis		Asian Financial Crisis		Pre-Global Financial Crisis		Global Financial Crisis		Post-Global Financial Crisis to Present	
		Value (\$ million)	% of sector spending	Value (\$ million)	% of sector spending	Value (\$ million)	% of sector spending	Value (\$ million)	% of sector spending	Value (\$ million)	% of sector spending
Finance	Banking systems					66	2				
	Finance sector development	700	64	5,417	88	1,001	34	320	68	1,945	52
	Inclusive finance					1,154	40			40	1
	Insurance and contractual savings			100	2	300	10				
	Money and capital markets	400	36	630	10	400	14			1,660	45
	Small- and medium-sized enterprise finance and leasing							150	32	70	2
	Sector Total	1,100		6,147		2,920		470		3,715	
Health	Sector Lending as % of Total Policy-Based Lending		58.3		83		31		5		20
	Health sector development and reform	50	100	4	1	200	100	110	68	197	100
	Health system development							9	6		
	Social protection initiatives			600	99			43	27		
	Sector Total	50		604		200		162		197	
	Sector Lending as % of Total Policy-Based Lending		2.6		8		2		2		1
	Industry and trade sector development	51	100							919	82
Industry and trade	Large and medium industries									125	11
	Small and medium enterprise development					278	100			75	7
	Sector Total	51				278				1,119	
	Sector Lending as % of Total Policy-Based Lending		2.7				3				6
	Multisector			20	100	2,010	100	534	100	27	100
	Sector Total			20		2,010		534		27	
	Sector Lending as % of Total Policy-Based Lending				0.3		21		6		0.1
Multisector											

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Table continued

Sector	Subsector	Pre-Asian Financial Crisis		Asian Financial Crisis		Pre-Global Financial Crisis		Global Financial Crisis		Post-Global Financial Crisis to Present	
		Value (\$ million)	% of sector spending	Value (\$ million)	% of sector spending	Value (\$ million)	% of sector spending	Value (\$ million)	% of sector spending	Value (\$ million)	% of sector spending
Public sector management	Decentralization					995	32	106	1	569	6
	Economic and public affairs management	5	2	40	47	891	29	4,995	68	2,482	26
	Law and judiciary							300	4	300	3
	Public administration	30	11	45	53	445	14	200	3	26	0
	Public expenditure and fiscal management	250	88			762	25	1,774	24	5,205	55
	Reforms of state-owned enterprises									603	6
	Social protection initiatives									345	4
Sector Total		285		85		3,093		7,375		9,529	
Sector Lending as % of Total Policy-Based Lending		15.1		1.1			32		85		52
Transport	Rail transport (nonurban)	80	100							250	26
	Transport policies and institutional development									700	74
	Urban transport			200	100						
	Sector Total	80		200						950	
Sector Lending as % of Total Policy-Based Lending		4.2		2.7							5
Water and other urban infrastructure and services	Urban policy, institutional and capacity development					5	9			266	100
	Urban water supply					50	91				
	Waste management							70	100		
	Sector Total					55		70		266	
Sector Lending as % of Total Policy-Based Lending							1		1		1
Grand Total		1,887.08		7,424.50		9,542.98		8,726.90		18,331.31	

Notes:

1. Data include policy-based lending financed from Asian Development Fund/concessional assistance and regular ordinary capital resources and are based on gross approved amounts.
2. Pre-Asian financial crisis corresponds to 1 January 1992–1 July 1997. Asian financial crisis corresponds to 2 July 1997–31 December 1998. Pre-global financial crisis corresponds to 1 January 2003–14 September 2008, and global financial crisis to 15 September 2008–31 March 2010. Post-global financial crisis to present corresponds to 1 April 2010–30 December 2017.

Source: Asian Development Bank Independent Evaluation Policy-Based Lending Approvals Database (accessed September 2018).

Strengthening Asia's Financial Safety Net

The 1997–1998 Asian financial crisis and the 2007–2008 global financial crisis highlighted the need for global and regional financial safety nets to safeguard financial stability and enhance resilience to future crises. Over the past decade, Asian economies have made progress in establishing financing arrangements to strengthen the region's financial safety net. These arrangements have enhanced regional macroeconomic and financial surveillance, strengthened crisis management, and bolstered cooperation for financial stability and resilience. This report examines the evolution and the toolkits of regional financing arrangements and assesses the Asian Development Bank's role in providing crisis response mechanisms through its policy-based lending facilities.

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ADB is committed to achieving a prosperous, inclusive, resilient, and sustainable Asia and the Pacific, while sustaining its efforts to eradicate extreme poverty. Established in 1966, it is owned by 68 members—49 from the region. Its main instruments for helping its developing member countries are policy dialogue, loans, equity investments, guarantees, grants, and technical assistance.



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