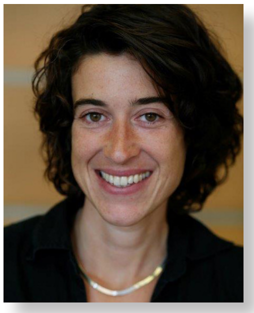
Towards the Marginalization of Multilateral Crisis Finance?

The Global Financial Safety Net and COVID-19

LAURISSA MÜHLICH, BARBARA FRITZ, WILLIAM N. KRING[1]



Laurissa Mühlich *accomplished her PhD in economics at Freie Universität Berlin and Yale University. She is research associate in the project team of the GFSN tracker. Her fields of expertise are development policy and development economics, international finance, and regional monetary cooperation.*

SUMMARY

On the eve of the COVID-19 crisis, the global financial safety net (GFSN) boasted more liquidity resources than at any other point in history. As the global economy entered a freefall due to the economic effects of the pandemic and efforts to stop the spread of COVID-19, both casual observers and experts were convinced that policy-makers had a broader range of institutions to draw on for international liquidity support than during the global financial crisis of 2008/9. Yet, increased resources of additional and reformed multilateral institutions for emergency liquidity have been surprisingly underutilized during the COVID-19 pandemic.

According to recently updated estimates from a new interactive database compiled by the Institute for Latin American Studies at Freie Universität Berlin and the Global Development Policy Center at Boston University, in 2018, the financing available from the fledgling GFSN had reached at least USD 3.5 trillion, or 4 percent of global GDP (Mühlich et al. 2020). Today, the IMF with its current one trillion lending volume is by far not the only actor to provide emergency liquidity. Further to the IMF, several regional financial arrangements (RFA) have been set up to provide crisis finance between neighboring countries or peers. Further, bilateral currency swaps between central banks of substantial volume have become an essential element of the GFSN landscape. While the level of support is larger than just a few decades ago, it is still less than one percent of total financial assets (FSB 2020).

This policy brief updates our analysis of the GFSN coverage in Mühlich et al. 2020 and explores the utilization of the GFSN during the COVID-19 pandemic in collaboration with the United Nations Conference on Trade and Development (UNCTAD). We find that newly created and reformed multilateral institutions on the global and the regional level – the IMF and the RFAs – have lent only a small

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Barbara Fritz *holds a joint appointment as professor at the School of Business & Economics and the Institute for Latin American Studies at the Freie Universität Berlin. Her fields of expertise are development economics and international macroeconomics, money and finance, with regional monetary cooperation as one research focus.*

William N. Kring *is the Assistant Director of the Global Development Policy Center, a university-wide center in partnership with the Frederick S. Pardee School for Global Studies. He previously was the Assistant Director and Research Fellow at the Global Economic Governance Initiative (GEGI).*

share of their available lending capacity in reaction to the COVID-19 shock until March 2021. While the RFAs have disbursed the paltry sum of about US $ 3.8 billion to member countries, the IMF has lent about US $ 108 billion, i.e. around 10 percent of its lending capacity. At the same time, the third element of the GFSN, bilateral swap arrangements between central banks, has provided much larger volumes of crisis finance liquidity. As of March 2021, about US $ 1.75 tr was accessible in bilateral central bank currency swaps. These swaps are being offered by a wide range of central banks, predominantly the US Federal Reserve (US FED) and the People's Bank of China (PBOC). So far, liquidity provision to prevent or backstop a financial crisis through the bilateral element of the GFSN, the currency swaps, has outpaced the multilateral realm by far. Voluminous as they may be, bilateral swaps lack the predictability and the transparency of multilateral lending: They are a discretionary element of the GFSN that is not provided at a level playing field but depending on the interests of the economically more powerful country involved in the bilateral arrangement.

