



Global Financial Safety Nets

Stephen Pickford

International Economics | October 2011 | IE BP 2011/02

Summary points

- As problems in the eurozone threaten to spread more widely through the global economy, in the run-up to the Cannes G20 Summit international policy-makers are actively considering strengthening support measures for countries affected.
- Beyond the EU Heads of State agreements of 27 October 2011, both the International Monetary Fund and regional financing arrangements (especially in Europe and Asia) have a big role to play in avoiding fears that existing mechanisms are inadequately resourced and too inflexible to deal with another systemic crisis.
- Consideration needs to be given to substantially augmenting the IMF's fire-power (including allowing it to borrow from the markets), improving cooperation between the IMF and regional arrangements, and setting up a multilateral system of central bank swap arrangements.
- More flexible ways for countries to access the IMF's new borrowing facilities could be achieved through automatic pre-qualification processes, and making clear the scale of resources available.
- It will not be easy to get agreement to these reforms, but the cost of not having effective mechanisms in place to deal with systemic crises in future would be enormous.

Introduction

The global economic crisis that began in 2007 has highlighted the ongoing need for effective mechanisms to help countries deal with financing problems, especially in the face of systemic crises. As the problems in the eurozone deepen and threaten to spread globally, action is required to strengthen financial safety nets beyond what was agreed by EU Heads of State on 27 October 2011.

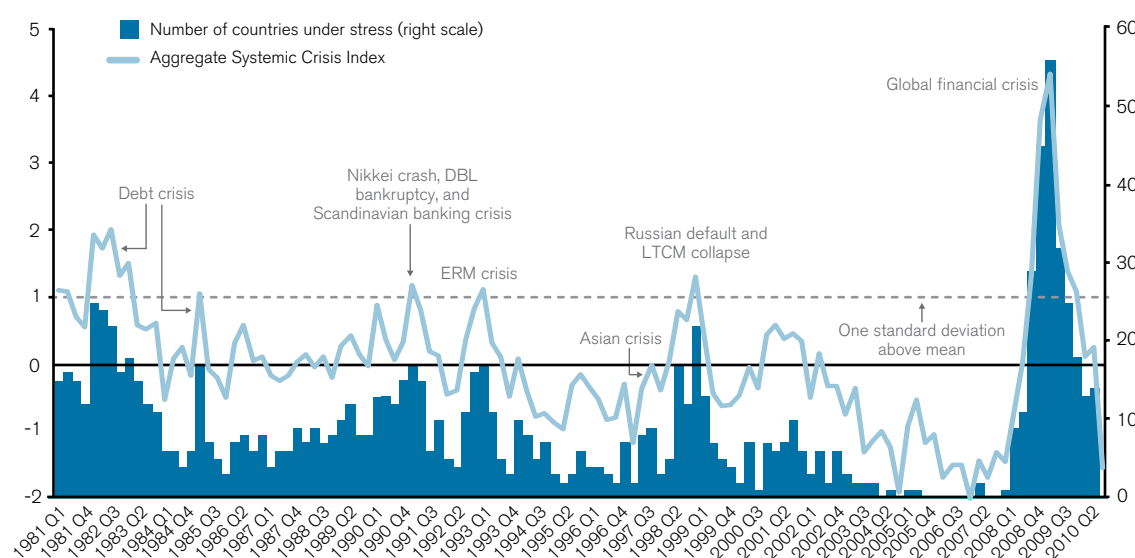
The crisis originated in the financial sectors of advanced economies but rapidly spread to other countries through financial and trade linkages¹ (see Figure 1). Smaller countries with relatively large financial sectors (such as Iceland and Ireland) or that were dependent on foreign-owned banks (including Latvia and Romania) were hit hard. As fiscal problems increased, countries with high initial debt and deficit levels came under pressure.

The immediate response to the global crisis by the international community was to channel liquidity through a network of central bank swap arrangements, and to use

existing mechanisms to finance affected countries, initially through International Monetary Fund (IMF) lending and (as the crisis spread within Europe) through EU financing mechanisms. IMF resources were substantially increased following the London G20 Summit in April 2009. New types of programme, which made use of the greatly enhanced financial resources, were quickly introduced, in particular the IMF's Flexible Credit Line (FCL) and Precautionary Credit Line (PCL).² The European Financial Stability Facility (EFSF) was set up to help eurozone countries.³

Despite these innovations, however, the financial capacity of existing resolution mechanisms to deal with another systemic crisis is in doubt. The new IMF FCLs, which require no conditionality and were intended to protect countries against contagion, were only taken up by three countries (Colombia, Mexico and Poland). As contagion spreads, more countries are becoming exposed to market pressures and facing severe financing difficulties.

