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Remapping Global Economic Governance:
Rising Powers and Global Development Finance

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ABSTRACT

The landscape of the global financial architecture has changed significantly in the ten years since the global financial crisis. Over the past decade, the scale of financing available for short-term liquidity needs has increased more than threefold and the scale of development finance has roughly doubled. According to data we compiled for this policy brief, there is now more than $15 trillion in short-term liquidity assistance available in the world economy and $6 trillion in development finance. Perhaps most significant is the fact that the vast majority of this growth—63 percent of the growth in liquidity finance and over 90 percent of the growth in development finance—has come from contributions by emerging market and developing countries (EMDs). Sixty-three percent of all liquidity finance is housed with the EMDs, and 80 percent of all development bank finance. What is more, more than three quarters of this finance is national—in the form of currency reserves and national development banks.

This new financing brings real benefits to an architecture that has long been under stress, especially for EMDs. Not only are there more and different sources of financing available to EMDs, the increase in choices for financing may increase their voice in the the international financial institutions dominated by advanced economies. However, this new and more complex system may also introduce new types of inequities into the system, and coordination across a fragmented system toward common goals may prove to be difficult. Finally, while the new capital available has indeed been significant, it still falls far short of being able to stem the next global financial crisis and to meet the Sustainable Development Goals. New levels of financing and coordination will be needed to achieve financial stability and economic development on a global scale.

The Need for Developmental Financial Institutions

In a classic work, The World in Depression, 1929 to 1939, economist Charles Kindleberger identified five global market failures that need to be addressed in order for the world economy to achieve stability and long run growth (Kindleberger, 1986). Three of those market failures were last resort liquidity lending, counter-cyclical financing for long run development, and general global macroeconomic coordination toward those and other ends.[1] He argued that the private sector will not provide sufficient liquidity support to national governments facing balance of payments difficulties and will be biased away from long-run finance in infrastructure and structural change. Without coordination, private and national markets will undersupply such global public goods.

Sixty-three percent of all liquidity finance is housed with the EMDs, and 80 percent of all development bank finance.

In response, a global financial safety net (GFSN), which is made up of Central Banks and their networks, the International Monetary Fund, and a variety of regional financial arrangements, has emerged. The GFSN attempts to supply the last resort function. Development banks are the major supplier of long-run financing, and the various "G" meetings (G-7, G20 et), annual meetings of the International Monetary Fund, BRICs summits, and regional arrangements are attempts at macro-economic coordination.

The need for these institutions and macro-economic coordination is justified now more than ever, especially for emerging market and developing countries. It is widely recognized that global capital flows are inherently pro-cyclical in the world economy, coming in massive surges and followed by sudden stops that leave EMDs with severe balance sheet effects and financial instability—such that financial crises appear to occur more than once per decade since the fall of Bretton Woods (IMF, 2012). The massive global infrastructure gap of over $40 trillion, that is even larger if such infrastructure addresses another global public good in climate change, the need for significant structural transformation in EMDs, and of course the persistence of global poverty each exemplifies the need for development bank finance for longer-run financing (Mckinsey, 2016).

The general problem has been that the scale of these institutions have not kept pace with the size of global finance and global development needs. Further, the governance of the advanced economy IFIs does not adequately reflect or incorporate the voice of EMDs, or the communities and other members of the public most directly impacted from financing packages.

The New Developmental Finance Landscape

Over the past decade, the scale of financing available for short-term liquidity needs has increased more than threefold, and the scale of development finance has roughly doubled. There is now more than $15 trillion in short-term liquidity assistance available in the world economy and $6 trillion in development finance. What is more, EMD-led finance is now twice the size of both liquidity support and development bank finance with nationally held financing dominating in the form of currency reserves and national development banks. There is still more financing necessary to backstop the global economy from financial crises and meet the Sustainable Development Goals (SDGs).

1 The other two are maintaining stable exchange rates and preventing protectionism during recessions, and are beyond the scope of this particular policy brief.

