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Task Force 03
REFORMING THE INTERNATIONAL FINANCIAL ARCHITECTURE

Towards a More Robust and Equitable Global Financial Safety Net

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Abstract

The global financial system has been facing a series of challenges including high levels of indebtedness, climate shocks, inflation and higher-for-longer interest rates. In response, many have called for the international financial architecture to ensure a more equitable and resilient Global Financial Safety Net (GFSN), or sets of institutions tasked with providing emergency liquidity assistance to countries in need.

Given the IMF's vital role within the international financial architecture, a strong and effective GFSN with a quota-based International Monetary Fund (IMF) needs to be at the center of the Group of Twenty (G20) initiatives. While the IMF's 16th General Review of Quotas resulted in an increase of IMF quota resources to $960 billion, the additional resources will replace borrowed resources and thus the IMF's lending capacity will remain the same. Furthermore, the additional quotas are to be allocated equi-proportionally. Thus, the quota shares do not reflect the increased importance of emerging market and developing economies (EMDEs) in the global economy. These fundamental shifts in the global economy require an adjustment of the Fund's quota formula to ensure better access to resources and more equitable governance. Any new formula-based reallocation applies only to the incremental quotas. So, this expansion of quota resources, without any change in existing shares, will make future reallocation of overall shares even more difficult. The increase in overall shares would have to be even larger.

The G20 must issue a set of guiding principles for the IMF's 17th General Review of Quotas. As the IMF considers changes to the quota formula, the G20 has a key opportunity to ensure a continuation of IMF governance reform to increase the voice and representation of EMDEs and to safeguard the most vulnerable IMF members. Such a renewed multilateral push for quota and governance reform at the IMF will help to strengthen the Fund's legitimacy as a quota-based anchor of the GFSN, while also

ensuring that it is sufficiently resourced to tackle the unprecedented risks in the global economy.

Keywords: International Monetary Fund, Financial Crisis, Global Financial Safety Net

Challenge[1]

While the global economy has largely emerged from the COVID-19 crisis, countries continue to face a myriad of challenges including slower growth outlook, high levels of indebtedness, and climate shocks. Given its role as the center of the GFSN, the IMF has a vital role to play given its position within the multilateral system. (Ramos et al, 2023)

Despite the G20's longstanding call for a "strong, quota-based and adequately resourced IMF at its center" (G20 Communique, 2016), the 16th General Review of Quotas fell far short of expectations. Despite a much-needed shift towards permanent, quota-based resources and away from temporary sources of funding, the review concluded with no realignment of IMF quota shares. Thus, voice and representation at the IMF also continue to be disproportionately allocated to advanced economies. (Merling and Kring, 2023) Since quota allocations determine access to IMF resources, and there are significant gaps in the GFSN, advanced economies are significantly better insured as compared to emerging markets (Mühlich and Zucker-Marques, 2023). At the same time, advanced economies are least likely to require those resources.

The IMF and other components of the GFSN must balance their primary role of helping countries tackle balance of payment and debt crises, while also balancing longer-term challenges posed by climate change. The G20 must take proactive steps to ensure that the GFSN is sufficiently resourced, coverage gaps across the different sources of the GFSN are minimized, and multilateral institutions like the IMF are the primary sources of finance. The latter ensures transparency, predictability and common standards to ensure an efficient and coordinated GFSN that is prepared to tackle today's global challenges.

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[1] The opinions and thoughts expressed here reflect only the author's views.

G20's Role

The G20 is the preeminent forum for international cooperation on economic and financial issues. In particular, it was founded in the aftermath of the Asian Financial Crisis and has been the critical venue in which the GFSN is influenced by key policymakers. Given this focus of the G20, it must play a key role in setting the agenda for fundamental reform of the GFSN that is anchored by a more robust and equitably governed IMF. While the outcome of the 16th General Review of Quotas was disappointing with no realignment of voice and representation at the Fund, the 17th General Review of Quotas is envisioned to focus on realignment through a new quota formula (IMF, 2023a).