Figure 1: Systemic crisis index and countries under stress



The aggregate systemic crisis index is a simple average of each country's (normalized) systemic crisis index. A country is under stress if its systemic crisis index is above one standard deviation from its mean.

Source: IMF (2011a)

1 The nature of crisis propagation and contagion in the increasingly interconnected world has been extensively documented. Recent work by the IMF shows that while systemic crises tend to originate in large or more integrated economies, they are rapidly transmitted across national boundaries through trade and financial interlinkages (<http://www.imf.org/external/np/pp/eng/2011/053111.pdf>).

2 For further details on the FCL and PCL, see <http://www.imf.org/external/np/exr/facts/fcl.htm> and <http://www.imf.org/external/np/exr/facts/pcl.htm> respectively.

3 For the European Financial Stability Facility, see <http://www.efsf.europa.eu>.

The case for global financial safety nets

This situation has led to repeated calls, not least from the G20, for more effective and more far-reaching mechanisms – ‘global financial safety nets’.⁴

The reason behind these calls is clear from the experience of the last three years:

- After almost a decade during which crises were largely absent, the catastrophic drying up of liquidity world-wide following the bankruptcy of Lehman Brothers in September 2008 re-emphasized the need for global and coordinated solutions.
- Exacerbated by deeper cross-border financial linkages, there were unprecedented spillovers from the core crisis countries to a wide range of other countries, many of which had been seen as having strong fundamental positions and policies – the ‘innocent bystanders’.
- The perceived past failures of crisis resolution mechanisms (especially in the Asian crisis of the late 1990s) were one reason why many emerging markets had built up national foreign exchange reserves as a way to self-insure against future crises.⁵ The resulting current account imbalances, and capital outflows from emerging markets, were seen as a contributory factor behind the exceptionally low global interest rates, the ‘search for yield’, and asset bubbles in many advanced economies in 2006 and 2007.

These developments help explain the renewed policy interest in global financial safety nets. Various ways have been proposed to strengthen safety nets, but there is fairly widespread agreement that global mechanisms should:

- provide fast-disbursing financial assistance in large amounts to countries open to global capital markets

and facing liquidity problems (in particular the ‘innocent bystanders’);

- reduce the demand for self-insurance through reserves accumulation, by offering countries a realistic and attractive alternative multilateral safety net; and
- reduce global imbalances (ultimately seen as crucial for global growth).

Distinguishing between liquidity and solvency

Distinguishing between liquidity and solvency problems is important in the design of financial safety nets, but the last crisis showed again that the distinction is not clear cut.

‘ If problems that start out as liquidity-related can turn into solvency issues, dealing with them in their early stages can help avoid the more damaging (and costly) later stages ’

Liquidity problems tend, if they last for any length of time, to lead to solvency problems. This is as true at the country level as it was for banks in 2007 and 2008. Countries facing high borrowing costs can quickly find that their fiscal positions become unsustainable.

Proponents of stronger financial safety nets see this as further justification for such measures. If problems that start out as liquidity-related can turn into solvency issues, dealing with them in their early stages can help avoid the more damaging (and costly) later stages.

4 At the meeting of G20 Finance Ministers and Central Bank Governors on 14–15 April 2011, they agreed ‘to focus our work, in the short term, on ... an improved toolkit to strengthen the global financial safety nets’ (<http://www.g20.org/Documents2011/04/G20%20Washington%2014-15%20April%202011%20-%20final%20communiqué.pdf>).

5 However, this was only one of a number of reasons. There have been fierce debates in recent years about how far the build-up of reserves in emerging markets was due to the desire for self-insurance, and how far it reflected a deliberate policy to maintain under-valued exchange rates as a way to stimulate export-led growth. Whatever the relative strength of these motives, the tensions that they have generated and the impact on global imbalances are clear.

Enhanced safety nets

Existing mechanisms for dealing with crises are seen as being deficient in two respects:

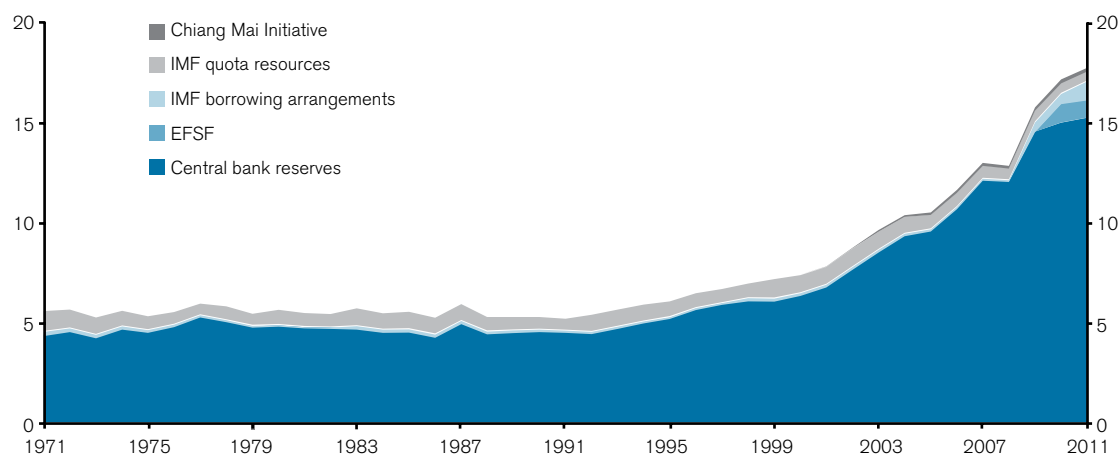
- insufficient amounts of financial ‘fire-power’ to provide sufficient liquidity to offset private outflows and convince markets; and
- insufficiently flexible (and rapid) ways to disburse funds.

The level of financial resources available for support operations has been increased substantially in the last two years, first through the tripling of IMF resources agreed at the London G20 Summit in 2009,⁶ and second through the creation and strengthening of regional financing arrangements (RFAs). The European Balance of Payments Facility for non-eurozone countries, and the European Financial Stabilisation Mechanism (available to all EU members),

were augmented in 2010 by an additional mechanism to support eurozone countries in crisis – the European Financial Stability Facility.⁷ The Chiang Mai Initiative (CMI), set up in the wake of the Asian financial crisis as a mutual support mechanism among the ASEAN+3 countries, was substantially strengthened in 2010,⁸ but as yet it has not been used.

However, even after these reforms, the total quantum of multilateral financial fire-power available through the IMF, the European mechanisms and the Chiang Mai Initiative has done little more than keep pace with global GDP growth, standing at around 2–3 per cent (and has fallen far behind the increase in global trade and financial flows)⁹ (see Figure 2). At the peak of the crisis, central bank swap arrangements with the US Federal Reserve added another \$600 billion to the available resources, as well as €250 billion in swaps provided by the European Central Bank (ECB).

Figure 2: Global financial safety nets as percentage of world GDP



Source: IMF (2011a)

6 The G20 agreed to increase bilateral financing from \$250 billion to \$750 billion, including through the New Arrangements to Borrow (NAB). In addition a general SDR allocation of \$250 billion was agreed, 'to increase global liquidity'. For details see http://www.g20.org/Documents/Fin_Deps_IFI_Annex_Draft_02_04_09_-_1615_Clean.pdf.

7 The EFSF was launched in May 2010, and the increase in size to its current level of €440 billion has just been ratified by all eurozone countries. Under current plans, the EFSF will be replaced in 2013 by a permanent mechanism, the European Stability Mechanism (ESM).

8 The Chiang Mai Initiative Multilateralization (CMIM) agreement was made operational in March 2010, as a 'self-managed reserve pooling arrangement' with a total size of \$120 billion.

9 IMF, 'Strengthening the International Monetary System: Taking Stock and Looking Ahead', March 2011, <http://www.imf.org/external/np/pp/eng/2011/032311.pdf>.

But by far the largest part of the resources available to countries is their national reserves, which have grown in total over the last ten years from about 5 per cent to 15 per cent now. However, these resources are spread very unevenly, and (not coincidentally) tend to be concentrated in countries that are less likely to suffer financing problems. They are also costly for countries to maintain, usually with substantial carry costs. And as noted earlier, they have contributed to the growth of global imbalances.

‘There are increasing calls for an “international lender of last resort” role, by analogy with the role central banks play in supporting essentially solvent banks which face liquidity shortages’

IMF financial instruments were also redesigned to better meet the needs of ‘innocent bystanders’, through the creation of the FCL, and its cousin the PCL. The FCL is designed to provide access to very substantial amounts of financing on a contingent basis for countries with ‘very strong policy fundamentals and frameworks’, to be drawn down as needed but without any further review or conditionality once a country has qualified. The PCL is designed for less strong countries, and requires some extra conditionality when funds are drawn on.

However, there remains a widespread view that much more needs to be done. Countries are still counting the cost of the crisis. In many cases their fiscal positions are much more fragile than they were four years ago in terms of deficits and debt levels, and the loss of output and slow growth make them more vulnerable to financing difficulties.