The GFSN tracker

The GFSN tracker www.gfsntracker.com tracks the agreed amounts of IMF and RFA loans as well as active swap agreements between central banks for all UN member countries during the COVID-19 pandemic, starting February 2020. The GFSN Tracker forms part of a larger collaboration with UNCTAD, as part of the project: *Response and Recovery – Mobilizing financial resources for Development in the time of COVID-19*. It is the first and, to our knowledge, only COVID-19 tracking source that includes a regularly updated overview of all RFA loans and of central bank currency swaps disbursed in reaction to COVID-19. Numerous COVID-19 reaction tracking interactives have emerged since the pandemic hit. First and foremost, IMF, multilateral development banks and other lending institutions track their lending activities interactively themselves. Furthermore, more comprehensive overviews on countries' policy responses are provided, such as by the Yale School of Management for all countries or by the Center for Strategic and International Studies for specific regions or by the Bank for International Settlement for central banks' reactions in selected countries.

In contrast to other interactives, the GFSN tracker presented here covers all UN member countries, and focuses on the sources providing short term external liquidity provision at the global, the regional and the bilateral level, i.e. IMF, RFAs and central bank currency swaps as well as the countries that request external liquidity from those sources for crisis prevention and backstop. We provide information both on potential lending capacity and on actual utilization. Country specific information on approved loan amounts by RFAs and the IMF is constantly updated and shown in different interactive graphs and analytical categories. To our knowledge, the GFSN tracker is the only tracking exercise that provides real-time and comprehensive information on bilateral currency swap activities, based on current and publicly available information of the involved central banks (in contrast to historical data in the Council of Foreign Relations, Scheubel/Stracca 2019, Denbee et al. 2016).[2]

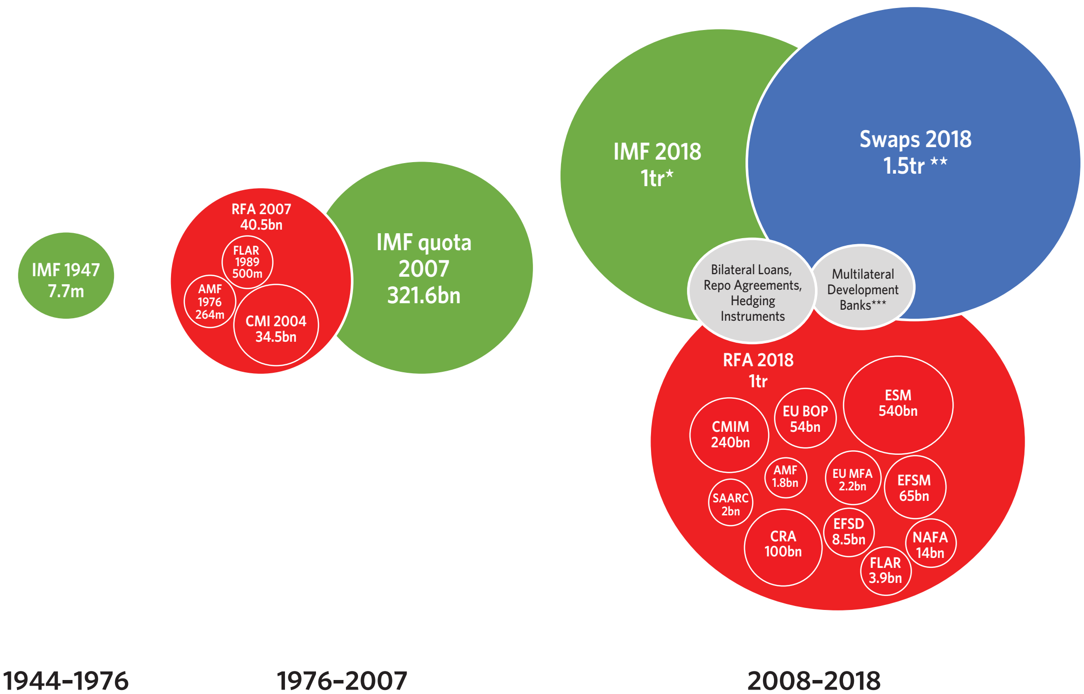
The Global Financial Safety Net on the Eve of the COVID-19 Crisis