At the 2023 meeting of the G20 Finance Ministers and Central Bank Governors in Gandhinagar, India, Managing Director Kristalina Georgieva urged the Group to undertake the fundamental reform of international financial architecture as a key priority. While the global economy has expanded significantly since the creation of the post-World War II international financial architecture, the world faces new and increasing types of shocks but "resilience is not evenly distributed -- some countries are in a better position to protect their people than others." (IMF, 2023b)

In addition to the G20's critical role in setting the agenda for the international financial stability, it must play a key role in facilitating a commitment amongst the world's largest economies to fundamentally reform the GFSN. The G20 has consistently articulated its commitment to ensuring "a stronger global financial safety net with a strong, quota-based, and adequately resourced IMF at its center" (G20, 2020) Thus, the G20 must advocate for a stepwise increase of IMF resources; a realignment of its quota shares to improve voice and representation; and a multilateral approach to global liquidity provision.

Recommendations to the G20

In order to ensure that the Global Financial Safety Net is sufficiently resourced, quota based, equitably distributed, and provides voice and representation to all countries, this policy brief makes the case that the G20 must call for: (1) a stepwise increase of the IMF's resources; (2) a realignment of IMF quota shares to improve voice and representation and (3) a multilateral approach to global liquidity provision. The G20 must play a key role in building political consensus on the reform of the GFSN that incorporates these key pillars.

1. A Stepwise Increase in the IMF's Resources

The lending capacity of the IMF has failed to keep pace with the growing dynamism of the global economy relative to numerous benchmarks, such as global trading volumes, global assets, and global GDP. (Kring and Gao, 2023; Merling and Kring, 2023; Mohan, 2020) The IMF's US $1 trillion in lending capacity represents just 30 percent of the GFSN's US $3.5 trillion in total lending capacity and is insufficient relative to potential borrowing needs across the global economy in a time of systemic crisis, as it is equivalent to only 1% of global non-bank financial assets as of 2022. (Mühlich et al, 2022)

In order for the IMF to effectively anchor the GFSN as the primary multilateral international lender of last resort, it must be adequately resourced and quota-based. (Kring and Gao, 2023) Yet the 16th General Review of Quotas left unchanged the IMF's lending capacity at US$ 1 trillion, or approximately only 1 percent of global GDP. A stepwise increase in the IMF's lending capacity is urgently needed to ensure that the GFSN is anchored by a credible and sufficiently resourced IMF.

An innovative paper by Mühlich and Zucker-Marques (2023) estimates that if the IMF were to have sufficient quota-based resources to cover the gross external financing needs of the most vulnerable countries, the IMF's quotas would need to increase by more than US $1 trillion, i.e., a doubling of the quota resources. This quota increase would also enable a significant shift in quota and voting shares of EMDEs. Resources within the IMF could also be put to better use to enhance global financial stability. Ocampo (2017) notes that with the exception of Portugal, Greece, Ireland and Iceland during the 2007-8 North Atlantic financial crisis, advanced economies have not turned to the IMF for funding. Increasingly, advanced economies have turned to bilateral swaps between their central banks or built their own bailout mechanism, as is the case with the European Stability Mechanism. Mühlich and Zucker-Marques (2023) posit that these untapped IMF resources could be reallocated to fund increases in lending for emerging markets and developing economies.

The US $1 trillion fire power of the IMF is unimpressive relative to the potential financing needs of the global economy. (Mühlich and Zucker-Marques, 2023) Thus the G20 has the opportunity to call for a stepwise increase in Fund resources dedicated primarily to providing financing in times of crises to developing economies and to respond to systemic global financial crises.

2. Realignment of IMF Quotas Shares for Voice and Representation at the IMF

In addition to the urgent need to scale up IMF funding, it is timely for the IMF to fundamentally reform governance following the 16th General Review of Quotas. Despite repeated calls for a realignment of quota shares (G-24 2023, Kring and Gao, 2023, Merling and Kring 2023, Merling 2022, González 2022), quota shares remain out-of-line with the increased economic weight of dynamic EMDEs.