The amount of money available to support these countries is still not seen as sufficient to deal with another episode on the scale of the 2007 crisis (especially as the eurozone crisis worsens and takes up more of the available resources). The IMF’s resources were substantially augmented in 2009, but a significant proportion is already committed to its programmes.¹⁰ There have also been very significant additions to the European and Asian regional mechanisms, but much of the EFSF funds has already been earmarked for the programmes for Portugal, Ireland and Greece, while the central bank swap lines introduced at the height of the last crisis have since been wound back.

The extremely limited take-up of the FCL and PCL to date suggests that they are still not fulfilling their desired role as ways to deal with contagion and liquidity pressures.

In these circumstances there are increasing calls for an ‘international lender of last resort’¹¹ role, by analogy with the role central banks play in supporting essentially solvent banks which face liquidity shortages.

Moral hazard

Critics of any expansion in the crisis resolution toolkit cite the danger of ‘moral hazard’: the possibility that the ready availability of finance will encourage governments and private investors to take excessive risks. But there is no agreement on how important this risk is in practice; and tighter financial regulation and more effective international surveillance respectively can help guard against risky private behaviour and national policies.

Excessive risk-taking by private investors on the assumption that they (or the countries they lend to) will be bailed out is clearly a potential problem. But very risky lending and investment behaviour was a real *actual* feature in the run-up to the 2007 crisis, and the presence or absence of effective international lending facilities does not appear to have had a marked effect on private-sector behaviour. Instead, excessively risky private behaviour should be addressed through internationally coordinated reforms to financial regulation and supervision.

¹⁰ At August 2011 the IMF’s forward commitment capacity stood at just under \$400 billion.

¹¹ Stanley Fischer proposed just such a role for the IMF in the aftermath of the Asian crisis: <http://www.imf.org/external/np/speeches/1999/010399.htm>.

The other potential source of moral hazard is that making financing available to countries on ‘easy’ terms, with little or no conditionality, could encourage poor national policies. The low-conditionality IMF facilities (the FCL and, to a lesser extent, the PCL) have only recently been introduced, so there is little evidence on their effects. But the three countries that have taken up the FCL are all generally thought to have followed, and continue to follow, good policies. The problem seems to have been not that too many countries of the ‘wrong sort’ would take out FCLs, but rather that demand from the ‘right sort’ of countries has been insufficient.

‘ Apart from running current account surpluses, there is no easy way for countries to boost their reserves, especially in the current difficult market conditions for sovereign borrowing ’

Options for reform

Reforms are needed to increase substantially the scale of financial resources available if a global systemic crisis hits again, and to introduce more flexible mechanisms that would allow funds to be disbursed very rapidly. In order to avoid a liquidity shortage turning into a solvency problem, countries would need to be prepared to sign up to financing facilities before the crisis hit.

Increasing finance

There are three lines of defence for countries facing financing problems: domestic reserves, global mechanisms and regional financing arrangements.

Many countries, especially emerging markets, have through the last decade increased their foreign currency reserves. However, they are concentrated in countries that are less vulnerable to financial crisis (in part precisely because they have built up their own defences). Apart from running current account surpluses, there is no easy way for countries to boost their reserves, especially in the current difficult market conditions for sovereign borrowing.

Potentially a Special Drawing Right (SDR) allocation could be of use. But in practice a general allocation would again provide reserves mainly to countries that have less need of them. Moreover, in crisis conditions SDRs are less usable than holdings of tradable currencies.

Access to IMF borrowing through its facilities is the traditional route for countries facing financing difficulties. This could either take the form of financing through low-conditionality facilities such as the FCL, for countries that lack access to short-term liquidity but do not require policy adjustments, or it could entail a combination of finance and policy adjustment. In either case, financing would be needed.

So boosting the IMF’s financing capacity would provide another line of defence. As a form of credit union, the bulk of the IMF’s financial resources is provided by quotas (in effect a line of credit from countries with stronger financial positions). But a general quota increase typically takes many years to gain approval, since it has to be ratified by the great majority of member countries’ legislatures. Another ad hoc increase, giving bigger increases for some countries (as G20 finance ministers agreed in October 2010¹²) is also unlikely to be implemented quickly, since it would need to be part of the ongoing process of governance reforms at the IMF.

The most straightforward way to increase IMF financing capacity is through borrowing. Since 1962 the IMF has had in place arrangements to borrow from a group of its members – the General Agreements to Borrow (GAB) and New Arrangements to Borrow

12 G20 Communiqué (2010), http://www.g20.org/Documents/201010_communique_gyeongju.pdf.

(NAB).¹³ But it is likely to be difficult to agree another increase in borrowing from members so soon after the latest round. Almost all the advanced economies which have traditionally provided most bilateral credit to the IMF through the GAB and NAB currently face severe fiscal constraints. While a number of emerging markets have the capacity to lend to the IMF (for example, through further note purchases), they favoured further quota increases rather than bilateral financing.