Table 1: Short and Long-Run Financing Arrangements in the Global Economy

Liquidity Support			Development Banks		
Institution		*Size (millions)*	*Institution*		*Total Assets (millions)*
Multilateral Institutions			Multi-lateral Development Banks		
International Monetary Fund		653,000	Advanced economies		936,310
People's Bank of China		480,000	EMD-led MDBs		257,049
Chiang Mai Initiative Multilateralization		240,000			
Contingent Reserve Arrangement*		100,000		sub-total	1,193,359
European Stability Mechanism		90,600			
Eurasian Fund for Stabilization and Development		8,513			
Arab Monetary Fund		3,530			
Latin American Reserve Fund		2,880			
	sub-total	1,578,523			
National Reserve Holdings			National Development Banks		
Advanced economies		3,900,000	Advanced economies		1,087,152
EMDs		7,400,000	EMD NDBs		3,768,774
	sub-total	11,300,000		sub-total	4,855,926
EMD-led		**8,158,123**	**EMD-led**		**4,025,823**
advanced economy-led		**4,720,400**	**advanced economy-led**		**2,023,462**
Total		**12,878,523**	**Total**		**6,049,285**

Sources: annual reports of various institutions, IMF 2017, Fritz and Mühlich (forthcoming), and McDowell 2016.

New Lenders of (close to) Last Resort

There is more than $12.8 trillion 'on hand' for short-term liquidity support in the world economy. The left side of of Table 1 lists the the major multilateral institutions that provide liquidity support as well as national reserve holdings (minus gold). The table does not include the virtually unlimited amount of liquidity that was made available by the United State Federal Reserve and the 'C6' Central Banks through a multitude of currency swap arrangements in the wake of the crisis (Mehrling, 2015). Fewer of the Central Bank swaps were for EMDs, and it is unclear whether the Central Banks of advanced economies will stand ready to act in a similar manner during the next crisis.

Prior to the crisis in 2007-8, there was approximately $5 trillion available in liquidity support (aside from the C6) in the world economy. That amount has increased by two and a half times since the crisis, with EMDs capturing more than 63 percent of the total growth in liquidity support over the period—and EMDs coincidentally now hold roughly 63 percent of the total short-term liquidity assets in the global economy. IMF resources increased from $354 billion to $653 billion since the crisis, and the Chang-Mai Initiative in Asia multilateralized its swaps and increased their swap capacity from $78 billion to $240 billion. A major newcomer to this crisis was China, with the Peoples Bank of China providing upwards of $480 billion in swaps across the world, three quarters of which went to EMDs

Other significant newcomers are the European Stability Mechanism, with a base of $90 billion, and the BRICS-led Contingent Reserve Arrangement, which aims to have $100 billion. Smaller regional funds were also bolstered in the wake of the crisis, in the Eurasian Fund for Stabilization and Development, the Arab Monetary Fund, and the Latin American Reserve Fund. In addition to constituting new credit facilities and swap arrangements, such institutions also offer models of institutional governance that differ significantly from traditional western-backed IFIs. (Kring and Grimes, forthcoming 2017)

Close to 90 percent of total liquidity support is in the form of national reserves, with the overwhelming majority of liquidity support and 40 percent of the reserve growth since the crisis in EMDs.

China's contributions are a major part of this story, but not all of it. Aside from C6 swaps, currency swaps from the People's Bank of China and other China-led financial institutions amount to 31 percent of the total non-C6 liquidity support and 38 percent of the growth in liquidity support for EMDs. On a national level, China accounts for 31 percent of the growth in national reserve assets and 28 percent of global reserves—up from 25 percent in 2006.

Longer Run Development Finance

Longer-run development finance has also experienced a resurgence, increasing nearly twofold since the global crisis. The United Nation's SDGs have shifted from a micro-level focus to more ambitious economy-wide goals in terms of infrastructure provision, climate change, and social inclusion. In this realm, there has been a stepwise increase in global development finance. Some of the advanced economy-led MDBs saw modest increases in their base capital, and two significant new EMD-led multilateral development banks were launched in the Asian Infrastructure Investment Bank and the New Development Bank.

For decades the policy and academic attention to development banking has focused on the World Bank Group and the advanced economy-backed MDBs. What is often overlooked is the fact that the assets of national development banks, now at $4.8 trillion, are four times the size of the MDB system. Table 2 lists the ten largest national development banks, which represent just over 70 percent of the assets of all NDBs in the world economy.