In the decade preceding the COVID-19 pandemic, the GFSN evolved from one single global institution responsible for liquidity provision, the IMF, to a complex landscape of heterogenous actors. The GFSN is primarily comprised of the IMF, RFAs, and bilateral swap arrangements. When summed together, the estimated total lending capacity of the GFSN is USD $3.5 trillion. In April 2020, we

[2] For lending activities of the IMF and the RFAs, we resort to information publicly provided by these institutions. For swap activities between central banks, we resort on information published by the central banks of all UN member countries. Lending capacity of the GFSN is updated on a yearly basis.

argued that should the COVID-19 pandemic evolve into a systemic financial crisis (Mühlich et al. 2020), emerging market and developing economies (EMDE) may lack sufficient access to crisis finance. Our calculation showed that out of the USD $3.5 trillion in lending capacity in the GFSN in 2018, about three quarters of the funding, or USD $2.5 trillion, was designated to AE. This means EMDE can only access a quarter of the total lending capacity, or USD $1 trillion.[3] Hence, the GFSN as currently constituted does not meet the potential requirements to adequately respond to the financial necessities of EMDE resulting from COVID-19. The overhauling of existing IMF catastrophe lending such as the Rapid Financial Liquidity (RFC), the Rapid Credit Facility (RCF) and the creation of a new Short-term Liquidity Line (SLL) have not substantially changed this picture.

Figure 1: The Global Financial Safety Net: IMF, RFAs, and Swaps



Source: Authors' compilation (Mühlich et al. 2020).[4]

[3] This holds even if we count only the lendable liquidity of up to 30 % of a country's accessible financing of the Southeast Asian Chiang Mai Initiative Multilateralization (CMIM) and the BRICS' countries' Contingent Reserve Arrangement (CRA) that is not linked to an obligatory IMF program.

[4] AMF - Arab Monetary Fund; FLAR - Latin American Reserve Fund (according to its Spanish acronym); CRA – Contingent Reserve Arrangement of the New Development Bank; CMIM –Chiang Mai Initiative Multilateralization; SAARC - South Asian Association for Regional Cooperation Swap Arrangement; EFSD – Eurasian Fund for Stabilization and Development; NAFA – North American Framework Agreement; ESM – European Stability Mechanism; EFSM – European Financial Stabilization Mechanism; EU BOP – EU Balance of Payments Assistance; EU MFA – EU Macro Financial Assistance. The figures for CRA and CMIM include the total amount of accessible liquidity, including the 70 percent that are only available upon agreement on an IMF program. The lending capacity of the RFAs per country is calculated based either on the given maximum borrowing amounts, independent of the maturity, or the stated multiple of the paid-up capital for the maturity of one year – depending on each RFA's individual rules and regulations.

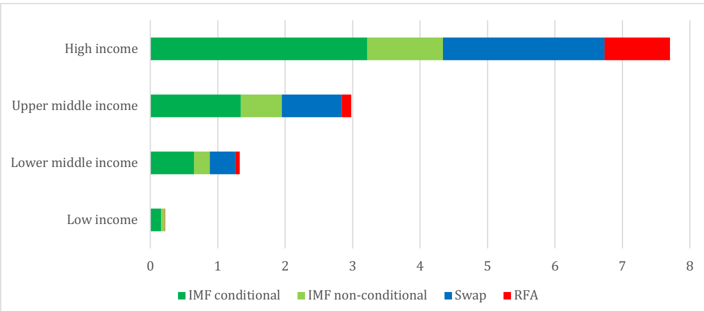
* Total resources stated by the IMF is SDR 978bn; lending capacity is stated to be SDR 715bn (about US$ 958.1bn) (IMF n.d.a). Authors' data sum up to US$ 927bn based on member country's quota under normal access (maturity of one year of 145% of paid in quota).