Another route that should be considered is for the IMF to borrow from capital markets.¹⁴ There is provision for this in the IMF's Articles of Agreement,¹⁵ and the G20 agreed at the London Summit to 'consider' market borrowing by the IMF. The IMF has never yet used this option, but in current circumstances it is worth looking at again. Given that the IMF has super-senior status¹⁶ and that its financial structure is underpinned by the backing of its members, it should have no difficulty in borrowing from the markets (the World Bank, which has similar backing from its members, has \$120 billion of market borrowing outstanding, and typically borrows around \$30 billion a year at AAA rates).

Furthermore, market financing in the face of a global systemic liquidity shortage is a logical solution. If private investors are afraid to lend to entities that are seen as risky (whether banks or sovereigns), borrowing by the IMF could also help stabilize markets by creating assets that would be virtually risk-free for investors. In effect the IMF would have a similar role, at the sovereign level, to that played by many central banks in the recent crisis in inter-mediating between private-sector borrowers and lenders.

During the recent crisis, central bank swap lines provided by the US Federal Reserve and the ECB also played an important role in stabilizing markets. The Federal Reserve swap lines with the central banks of Brazil, Korea, Mexico and Singapore were particularly effective in restoring a measure of confidence to these countries. But these

arrangements were very ad hoc and relied on the willingness of the Federal Reserve and the ECB to use a substantial portion of their balance sheets in this way.

‘ Another route that should be considered is for the IMF to borrow from capital markets ... market financing in the face of a global systemic liquidity shortage is a logical solution ’

Institutionalizing a central bank swap mechanism, and extending the range of countries that could benefit from them, could be another useful tool for use in a future crisis. But to maximize its impact in the event of a crisis, it would be important to work out in advance how it would operate.¹⁷ In particular, providing clarity over the amounts available, the potential counterparties and conditions for activation would send a clear signal that large-scale liquidity would be available if needed. Working out these details would not be straightforward, since those central banks providing swap lines are likely to prefer to maintain freedom of manoeuvre. But experience shows that having the mechanisms fully worked out in advance is preferable to inventing them in the midst of a crisis.

Regional financing arrangements could also play a greater role in future crises. The latest increase in the size of the EFSF to €44 billion has only just been ratified by all eurozone countries, and the European summit in the last week of October has agreed to further leveraging of the Facility. But whatever the final size, experience to

13 For further details see <http://www.imf.org/external/np/exr/facts/gabnab.htm>. Also, following the London G20 Summit, the IMF agreed to issue notes which were then sold to China.

14 This is one of the proposals from the Palais-Royal Initiative, http://www.global-currencies.org/smi/gb/telechar/news/Rapport_Camdessus-integral.pdf.

15 See <http://www.imf.org/external/pubs/ft/aa/index.htm>.

16 In practice IMF loans to countries have preferred creditor status, and to date no country has defaulted on its loans to the IMF.

17 Farhi, Gourinchas and Rey (2011) propose a permanent network of central bank swap arrangements centred on the IMF; see <http://www.voxeu.org/sites/default/files/file/Reforming%20the%20International%20Monetary%20System.pdf>.

date with the European mechanisms suggests there is anyway scope to improve their functioning. Moreover, even though the Chiang Mai Initiative has now been put on a fully multilateral basis, it has not yet been tested.

One of the lessons of the ongoing crisis in Europe is that coordination between RFAs and the IMF needs to be seamless. The CMI has instituted some of the necessary coordination mechanisms: the bulk of its financial resources will be available only in conjunction with an IMF programme;¹⁸ and the IMF is also heavily engaged with AMRO, the new analytical body being set up in Singapore to support the CMI.

“In the event of a systemic crisis there will need to be rapid provision of financial support in large amounts to countries at risk of contagion. That requires some degree of pre-qualification”

Within Europe all current support operations have to date been carried out jointly with the IMF. But some of the European institutions have been reluctant to accept this link, and coordination with the IMF has not been smooth. It would be in the interests of Europe to improve this coordination. The IMF has considerable expertise in designing adjustment programmes and, importantly, can bring credibility (since the design of European programs has been seen as influenced by political compromises within the eurozone). Just as importantly, better cooperation with the IMF can bring in additional resources. Given the debates within Europe about how (and indeed whether) to leverage the resources of the EFSF, being able to access the IMF's resources further could be essential.

Agreement in advance between European institutions and the IMF on key issues – which institution leads on

design of adjustment programmes, what proportion of financing is provided by each, and on what terms – will help improve the efficiency of future lending operations.

