

Chapter 4: The Future of the International Financial Architecture in a Geopolitically Fragmented World

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The International Financial Architecture





The Global Financial Safety Net

The Global Financial Safety Net

▶ **What is the GFSN?**

- ▶ A collective set of mechanisms aimed at mitigating financial instability risks in an interconnected global financial system.
- ▶ A multi-layered system designed to prevent and respond to financial crises (Aiyer & Ilyina, 2022).
- ▶ Emergency liquidity provision during balance of payments issues, currency crises, or systemic shocks.

▶ **Components of the GFSN:**

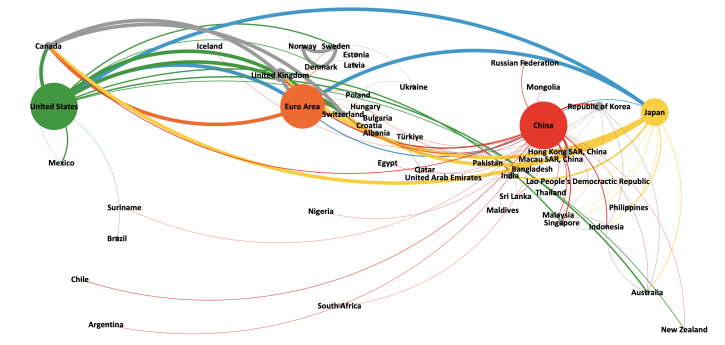
- ▶ Foreign Exchange Reserves
- ▶ Bilateral Central Bank Swap Lines
- ▶ Regional Financing Arrangements (RFAs).
- ▶ International Monetary Fund (IMF). Provides financial assistance on a global scale.

The Bilateral Swap Network: An Illustration

Figure III.F.5

Bilateral swap line networks, 2022

(Scaled by volume)



Source: UN/DESA based on IMF and the GFSN Tracker.

Note: Color coded as – US: green, China: red, euro area: orange, Japan: yellow. Swap lines between these countries are blue. All other countries are gray. The size of each bubble represents the total amount of swap lines in U.S. dollar terms. Line thickness is scaled by the volume of bilateral swap line, unlimited bilateral swap lines are set at maximum thickness.

Sources: Global Financial Safety Net Tracker.

United Nations, Inter-agency Task Force on Financing for Development, Financing for Sustainable Development Report 2023: Financing Sustainable Transformations. (New York: United Nations, 2023)

Central Bank Swap Lines/Repo Facilities

- ▶ **Benefits: Swap lines & Repo facilities offer emergency liquidity support during periods of market stress.**
 - ▶ Fed Swap lines (standing & temporary)
 - ▶ FIMA Repo facility
 - ▶ EUREP facility
- ▶ **Limitations: Uneven access to liquidity support:**
 - ▶ Major developed economies.
 - ▶ Excludes most EMDE access to dollar/euro liquidity.
 - ▶ Governed by closeness of economic/financial ties.
- ▶ **FIMA Repo:** emergency dollar liquidity access, broader set of countries during crises. Liquefy UST holdings.

The IMF, Reserves and Regional Financing Arrangements

- ▶ **The IMF is an indispensable component of the GFSN:**
 - ▶ Emergency financial assistance through various instruments during crises.
 - ▶ Challenges: Stigma, policy conditionality, governance & representational issues.
- ▶ **Reserves: Reserves offer immediate, self-insured support.**
 - ▶ primary **domestic defense** against liquidity shortages and speculative attacks.
 - ▶ Costs: low-yield assets, sterilization costs & inflationary pressures if inadequately sterilized.
- ▶ **Could RFAs gain traction?** In nascent stages, uncharted waters.
 - ▶ Several arrangements currently use USD as currency of choice.

The way forward in a geopolitically fragmented world

- ▶ The key mechanisms of the GFSN require **international cooperation** → mitigate future financial shocks & ensure a more resilient global economy.
 - Financial statecraft: Tools for global financial stability.
- ▶ **Chinese swap lines:** foster economic ties & enhance geopolitical leverage.
- ▶ Further fragmentation: will countries rely more on **self-insurance**?
 - Unlikely to be optimal globally as does not comprise cooperation/risk-sharing at supranational level.

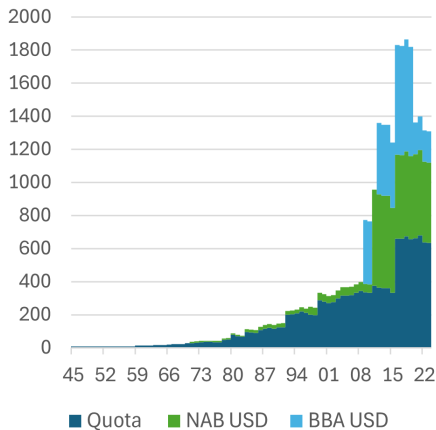
The background of the slide features a row of five globes, each showing a different hemisphere of the Earth. The globes are arranged in a slightly overlapping, receding line from left to right. The title text is centered over the middle of the globes.

The Multilateral Financial Institutions and International Forums

Geo-economic tensions come at a time when IMF lending capacity is under strain...and at a key moment for the IMF.

- ▶ IMF resources stand at 0.61% of world GDP.
- ▶ 16th quota reform expected to increase quotas by 50%. Agreed upon but not yet implemented.
- ▶ New Arrangements to Borrow (NAB) and Bilateral Borrowing Arrangements (BBA) are set to expire.

Figure 1: IMF resources



MFIs have adapted to changing global economic realities.....GEF will likely further complicate the governance landscape.

Figure 2: Deviation in pp in actual IMF quotas from IMF quota formula



Source: IMF finance department and authors calculations.

Sovereign debt restructuring



Sovereign debt restructurings and geoeconomic fragmentation

- ▶ **Sovereign debt restructurings are notoriously complex.**
 - ▶ Challenge: Absence of an international bankruptcy framework
 - ▶ Since the 1990s, a blueprint worked well for many years

Main reason: Paris Club

- ▶ **The system was also able to adapt to remain fit-for-purpose.**
- ▶ Geopolitical fragmentation makes **coordination among creditor nations more challenging.**
- ▶ This could...
 - ▶ Delay restructuring
 - ▶ Constrain lending capacity
 - ▶ **Increase the pressure for multilateral institutions to participate in debt restructurings**

Heightened Pressure in a Fragmented World

IFA was already facing **growing challenges**

- ▶ Systemic shocks like COVID-19 exposed the need for cross-border coordination and bigger lending capacity.
- ▶ Traditional multilateral bodies under strain. Traditional approach to debt restructuring inadequate.

Fragmentation puts **heightened pressure on IFA**

- ▶ Harder to achieve global agreements. **Erosion of IFIs and forums for economic decision-making.**
- ▶ ... could lead to a roll back of surveillance and coordinated financial sector policies.
- ▶ ... could weaken GFSN's credibility.
- ▶ ... and may lead to the GFSN being inadequately resourced or too slow to deploy.

→ A fragmented order **threatens the GFSN's ability to act as a global crisis backstop.**

Thank you!