** Estimated volume for 2018, based on Denbee et al. (2016), updated by Essers/Vincent (2017). We follow Denbee et al. (2016) by assuming that the reciprocal nature of currency swaps among advanced economies requires counting each swap twice, and by assuming that the unlimited swap lines between the US Fed and the ECB, Canada, Japan, United Kingdom, and Switzerland can be estimated by the amounts drawn during the global financial crisis, which sums up to about US$ 600bn.

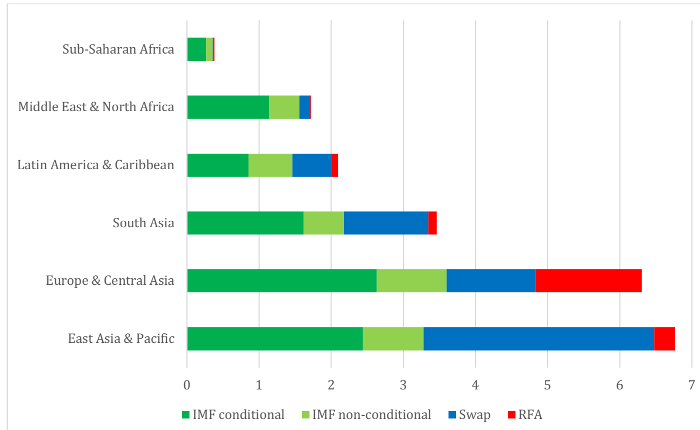
Figure 2 shows the lending capacity of the GFSN in 2020. IMF lending is displayed as non-conditional and conditional lending[5], RFAs, and central bank currency swaps. On the left side (fig. 2a), we see that, on average, the volume of potential liquidity access in percentage of GDP strongly correlates with the income level: the higher the income level of the country, the higher the volume of liquidity resources and the diversification of sources it has access to in the GFSN.

Figure 2: GFSN Lending Capacity 2020

a. By Income Group (percentage of GDP)



b. By region (percentage of GDP)



Source: Authors, based on data provided in www.gfsntracker.com.

Notes: Lending capacity on average per country for three years in 2020 as % of GDP weighted by GDP share. Includes only IMF-de-linked shares of CRA, CMIM equivalent to 30% of total lending capacity. Unlimited swaps are not included here; North America is not included in Fig. 2b.

When one considers the geographic distribution of the GFSN liquidity coverage, we find that Asia and Europe have the most robust liquidity coverage. Especially in Europe, RFAs constitute the largest of resources available to those countries. The geographic distribution shown in Figure 2b also demonstrates that, on average, a country in Sub-Saharan Africa; the Middle East & North Africa; and Latin America and the Caribbean has the least amount of crisis finance available to them in relative terms. This limited access to liquidity resources is especially problematic for those countries which have to cope with especially high decline in growth due to the COVID-19 shock, combined with rising corporate and public debt levels. The low income developing countries, concentrated in these regions, might rather need debt cancellation and grants (see also UNCTAD 2020). Latin America, with its relatively small regional RFA, the FLAR (see Mühlich and Fritz 2018) and central bank currency swaps exclusively only offered to the large EME in the region, such as Brazil, Chile and Mexico, belongs to the group of countries that have to rely almost exclusively on IMF financing in the case of balance of payments stress. In contrast, the emerging market economies (EME) in East and Central Asia, and the Euro member countries have access to relatively well-equipped RFAs and/or to central bank currency swaps.

Swaps with EMDE involved are counted once. When we apply these assumptions to our estimates for the year 2018, the amount of total active swaps sums up to about least US$ 1.5tr.

*** Several multilateral development banks (MDBs) have established credit lines for emergency lending during the global financial crisis (see Grabel 2017). In response to the COVID-19 pandemic, multilateral development banks set up temporary short-term liquidity access between US$ 1bn (European Bank for Reconstruction and Development), US$ 6.5bn (Asian Development Bank) and US$ 8bn emergency finance by the International Finance Corporation under World Bank's COVID-19 lending of about US$ 160bn.