Increasing flexibility

The IMF introduced a significantly greater degree of flexibility into its facilities when it launched the FCL and PCL in 2009 and 2010. These facilities were aimed at strongly performing economies hit by external shocks – the ‘innocent bystanders’. They provided large-scale access to finance on an as-needed (‘precautionary’) basis without the need for further approval by the IMF executive board to activate lending, after the initial pre-qualification process.

Nevertheless, as noted, so far only three countries have applied for the FCL and one country (Macedonia) for the PCL, which was designed for the next tier of countries. There still seem to be barriers preventing countries from signing up for these facilities. A major problem (as with other attempts in the past by the IMF to design precautionary lines of credit) is stigma – countries fear that applying for these facilities would be seen by the capital markets as a sign of underlying weakness, and as indicating that the countries were in difficulties. The only way to avoid this adverse signalling is to make qualification for these facilities, and the level of financial support available, as automatic as possible.

The issue of pre-qualification for IMF precautionary facilities has been on the table for many years, but to date major shareholders in the IMF have been unwilling to accept going this far, arguing that this would generate moral hazard and expose the Fund to unsustainable financial risk. It was difficult to get agreement even to the relatively light conditions for accessing the FCL and PCL.

Nevertheless, in the event of a systemic crisis there will need to be rapid provision of financial support in large amounts to countries at risk of contagion. That requires some degree of pre-qualification. The problem is how to get round the fact that in advance of a crisis countries are unwilling to apply, since to do so could risk sending an adverse signal to markets.

¹⁸ In order to draw above 20 per cent of their CMIM allotment, countries must sign up to an IMF programme.

One obvious mechanism for managing pre-qualification would be the Article IV process.¹⁹ Part of the IMF staff's judgment on each country's economy could be to signal whether it was strong enough to justify access to the FCL or PCL if the need arose.²⁰ This would take away the stigma from countries applying for a financing facility. It would still raise sensitive issues: publication of this judgment could cause difficulties, especially for countries that do not qualify (or lose their qualification). Nevertheless the benefits of providing a core of countries with protection against contagion from systemic crises are very great.

The other proposal is to make clear *ex ante* the scale of resources that could be made available to countries under the FCL or PCL. In the three FCL cases to date the normal rules on access to the IMF's resources have been suspended. This has avoided the situation where its programmes have been prevented by access limits from providing a sufficiently large scale of funds to resolve the crisis. But setting a scale (or possibly a range) for the resources available, even if only approximately, would be helpful. It would, if set sufficiently high, provide confidence that the resources were available to see countries through the crisis, and thereby help prevent it from spreading. And it would go some way towards allaying moral hazard concerns by establishing a limit to the IMF's exposure.

The size of the potential problem, and the political difficulties that would be involved in reaching agreement on a single mechanism of sufficient size, point towards trying to make progress on a number of fronts. This 'menu approach' may not be the most efficient, and there would clearly be problems that would need to be resolved in coordinating different mechanisms. But the experience of the recent crisis suggests that the coordination problem is much less severe than the problem of putting new mechanisms in place in the middle of a crisis. The difficulties faced by the Bush administration in getting congressional approval for the Troubled Asset Relief Program (TARP) in the United States in 2008 exemplify this point.

Conclusions

Existing mechanisms are insufficient to deal with another event on the scale of the 2007–09 crisis. Even after the augmentation of IMF and RFA resources, and the introduction of new precautionary facilities, the potential scale of need for financing to protect countries from another global systemic crisis is huge. Already nearly half of the IMF's total resources and one-third of the enhanced EFSF capacity have been committed.

Countries are generally now less able to withstand contagion pressures. The crisis has weakened most countries' fiscal and economic positions, leaving them more reliant on external borrowing, at the same time as global capital markets are more reluctant to lend to any but the highest-quality sovereign borrowers.

“There are no guarantees that reforms along these lines will be sufficient to avoid similar crises in future. But the risks of another systemic crisis make it worth taking measures to reduce these risks and putting in place measures to protect countries from contagion”

There are problems with both the quantum of finance available and the disbursement mechanisms. In the event of another global crisis many countries are likely to need to borrow from multilateral institutions on a large scale and in a flexible manner, and having in place mechanisms to allow this outweigh any potential moral hazard concerns.

19 The IMF produces an 'Article IV' surveillance report on the health of each country's economy and policies, usually annually.

20 Edwin Truman proposes that every Article IV review should include a staff judgment on the policy conditions necessary for that member to access IMF financial assistance: <http://www.piie.com/publications/wp/wp10-13.pdf>.

