T20 Policy Brief

Task Force 03

REFORMING THE INTERNATIONAL FINANCIAL ARCHITECTURE

Addressing the Uneven Geographical Coverage and Coordination Issues of the Global Financial Safety Net

Artem Levenkov, Head of Socioeconomic Analysis Department, Eurasian Fund for Stabilization and Development (Regional)

Gennady Vasiliev, Head of Partnership, Eurasian Fund for Stabilization and Development (Regional)

Aleksandra Morozkina, Deputy Dean, Higher School of Economics (Russia)

Mariam Voskanyan, Lecturer, Russian-Armenian University (Armenia)

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Abstract

The global financial safety net (GFSN) is an essential pillar for supporting a well-functioning international financial architecture.

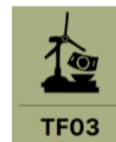
There are two challenges for the GFSN: the uneven geographical coverage and the provision of efficient coordination between its elements.

First, the uneven and geographically fragmented coverage of the GFSN's regional layer remains an issue. Regional financing arrangements (RFAs) are currently operational in Asia-Pacific, post-Soviet Eurasia, Europe, Latin America, and the Middle East. Effectively, the RFAs currently do not cover most of Africa, including Sub-Saharan Africa, as well as significant parts of Eurasia and Latin America, while all of these regions and sub-regions are prone to sizeable shocks.

These challenges should be addressed by the variety of measures to be discussed in the policy brief. They include the following. First, defining the taxonomy of instruments and resources. Second, increasing the capacity of the regional GFSN layer (RFAs). Third, widening geographical coverage of existing RFAs as well as, specifically, establishing an RFA for Africa. The G20 could review stabilization financing that is channeled through the non-GFSN institutions and consider an optimal allocation of resources between GFSN and other mechanisms.

Second, coordination should be further enhanced both within GFSN and with other sources of stabilization financing, such as multilateral development banks. There are several low-hanging fruits within the GFSN coordination agenda. E.g., timely data collection and public availability are prerequisites for monitoring coverage and enhancing convergence of approaches. It will in turn help prevent overlaps and facility shopping. We suggest organizing data collection on a more regular and timely basis with due attention to an immediate public accessibility of data.

Keywords: Global Financial Safety Net; international financial architecture; regional financing arrangement; development financing.



Diagnosis of the issue

Countries confront economic and financial threats emanating from multiple global shocks, including a subdued global economic recovery from the COVID-19 pandemic, increased debt vulnerabilities in low- and middle-income countries, tighter financial conditions, climate risks, and geopolitical tensions. The multiplicity and simultaneity of the problems, as well as the increased risk of geo-economic fragmentation, severely limit countries' ability to respond to these challenges. To manage the threats, domestic policies and financial mechanisms should work together with the GFSN. In light of the above, there is an unprecedented need for a strong GFSN to facilitate a socially, environmentally, and economically sustainable growth path which is essential to achieve the Sustainable Development Goals (SDGs) and deal with the increasingly urgent climate needs.

The G20 has been reiterating its commitment for strong and coordinated GFSN. The GFSN is an international multi-level system of financial institutions that provide financial support to countries in the event of a crisis or to prevent it. The GFSN has four elements: international reserves assets, bilateral central bank swap lines (BSAs), regional financing arrangements (RFAs), and the IMF, the global lender of the last resort (Vinokurov et al., 2022).

The GFSN has grown significantly since the global financial crisis, reflecting the continued accumulation of reserves and expansion of the official bilateral and multilateral arrangements. It has reached USD 3.7 trillion or 4.5% of global GDP – at its peak since the COVID-19 pandemic in April 2021 (Mühlich et al., 2022), but it is still less than one 1% of the global financial assets in the same year (FSB, 2020). More than half of the world’s economies have access to only one element of the GFSN: the IMF. However,

most countries would need to have access to several components of the GFSN to reliably cover their financing needs, which could probably raise coordination issues.

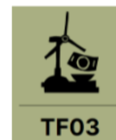
BSAs became one of the central elements of the GFSN, especially after COVID-19. The extension of BSAs supported financial markets and helped ease international liquidity pressures. Since the beginning of the COVID-19 crisis, the US Federal Reserve, European Central Bank and People's Bank of China have expanded the set of countries they offered bilateral swap arrangements.