[5] IMF lending without standard conditionality ("non-conditional") includes accessible liquidity under the Rapid Finance Instrument (RFI), the Rapid Credit Facility (RCF), the Flexible Credit Line (FCL), the Precautionary and Liquidity Line (PLL), and the Short-term Liquidity Line (SLL). IMF conditional lending includes accessible liquidity under the Stand-By Arrangements (SBA), the Extended Fund Facility (EFF), the Catastrophe Containment and Relief Trust (CCR), and the Extended Credit Facility (ECF).

Emergency Liquidity During the Pandemic: Multilateral Lenders Staying Behind

Our tracking of the lending activities of all GFSN institutions at the global, the regional and the bilateral level since February 2020 to March 2021 provides surprising results, regarding their intensity: Currently, the bilateral element, currency swaps between central banks, by far outshines the activities of multilateral institutions both the IMF and RFAs. While the latter have lent only a small share of their available lending capacity in reaction to the COVID-19 shock until March 2021, swaps further increased in number and volume, compared to their pre-crisis level.

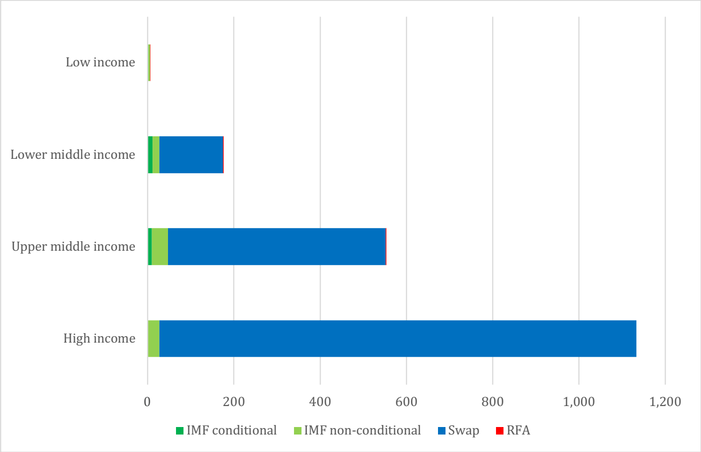
The IMF has lent about US $ 108 billion, i.e. around 10 percent of its lending capacity of 1 trillion; the RFAs have disbursed the paltry sum of about US $ 3.8 billion to member countries, of their 1 trillion lending volume. During this same time period, liquidity provided through swaps increased to about US $ 1.75 tr March 2021. These swaps are being offered by a wide range of central banks, predominantly the US FED and the PBOC, but, to a smaller degree, also by other advanced economies' central banks such as Japan, Great Britain, Australia, Sweden, Switzerland; even a few EME central banks have engaged in bilateral currency swaps.

Voluminous as they may be, bilateral swaps lack the predictability and the transparency of multilateral lending: They are a discretionary element of the GFSN that is not provided at a level playing field but depending on the interests of the economically stronger country involved in the bilateral arrangement, especially with regards to trade and financial ties, but also due to geostrategic issues (Aizenman et al 2011; 2021).

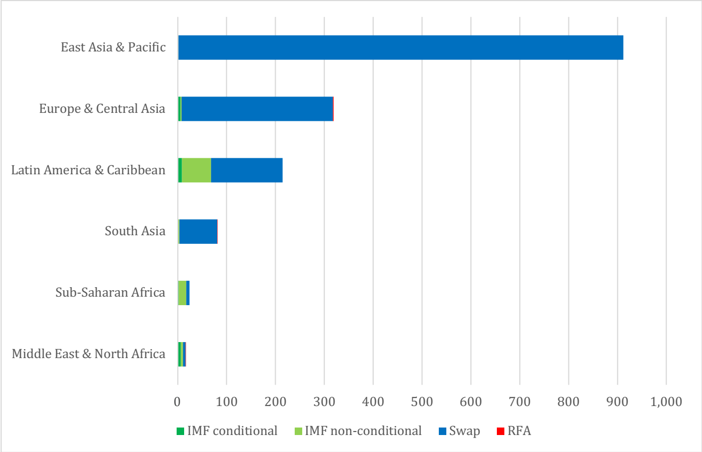
Figure 3 shows that liquidity provision during COVID-19 is strongly skewed towards higher income countries (Fig. 3a). When we break down lending during COVID-19 regionally (Fig. 3b), we also find resources to be unequally distributed. Central bank currency swaps were mainly offered in East and Central Asia and Europe. They are predominantly from the central banks of the US, China, Japan, Sweden, Switzerland; we also find a few cases of bilateral EME swaps (i.e. Qatar and Turkey, or South Korea and Indonesia).