Table 2: Ten Largest NDBs in the World Economy

	NDB	Country	Total Assets in USD (millions)	Total lending in USD (millions)
1	China Development Bank	China	1,957,057	1,427,801
2	KfW Bankengrup	Germany	536,820	477,054
3	Banco Nacional de Desenvolvimento Econômico e Social (BNDES)	Brazil	251,114	175,098
4	Korea Development Bank	South Korea	235,151	124,554
5	Japan Bank for International Cooperation	Japan	161,597	124,463
6	Development Bank of Japan, Inc.	Japan	141,171	119,056
7	IDBI Bank Ltd.	India	55,714	32,129
8	Bank for Development and Foreign Economic Affairs (Vnesheconombank)	Russia	53,284	28,409
9	Banco Nacional de Obras y Servicios Públicos S.N.C. (Banobras)	Mexico	34,151	17,985
10	Bank for Investment and Development of Vietnam	Vietnam	30,680	20,714
			3,456,738	**2,547,264**

Source: NDB annual reports

The China Development Bank (CDB) is the largest NDB in the world, and played a key role in China structural transformation and economic growth. The KfW, started in part with the Marshall Plan funds, is the largest NDB in the advanced economies, recently playing the catalyzing role in transforming Germany's economy toward cleaner energy technologies (Griffith-Jones, 2016).

Building upon initial research on NDBs in UNCTAD's 2015 Trade and Development Report, EMD-led MDBs and NDBs are 67 percent of all development finance in the world economy. In the case of development banking, the growth of the CDB accounts for roughly 90 percent of the growth in development bank finance since the crisis. Whereas the CDB held $371 billion in assets in 2006, they were approaching $2 billion in 2016. China is also a key player in the Asian Infrastructure Investment Bank and the New Development Bank.

New Benefits, New Risks

The rise of EMD finance bring new benefits to EMDs and the world economy as a hole. First, the scale of finance has increased significantly, with both liquidity finance and development banking increasing at a higher rate than gross domestic product since 2006. Second, many EMDs now have more choices for financing, which can create healthy competition across the system. Many EMD-led sources of financing do not have the controversial conditionalities that often come with advanced economy-led finance. Third, EMDs can leverage this competition to gain more voice in the advanced-economy led institutions where their voices are a minority (Gallagher, 2015; Grabel, 2017).

With new benefits also come new risks, it is not clear that such a diverse and fragmented system can solve some of the coordination failures central to Kindleberger's thesis. Some point to the way the IMF worked with the European Union's stability mechanism and the European Central Bank to show that coordination has the potential to be coherent in terms of providing liquidity financing, while others see the possibility for coordination on a global scale and in other regions to be less likely and perhaps even unwise given the diversity of actors and goals in the system (Henning, 2017; Grabel, 2017).

The scale of financing available for short-term liquidity needs has increased more than threefold, and the scale of development finance has roughly doubled.

There are also major risks associated with long-run development finance. While most nations have endorsed the SDGs, it is not clear that such goals have been incorporated into national and MDB development banking (Gallagher and Studart, 2016). Large scale infrastructure projects involve many countries and actors, and are often associated with cost overruns and corruption that can jeopardize their financial viability. What is more, if development banks do not have the proper social and environmental safeguards in place many projects can bring significant cost to livelihoods and the environment.

Perhaps the greatest concern is that despite a significant increase in the scale of financing, it is still not enough to backstop the global economy and finance the SDGs (Fritz and Mühlich, forthcoming 2018). The liquidity finance in Table 1 only accounts for 4 percent of global financial assets, which are now more than $300 trillion (FSB, 2017). And it is not clear whether the Federal Reserve Bank of the United States and/or the C6 will serve as the ultimate lender of last resort for EMDs as they did for a handful of EMDs in the wake of the global financial crisis. Whereas in 2007-8 the United States Federal Reserve Bank and its counterparts in the advanced economies were heavily exposed to risky assets at that time, the majority of debt in the global economy resides in EMD's themselves and is less linked to the United States than during the global financial crisis. As was the case with all EMD financial crises previous to the global financial crisis, EMDs will likely have to turn to the IMF and the regional financial institutions if their own reserves do not prove to be sufficient.

Similarly, there lacks the necessary development bank financing to meet the world's goals of transforming the global economy into one that is low-carbon and socially inclusive, representing just 8 percent of global GDP. If all development banks in the world economy committed one third of their balance sheets to addressing the sustainable infrastructure gap that stands at $48 trillion, (as many of the advanced economy backed MDBs have), they would need a leverage factor of public to private finance of 1:4 yet some of the most successful development banks have not been able to leverage 1:10.

Nevertheless, the global development finance map has changed. There has been a significant expansion in new institutions and a re-invigoration of established institutions. EMDs are poised to lead as they control 63 percent of non-C6 liquidity finance and 80 percent of development bank financing. Beyond global summits and annual/spring meetings of the advanced economy-led international finan-

cial institutions, broader and more inclusive forums for cooperation will be needed. Such efforts should be bolstered and be put on more equal footing with the advanced economy backed forums on global development finance.

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