The lack of aggregated project data also creates risks for the GFSN as it complicates coordination efforts of institutions involved. ESFD has established a database on sovereign financing in Eurasian region, however, there is a need in a more comprehensive dataset. In this regard, the first step is a common taxonomy of GFSN instruments.

RFAs emerged as a regional line of defense in the safety net to assist in safeguarding financial and economic stability, having detailed expertise on the features of member economies and the region as a whole. For instance, from the GFC we have seen the establishment of the new RFAs with large lending capacity as well as the strengthening of existing institutions. RFAs are currently operational in Asia-Pacific, post-Soviet Eurasia, Europe, Latin America, and the Middle East. Since the beginning of COVID-19, RFAs have been assisting their member states. Overall, in Eurasia EFSD approved nearly the same amount of stabilization financing from the year of its establishment as the IMF did (Vinokurov et al., 2023). The measures were broadly of two types: financing their members through different lending modalities and timely economic monitoring and provision of technical assistance. Among existing RFAs, the Arab Monetary Fund and Eurasian Fund for Stabilization and Development (EFSD) provided financial support to member countries, partly in parallel with the IMF (Vinokurov et al., 2021).

RFA institutions do not cover most of Africa, including Sub-Saharan Africa, as well as significant parts of Eurasia and Latin America, while all of these regions and sub-regions are prone to sizeable shocks. For instance, the absence of this financial stability mechanism leaves indebted African countries to struggle with debt distress and other challenges with lesser capacity than other regions.

Failing to solve the issue of uneven geographical coverage may lead to shortfall in inclusive stabilization, failure to address macrostabilization and other emerging issues, such as climate, in many lower-middle and low-income economies.



Recommendations

For taxonomy purposes, we tag with “stabilization financing” operations that provide budget or balance of payments support. The universe of institutions that we consider in the taxonomy are two. First, conventional elements of the GFSN – international reserve assets, swap lines, regional financing arrangements, and the IMF. Second, the other institutions that extend stabilization support in various forms: Multilateral Development Banks (MDBs), bilateral sovereign borrowing and debt reliefs, and bilateral agencies.

The classification has a synthetic nature. The cornerstone of classification is the IMF toolkit (IMF, 2019). The justification behind this approach is the fact that the IMF is in the center of the GFSN, according to the G20 concept, as well as that the IMF suggests the most comprehensive logic for the cases of support needed. In addition to the IMF methodology, the authors enriched the concept with other non-GFSN practices that include MDBs and bilateral support. The authors also relied on the suggested RFA toolkit classification (Cheng et al., 2020).

TABLE 1. Taxonomy of stabilization support instruments and sources

Grouping / criteria	**Types**
Instruments	
Type of Financing	Grants, market-based loans, concessional loans, non-financial
Type of Challenges	Liquidity support, policy support for short-term adjustment, sector-specific support adjustment of protracted challenges,
Requirement of a Financing Gap	Identified gap is required, Identified gap is not required
Mode of Disbursement	Single-tranche, multi-tranche, credit line
Non-Financial Conditionality	Non-conditional, macro framework, economic policy framework, non-economic conditionality
Application of Non-Financial Conditionality	Ad hoc, ex-ante
Disclosure regime	Provided on a confidential basis / disclosed
Sources	
Type of Institution	1. GFSN a. Multilateral b. Bilateral 2. Non-GFSN a. Multilateral b. Bilateral
Source of Financing	Market financing, mix strategy, contributions only, direct budget support, central bank funding (currency swaps)

Source: authors

Type and Source of Financing criteria are closely interlinked. In some cases, sources of financing are applied flexibly based on a recipient-country income group and /or debt sustainability. E.g., this approach is used by the IMF, the EFSD, the Asian Development

Bank, and the International Bank for Reconstruction and Development. In other cases, the terms of financing are market-based with no concessional window in place for recipient-specific adjustment of borrowing terms.

In the Type of Challenges criterion, the authors distinguish between the range of instruments starting from swift support in case of a liquidity crisis up to comprehensive programmes aimed at elimination of protracted imbalances, resolution of challenges that require a multi-year adjustment agenda.