Figure 3: GFSN lending during Covid-19 pandemic

a. By income group



b. By geographical region (in US $ billion, Feb. 2020 to March 2021)



Source: Authors, based on data provided in www.gfsntracker.com.

Notes: Unlimited central bank currency swaps are not included. Currency swaps between advanced economies (AE) are counted twice; and between EMDE once.

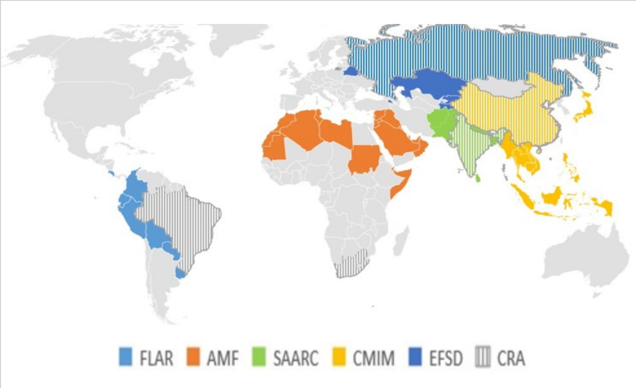
We also see that demand for IMF lending is mostly directed towards credit lines without standard conditionality, and concentrated, in most cases, on the new RFI and RCF lending facilities. Especially Latin American countries have been drawing intensively on these lines. Lending with standard conditionality, however, has been very scarce, and demanded in part by countries which already have been in negotiations for conventional IMF crisis lending before the pandemic broke out, or have prolongated earlier agreements with standard conditionalities.

The Role of Regional Funds in response to COVID-19

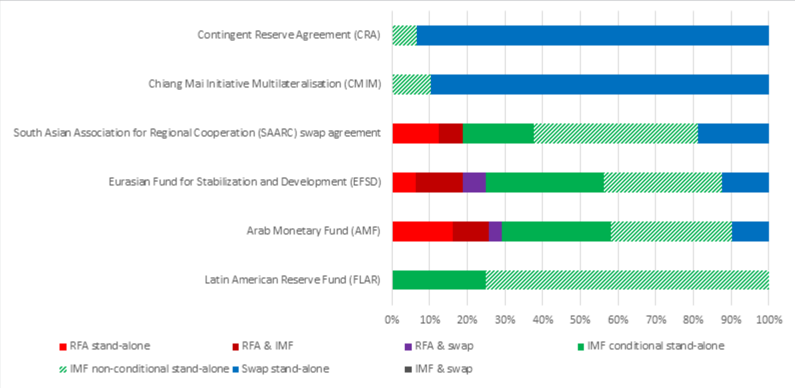
The currently existing six RFAs between EMDE comprise 61 countries. Figure 4a shows the geographical spread of the RFA membership. One of those RFAs, the CRA, is in fact the first trans-regional liquidity sharing mechanism that exists. Figure 4b shows the utilization of the RFA in the member countries' COVID-19 response, by number of loan or swap agreements. We see that the voluminous regional and trans-regional funds CMIM and CRA have remained untapped. Member countries resorted almost exclusively on voluminous bilateral central bank currency swaps. Further, those RFA, like EFSD and SAARC that provide substantial amounts of liquidity for some borrowing member countries were utilized several times, partly in combination with IMF programs and partly also in combination with bilateral central bank currency swaps. For the borrowing countries that requested their RFA, the latter substantially contributed to their COVID-19 response. Finally, out of the small funds AMF and FLAR, only the AMF was requested even though its overall lending volume can be considered too small for the majority of its member countries to respond to a crisis as a stand-alone source. AMF programs have been combined with IMF programs, most of them from non-conditional facilities and very selectively also in combination with central bank currency swaps. Hence, while large regional liquidity resources for EMDE have remained untapped, the agreed loans represent an important contribution to the crisis response of the borrowing countries.

