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THE POST-PANDEMIC G-20 ROLE IN THE GLOBAL FINANCIAL ARCHITECTURE

Relevant for: International Relations | Topic: G20

G-20 leaders must rally institutions and coordinate efforts like they did in the last global crisis to fight off the current one

The 15th Summit of G-20 leaders was scheduled to take place virtually over the weekend in Saudi Arabia. Among the several important issues expected to be on their agenda was the health of the extant Global Financial Architecture (GFA) in addressing the covid-related economic crisis. Reshaping the GFA, along with tightening financial regulation, was one of the big challenges before G-20 leaders when they first met in the wake of the Global Financial Crisis (GFC) of 2008-09.

Since financial markets in emerging economies were already fairly tightly regulated, they were not too heavily engaged in the intense G-20 debates over financial regulation, but they took a keen interest in the debates over GFA reform.

This architecture can be seen as a triptych, with international capital markets dominated by advanced economies in the central frame, bilateral and multilateral assistance on which developing countries were dependent for balancing their current accounts on one side of it, and the large self-insurance mechanism of foreign currency reserves of major emerging economies on the other side.

Emerging economies had long accessed international capital markets for commercial borrowings and private equity flows. These markets, however, exposed them to the vagaries of shifts in US Federal Reserve policies, sudden stops and balance of payments (BoP) crises. This is what happened during the Latin American debt crisis of the 1980s, India's BoP crisis of the early 1990s, the Asian financial crisis of 1997, and the GFC.

The resources of multilateral financial institutions (MFIs), however, did not grow in tandem with their external financing needs, as the fiscal space of their advanced-economy donors shrank with their declining trend growth. International Monetary Fund (IMF) procedures were also not considered nimble enough, and following the Asian financial crisis, they became wary of the stigma effect of IMF packages on markets that raised their borrowing costs. Emerging economies consequently built up their own self-insurance mechanism of foreign currency reserves, aided by a strategy of export-led hyper growth. Low income and Latin American countries, though, continued to depend on MFIs.

The G-20 strengthened the firepower of MFIs to deal with crises, and marginally enhanced the representation of emerging economies in the IMF's governance structure. Emerging economies, however, were not the direct beneficiaries of the enhanced global safety net to which they contributed, as this was mostly used to bail out countries in the European Monetary Union. The IMF was also nudged towards streamlining its crisis lending protocols by mitigating the stigma effect and becoming nimbler in providing liquidity in future crises.

One of the surprise outcomes of the GFC was the emergence of the US Federal Reserve, issuer of the world's de facto reserve currency, as a major pillar of the GFA. It was the Fed that first got off the block in providing global liquidity during the GFC, well before the IMF, through swap arrangements with major central banks that offered them standby dollar funding. These swaps

were mainly for major allies of the US, though, and not for poorer countries, which stayed dependent on multilateral and bilateral aid.

Back then, the G-20 was of the view that the robustness of its reinforcement of the GFA and its reforms in the area of financial regulation would be tested in the next crisis. That crisis is upon us now. The financial system has held up quite well so far, aided by a strong monetary response by central banks through the lowering of interest rates, liquidity provisions and asset purchases.

As it did during the GFC, the US Fed has made dollar funding available to other central banks during the ongoing covid crisis. In addition to extending the maturity of its existing swap lines to central banks in Canada, England, the Eurozone, Japan and Switzerland, it has also extended fresh swap lines to the central banks of Australia, Brazil, Denmark, Korea, Mexico, New Zealand, Norway, Singapore and Sweden.

The IMF has been more nimble in providing assistance during the current crisis. Of the roughly $150 billion mobilized as emergency multilateral assistance for covid-19 to date, about two-thirds has come from the IMF. Another 25% has come from the Asian Development Bank and European Bank for Regional Development, for Asia and poorer European countries respectively. Whereas during the GFC much of the IMF lending had gone to European countries, this time round, over 90% has gone to the western hemisphere, which is worst affected by covid, Sub Saharan Africa, the Middle East and Central Asia.

Both Asia and Europe now appear to be less dependent on the IMF for crisis support, the mantle having devolved upon regional multilateral institutions. These are the Asian Development Bank, The Asian Infrastructure Investment Bank, and the New Development Bank in Asia. The European Stability Mechanism and the European Central Bank play a similar role in Europe.

However, the continued inability of Asian countries to unlock their vast foreign currency reserves by operationalizing their regional financial safety net through the Chiang Mai Initiative Multilateralization has been a major failure of the GFA during the current crisis. Over the weekend, the G-20 took the initiative to suspend debt repayments by poor countries during the pandemic and pressure MFIs to use their existing tools and resources effectively.

The covid pandemic, however, is by no means under control. If it were to escalate, the G-20 would be expected to further bolster the extant GFA. The environment of global economic governance has changed vastly since the early G-20 summits. Sentiment across the world has turned sharply against globalization, and US President Donald Trump skipped the latest summit's covid session. The G-20 might remain the most effective extant international institution to address the challenges that arise from globalization, which willy nilly continues its inexorable march, the rise of nationalist sentiments notwithstanding.

Unfortunately, global cooperation of the kind seen at the time of the GFC a little over a decade ago still looks difficult in the current environment, unless the incoming US President takes the nationalist bull by the horns.

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