Despite generating 58 percent of global GDP PPP adjusted and being home to 86.4 percent of the world population, “emerging market and developing economies hold 40.9 percent of votes and 38.6 percent of quota shares” at the IMF. (Merling 2022) Likewise, G-24 countries account for nearly 40 percent of global GDP PPP adjusted and yet have just 20 percent of quota shares at the IMF. (Merling and Kring, 2023) Because quota shares determine the allocation of voting power at the Fund, this means that the voting power and influence on Fund decision making disproportionately rest in the hands of the advanced economies, or those least likely to turn to the IMF for support. (Kring and Gao, 2023; Merling and Kring, 2022)

The 16th General Review of Quotas took a much-needed step forward in strengthening the resource base of the IMF through an increase in permanent-quota based resources. However, because IMF shareholders again delayed a fundamental reallocation of voting

power to ensure equitable voice and representation, the new quota resources are equi-proportionally allocated. As a result, out-of-lineness at the IMF has been further solidified, as any future quota allocations, even if they are distributed in-line with economic weight, will represent a smaller share of total quota shares.

In concluding the 16th General Review of Quotas, the IMF pledged to reform the quota formula that determines the allocation of quota shares in the 17th General Review of Quotas. The G20 countries must ensure that the IMF honors this commitment and fundamentally revises the quota formula in order to realign quota and voting shares to today’s economic reality.

3. Fostering a multilateral approach to the GFSN

As the global financial safety net has evolved, RFAs have become critical components of the crisis finance regime. In the last decades, many countries have taken significant steps to enhance the resource base of RFAs and to broaden their mandates. (Kring and Gallagher, 2019) As a result, the collective resource base of RFAs has come to rival that of the Fund, with RFAs lending capacity matching the IMF’s US$1 trillion lending capacity. (Mühlich et al, 2022) And RFAs have also developed new capacities, such as the robust country-level and regional surveillance protocols developed at the Chiang Mai Initiative Multilateralization’s ASEAN+3 Macroeconomic Research Office (AMRO).

Despite the increase in resources at the regional level, the GFSN resources remain inequitably distributed: access to currency swaps is not available to many developing economies, RFAs do not cover all regions and there is significant variation in the scale of funds available to countries that have access to RFA funds. (Kring, forthcoming) Data recently released from the GDP Center, Freie Universität Berlin and United Nations Conference on Trade and Development (UNCTAD) reported in the Global Financial Safety Net Tracker find that lower- and upper middle-income countries, in particular in Africa, have the least access to liquidity resources across the GFSN and higher-income countries have disproportionately higher access to finance: www.gfsntracker.com. (Mühlich et al, 2023)

Thus, further steps should be taken to enhance the coverage and integration of the GFSN. The IMF and RFAs, within their respective mandates, should broaden their engagement to ensure better coordination of the GFSN lending practices in an effort to “reduce the transaction costs both for borrowing countries and institutions” (Mühlich et al, 2022) of obtaining and providing liquidity finance. One potential avenue for greater efficiency could be improvements to the policy coordination instrument (PCI) at the IMF, such that countries could potentially bridge funding using multiple sources of financing from the GFSN.

Finally, data on the utilization of the global financial safety net from the COVID-19 period and its aftermath demonstrate that bilateral swap arrangements were more widely used than multilateral financing from the IMF or RFAs. (Mühlich et al, 2023) While bilateral swaps help to fill critical gaps in the GFSN distributional coverage and scale of available resources, the more the bilateral swaps become the primary source of global liquidity financing, there is a potential for a decrease in multilateral engagement for crisis response. The G20 must acknowledge the benefits of countries that provide bilateral swaps, but reiterate the need for a truly multilateral crisis finance regime with a better-resourced and more representative IMF as its anchor.

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