Figure 4

a: Regional distribution of RFA between emerging markets and developing economies



b: Number of borrowing agreements per RFA February 2020 - March 2021 as share of total



Source: Authors, based on data provided in www.gfsntracker.com.

Lessons from the GFSN lending during COVID-19

Our tracking exercise thus suggests that despite a joint statement by the IMF and RFAs claiming that they "have been part of this strong, multi-layered response to the COVID-19 shock" (IMF 2020), multilateral lending has been minimal. The IMF and RFAs increased their financial support and adapted their lending policies, toolboxes, and internal procedures to expedite the provision of emergency support to their members. Yet, overwhelmingly, voluminous liquidity was issued to AE and EME and was issued bilaterally between central banks in the form of currency swaps to support financial stability.

The GFSN tracker provides important insight on the inequities and inefficiencies of the GFSN. More specifically, in the context of the COVID-19 pandemic, it highlights three key lessons on a potential marginalization of the once fundamental multilateral elements of the GFSN.

First, despite pledges of rapid and abundant responses of liquidity from the IMF and the RFAs, these institutions have seen little use throughout the crisis. This could potentially be the calm before the storm: at the time of writing, many EMDE have not lost access to capital markets due to a high market liquidity overall. Yet, this could change as debt levels continue to surge (Forni and Turner 2021). If demand for liquidity resources grows, poorer countries and the above mentioned regions less covered by the GFSN will struggle to find the required crisis financing.

Second, while RFAs and the IMF are multilateral institutions, the extent to which swaps have outpaced multilateral liquidity provision throughout the crisis raises questions about countries' confidence in these institutions' crisis resolution capacity. Further, it raises the specter of national interests increasingly influencing the crisis finance regime. While it is certainly premature to draw any conclusions about the GFSN, we might be observing also increasing geostrategic considerations behind this vast volume of bilateral liquidity support, which, in parallel to what is discussed as a global "vaccine diplomacy" (i.e. Jennings 2021), we might call a 'liquidity diplomacy'. The future will show if bilateral currency swaps between central banks could crowd out multilateral liquidity provision by the IMF and RFAs.

Finally, the most important lesson that the GFSN tracker suggests is that multilateral institutions need to become more attractive to member countries to prevent their marginalization. Maintaining choice and competition in the system is important to encourage better service delivery and enhance the bargaining power of governments regarding programs to return nations to stability and sustainability (Kentikelenis et al., 2016; Kring and Gallagher, 2019). At the same time, inequalities in access to and availability of short-term financing point to the uncoordinated status quo of the GFSN. Most importantly, uncoordinated surveillance and lending entails the risk of mistakenly categorizing a solvency crisis as a liquidity crisis (see for a comprehensive summary of the discussion Henning 2020).

In addition to the initial signs of cooperation between the IMF and RFAs (IMF 2020), such efforts need to be systematically widened in scope to swiftly be prepared for the potential storm after the calm beyond 2021. Similarly important, further reform is needed to IMF conditionality to regain utilization as a flexible, predictive and adequately conditioned crisis response mechanism besides regional and bilateral ones. In addition, safeguards must be put in place to ensure the RFAs not only benefit from collaboration with the IMF, but also maintain their autonomy and independence that is so highly valued by their member constituencies (Mühlich and Fritz 2021).

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