On financing, the most promising reforms are:

- **allowing the IMF to borrow from the markets** to augment its traditional sources of finance from its members;
- ***ex ante* agreements between central banks for a network of swap arrangements**, deciding in advance the amounts involved, the range of countries covered, and the conditions under which the arrangements would be activated;
- **formalizing links between the IMF and the RFAs, especially the EFSF/ESM and Chiang Mai Initiative**, setting out clear modalities for cooperation on programme design and co-financing arrangements.

Flexibility of financing would be increased by:

- **using Article IVs to assess whether countries pre-qualify** for FCLs and PCLs;
- **making clear *ex ante* the scale of resources that could be made available** under these IMF programmes.

In view of the political problems in reaching agreement on any of the potential solutions, it is not prudent to rely on any one element. Given that the problem is global in nature, but solutions have to be implemented or ratified at the national level, there are strong arguments for implementing these measures as a package.

There are no guarantees that reforms along these lines will be sufficient to avoid similar crises in future. But the risks of another systemic crisis make it worth taking measures to reduce these risks and putting in place measures to protect countries from contagion.

References

- Farhi, Emmanuel, Pierre-Olivier Gourinchas and Hélène Rey (2011), *Reforming the International Monetary System*, available at <http://www.voxeu.org/sites/default/files/file/Reforming%20the%20International%20Monetary%20System.pdf>, Centre for Economic Policy Research (CEPR), ISBN (eBook): 978-1-907142-41-3.
- Fischer, Stanley (1999), 'On the Need for an International Lender of Last Resort', available at <http://www.imf.org/external/np/speeches/1999/010399.htm>. This is a slightly revised version of a paper prepared for delivery at the joint luncheon of the American Economic Association and the American Finance Association New York, 3 January.
- G20 Communiqué (2010), Meeting of Finance Ministers and Central Bank Governors, available at http://www.g20.org/Documents/201010_communique_gyeongju.pdf, Gyeongju, Republic of Korea, 23 October.
- G20 Communiqué (2011), Meeting of Finance Ministers and Central Bank Governors, available at <http://www.g20.org/Documents2011/04/G20%20Washington%2014-15%20April%202011%20-%20final%20communique.pdf>, Washington DC, 14–15 April.
- G20 Declaration (2009), *Declaration on delivering resources through the International Financial Institutions*, available at http://www.g20.org/Documents/Fin_Deps_IFI_Annex_Draft_02_04_09_-_1615_Clean.pdf, London, 2 April.
- IMF (2011a), *Strengthening the International Monetary System: Taking Stock and Looking Ahead*, Prepared by the Strategy, Policy, and Review Department, in consultation with the Finance, Legal, Monetary and Capital Markets, and Research Departments, available at <http://www.imf.org/external/np/pp/eng/2011/032311.pdf>, 23 March.
- IMF (2011b), *Analytics of Systemic Crises and the Role of Global Financial Safety Nets*, Prepared by the Strategy, Policy, and Review Department, available at <http://www.imf.org/external/np/pp/eng/2011/053111.pdf>, 31 May.
- Palais-Royal Initiative (2011), *Reform of the International Monetary System: A Cooperative Approach for the Twenty First Century*, available at <http://www.imf.org/external/np/speeches/1999/010399.htm>, 8 February.
- Truman, Edwin M. (2010), *The G-20 and International Financial Institution Governance*, WP 10-13, available at <http://www.piie.com/publications/wp/wp10-13.pdf>, September.

International Economics at Chatham House

International Economics at Chatham House produces policy-oriented research and analysis of the challenges facing the global economy today. It maintains links with policy-makers and researchers around the globe to ensure that our independent analysis of global economic issues translates into practical and timely policy insight on the challenges facing the world economy today. The main themes include the changing world economy and the G20 framework, reform of the international monetary system, growth of emerging market financial centres, and international competitiveness and growth.

A changing world economy and the G20 framework

In the wake of the recent financial crisis, the G20 has played an important role in facilitating international economic policy cooperation. It has yet to be seen, however, if the group can move beyond its roots as a crisis committee and play a more institutionalized role in confronting the array of challenges facing the global economy today.

The International Economics team has focused its research to explore the future prospects for the G20 and set out an ambitious schedule for international economic policy cooperation (*Preventing Crises and Promoting Economic Growth: A Framework for International Policy Cooperation*). In addition, current research explores the role of G20 observer countries and those outside the G20 process in international economic policy cooperation.

Reform of the international monetary system

The international monetary system is in flux – no longer meeting the needs of an increasingly unbalanced global economy, but not yet ready to move beyond the dollar as the world's reserve currency. Current research explores the future of the international monetary system, and assesses the prospects for a range of proposed reforms.