Requirement of Financing Gap criterion distinguishes instrument that is applied only when their assessment justifies that a recipient-country experience budget and/or balance of payments needs. In order to use this instrument an institution usually possesses a diagnostic toolkit that allows estimating the financing gaps and debt sustainability. The authors view this criterion as a distinctive feature for an institution whose core mandate is assisting in safeguarding financial and economic stability.

Non-Financial Conditionality criterion looks at how the provider of support frames the financial assistance. Depending on an arrangement, conjuncture in recipient-economy, and type of economic shock, different conditions may apply. The authors also distinguish a non-economic conditionality that may reflect political, security or other motives. However, it is difficult to detect non-economic conditionality since it is generally non-observable in formal public documents.

Several RFAs have limited coverage or no coverage. For instance, the Latin-American Fund (FLAR) does not cover several large regional economies, such as Argentina and Brazil. EFSD also lacks large regional members, such as Uzbekistan and Turkmenistan. The African region is not covered by an RFA at all.

A proposal to set up a stability mechanism for Africa is not new. The mechanism is required in order to take into account regional challenges in economic growth and

development. The African continent is an extremely diverse region, which consists of 54 countries with different levels of development and various macroeconomic challenges. As most countries in the world, African countries showed some decline in economic growth during the COVID-19 shock in 2020, however, they rebounded in 2021 and 2022 (Figure 1a). African Development Bank estimates real GDP growth at 3.2 % in 2023 and projects growth for 2024 at 3.8 % (AfDB, 2024). In terms of SDGs, most of African countries are far from achieving them, as out of 46 least-developed countries, 29 are situated in Africa. As per the latest data on poverty, 57% of the world's poorest live in Sub-Sahara Africa, which amounts to 397 mln people (Hoogeveen et al, 2024).

Social and economic development in Africa requires economic stability. However, only one African LDC was able to achieve SDG 8.1 target of 7% GDP per capita growth in 2022. Even for Niger situation may not look sustainable as its growth reflects rebounding from a two-year recession in 2020-2021. Full employment by 2030 (Goal 8.5) does not appear as a realistic perspective since 15 countries have a constant unemployment level above 10%, and among them, six countries – above 20% levels (Figure 1b). At the same time, low levels of unemployment in African countries reflect underdeveloped labour markets and high informal agriculture employment.

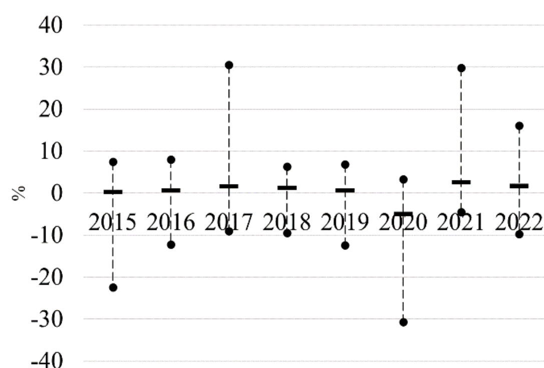


FIGURE 1a. Real GDP per capita growth in Africa, minimum, maximum and average growth rates, %

Source: World Bank (n.d.) World Development Indicators Database. URL: https://databank.worldbank.org/source/world-development-indicators

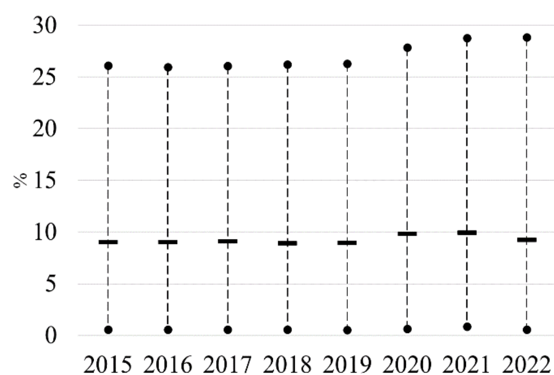


FIGURE 1b. Unemployment in Africa, minimum, maximum and average rates, %

Source: World Bank (n.d.) World Development Indicators Database. URL: https://databank.worldbank.org/source/world-development-indicators

With these diverse economic prospects, the future Africa stability mechanism (AfSM) should be able to face a wide stabilization agenda ranging from liquidity support to supporting comprehensive transition programs.

IMF, RFAs and MDBs should strengthen their coordination framework to bring their interventions more into line with their core mandates. Theoretically, this may be achieved

either by agreeing that institutions will rely on each other's expertise in confirming policy measures for their respective programmes or by revising the MDB toolkit and crisis response strategies. With respect to other elements of the GFSN, we advise that RFAs be considered together with the IMF when determining the distribution of roles for crisis support. A higher degree of coordination would help participating institutions to converge on uniform approaches and help prevent unnecessary and counterproductive competition and facility shopping by recipient countries. This would effectively strengthen the GFSN and the global economy.

Scenario of outcomes

There are several reasons why the taxonomy of instruments and resources is important for the stabilization agenda and the G20. The classification will enable mapping available instruments, may help to develop a multidimensional G20 database for stabilization financing, and may assist in fine-tuning the architecture of institutions involved in stabilization agenda. The coordination scheme can be further discussed with a clear mandate of the responsible institution(s) - e.g., the G20 Eminent Persons Group on Global Financial Governance. The taxonomy of the MDBs stabilization financing should be benchmarked towards GFSN instruments. While providing stabilization financing, MDBs are moving away from their core tasks (development finance, poverty alleviation, infrastructure financing). This diversion of MDBs resources may effectively reduce the scope of Sustainable Development Goals (SDGs) financing. Meanwhile, we should admit that the MDBs provide indispensable support for development. Moreover, when looking at their portfolios, the development finance for SDGs is the largest part of their project activities.

The G20 could review stabilization financing that is channeled through the non-GFSN institutions, and consider ruling principles for an optimal allocation of resources between GFSN and other mechanisms. This suggestion could be relevant in connection to the G20 work on MDBs capital adequacy frameworks.

Monetary policy at the global level must take into account the specifics of both emerging markets and the degree of its influence on the financial system of countries outside the G20. RFAs are institutions that are able to suggest a tailored, region-specific approach to their membership and are accumulating regional expertize to serve their member-states as a trusted advisor and an institution that is able to minimize external

shocks of large economies in the region. Ensuring that the larger number of countries in each RFA region is covered brings more value from the RFA for every region as a whole, safeguarding membership from regional shocks. The G20 could prioritize the RFA topic in its agenda, focusing on coverage and adequacy of a regional layer.

AfSM should be set up as a separate entity with an agenda, instruments and concessional resources that cover both short-term support and adjustment of protracted economic challenges. Separate entity argument is justified by approach taken by other institutions.

All RFAs are either international organizations or in transition to this status. Authors attribute this fact to unique mandates of an RFA that leads to drastic differences in mandates when an RFA is hosted by any other organization. The AfSM should be well resourced, with access to concessional financing to be able to serve all countries of African region. There are different models for resource mobilization for RFAs – market-based financing, contributions from member-states, and central bank's financing. The AfSM could consider any of the mentioned types as soon as there is access to affordable financing that allows lending at rates comparable to International Development Association terms. For market-based and central bank's financing, it will require an assessment to grant funds.

It is also important to improve national currency markets in order to strengthen the national financial systems of the RFA member countries. Greater diversification of international reserves is important, in particular the emergence of regional currencies, or currency baskets, in the structure, thereby reducing dependence on volatility in world currency markets. In general, international reserves, from the point of view of the concept of their construction and their role in ensuring the stability of financial systems, require revision, taking into account both the new geopolitical reality and risks.

On data availability and quantification of GFSN resources, we suggest that a platform be introduced for GFSN statistics that will be directly provided by the institutions and administered by a trusted partner. Currently, this data is fragmented or has significant gaps. There are several important initiatives underway to address the problem, e.g., the GFSN Tracker (gfsntracker.com). The EFSD keeps a comprehensive database for its region of operations based on the concept of an enlarged GFSN that encompasses all types of sovereign financing, including grants and technical assistance to sovereigns. This database may be further expanded with non-financial conditionality information that may assist donors in setting appropriate and coordinated arrangements.

The G20 should also return to the issue of strengthening donor cooperation platforms. In many cases, donors self-organise to coordinate their activities. However, the effectiveness of this effort varies case-by-case. The G20 Eminent Persons Group on Global Financial Governance recommended that effective country platforms be built to mobilise all development partners, unlock investments, and maximise their contributions as a group, including by convergence around core standards. The authors suggest that the G20 return this issue to its agenda.

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