Recent work has explored the prospects for a multi-currency reserve system (*Beyond The Dollar: Rethinking the International Monetary System*) and investigated China's ambitions for the renminbi as an international reserve currency ('One Currency, Two Systems': *China's Renminbi Strategy*).

Currently, a Chatham House taskforce is leading a review of the role of gold in the international monetary system, often the subject of heated debate. Chatham House is exploring the issue from different angles and perspectives, to focus on reform of the international monetary system.

Growth of emerging market financial centres

As the epicentre of global economic growth continues to shift towards emerging markets, Chatham House International Economics has embarked on a series of studies into the specific challenges and opportunities facing financial centres in emerging economies.

Recent work has focused on the strengths and weaknesses of the Gulf as a global financial centre (*The Gulf Region: A New Hub of Global Financial Power*) and the outlook for the Japanese financial sector in the light of recent international trends (*The Outlook*

for Tokyo: New Opportunities or Long-Term Decline for Japan's Financial Sector?).

Current research explores the prospects for financial centres in the Greater China region, including Hong Kong, Taipei and Shanghai, as well as the challenges and opportunities that shifting global financial influence may pose for Singapore's role as an established Asian financial centre.

International competitiveness and growth

The past quarter-century has seen massive changes in the world economy. Trade integration and the globalization of value chains, with more and more manufacturing now taking place in emerging economies, have created new challenges together with new opportunities. As we move forward into the next decade, it is critical to address the issue of how the industries of the future will look, and which sectors/industries will lead future growth.

International Economics is undertaking a series of projects to examine the outlook for key global industries over the next decade. These include a series of research study groups on the changing industrial landscape and industry case studies identifying emerging 'global champions'.

Chatham House is also partnering with the University of Warwick's Centre for Competitive Advantage in the Global Economy (CAGE) to explore how markets, institutions, and public policy interact to create and sustain competitive advantage in response to these global changes.

Recent publications:

- **Legitimacy vs Effectiveness for the G20: A Dynamic Approach to Global Economic Governance**
Briefing Paper
Paola Subacchi and Stephen Pickford, October 2011
- **Preventing Crises and Promoting Economic Growth: A Framework for International Policy Cooperation**
Chatham House/CIGI Report
Paola Subacchi and Paul Jenkins, April 2011
- **'One Currency, Two Systems': China's Renminbi Strategy**
Briefing Paper
Paola Subacchi, October 2010
- **Aiming for New Vigour: The UK in the Global Economy**
Briefing Paper
Vanessa Rossi and Jim Rollo, June 2010
- **The Role of the US in the Post-Crisis Economic Order**
Chapter in *America and a Changed World: A Question of Leadership*
Paola Subacchi, May 2010
- **Beyond the Dollar: Rethinking the International Monetary System**
Chatham House Report
Edited by Paola Subacchi and John Driffill, March 2010

Stephen Pickford is an Associate Fellow in International Economics at Chatham House. From July 2007 to January 2010 he was managing director, international and finance, at the Treasury in the United Kingdom. He previously served in a number of roles in the Treasury, including director for Europe, and director for international finance. Between 1998 and 2001, he was the United Kingdom's executive director at the IMF and World Bank.

Acknowledgments

The author would like to thank Eric Helleiner, Centre for International Governance Innovation, Chair of International Political Economy; Creon Butler, HM Treasury; and Dr Paola Subacchi, Chatham House, for providing comments on an advanced draft of the Briefing Paper. The author would also like to thank Parthasarathi Shome, Director of the Indian Council for Research on International Economic Relations (ICRIER), for providing a forum for advancing debate on Financial Safety Nets at the Global Cooperation for Sustainable Growth and Development, ICRIER G20 Conference, hosted in New Delhi in September 2011. The background support of Richard Varghese and Nick Maxwell at Chatham House was very much appreciated.

Chatham House has been the home of the Royal Institute of International Affairs for ninety years. Our mission is to be a world-leading source of independent analysis, informed debate and influential ideas on how to build a prosperous and secure world for all.

Chatham House
10 St James's Square
London SW1Y 4LE
www.chathamhouse.org

Registered charity no: 208223

Chatham House (the Royal Institute of International Affairs) is an independent body which promotes the rigorous study of international questions and does not express opinions of its own. The opinions expressed in this publication are the responsibility of the author.

© The Royal Institute of International Affairs, 2011

This material is offered free of charge for personal and non-commercial use, provided the source is acknowledged. For commercial or any other use, prior written permission must be obtained from the Royal Institute of International Affairs. In no case may this material be altered, sold or rented.

Cover image ©istock
Designed and typeset by Soapbox, www.soapbox.co.uk