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Rise of the global South and descent of the North?

Exploration of the rise of the global South and its impact on international financial architecture

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1. Introduction – The "rise of the global South" and the changing global geopolitical environment

The 2008 crisis and its aftermath have set out the context for a long-needed discussion about the future of the global economic system. First, it gave emerging market economies (EMEs) the opportunity to show their resilience against external shocks, which was particularly significant in a moment when the developed world was proven to not be as robust as it claimed. Secondly, the crisis exposed the flaws of the prevailing system, and of the ideology behind it. While this scenario has been making it increasingly difficult to deny the 'rise of the global South', it has also been raising a series of questions about the implications of the new balance of power in the global economy. Particularly, how will the pre-2008 global economic system change in order to maintain its relevance in the future and, most importantly, who will be the winners and losers in this re-arrangement? The answer to this question will have to take into account the establishment of new institutions by EMEs, such as the New Development Bank (NDB), the Contingent Reserve Agreement (CRA), and the Asian Infrastructure Investment Bank (AIIB), and their impact on the role traditionally played by the World Bank (WB) and the International Monetary Fund (IMF). Whilst recognising that these new institutions have been transforming the landscape of the global economic system and affecting the influence of the WB and the IMF, this paper will challenge the view that they are reflective of a corresponding decrease in the US-shaped international monetary and financial architecture, as so far these initiatives have failed to reduce the centrality of the US dollar.

The rise of the global South can be traced back to the early 2000s, when EMEs, particularly in Asia, began policies of reserve accumulation as self-insurance balance of payments strategies (Aizenman, Lee, and Rhee 2004; Rodrik 2006; Carvalho 2010). Reserve accumulation came as an immediate response of EMEs towards the trauma of having to resort to the IMF and submitting to the its conditionalities, when they faced financial crises in the late 1990s.[1] Indeed, the accumulation of international reserves was the way found by EMEs to protect themselves against an unstable international monetary and financial system with inadequate international financial institutions (IFIs). In 2008, developing and emerging countries accounted for 65 per cent of global reserves, against only 28 per cent in 1990 (Aizenman, Jinjarak, and Park 2010, 1).

Sizeable foreign reserve accumulation by EMEs is closely related to the rise of China. Leaving aside the fact that China itself has been the top holder of international reserves among these economies, it has also been decisive to allow the accumulation of international reserves by other EMEs. Following China's accession to the World Trade Organization (WTO) in December 2001, commodity prices began to rise steadily, improving terms of trade for commodity exporting countries, which resulted in current account surpluses that allowed EMEs to pursue policies of foreign reserve accumulation (Ocampo, 2007).

Moreover, favourable global economic conditions for EMEs and their stockpiles of international reserves gave rise to other policies that also contributed to reduce EMEs' dependence over traditional IFIs. First, EMEs were able to reduce their external debt exposure, which included paying off their remaining debts with the IMF, as Brazil and Argentina did in 2005. Second, sovereign wealth funds (SWFs) owned by EMEs emerged as major new players in the international monetary and financial system. As highlighted by Drezner (2008, 116), commodity exporters and countries running fiscal and trade surpluses were the two types of governments investing in SWFs in the early 2000s. Third, this period also witnessed the revival of regional monetary and financial cooperation among EMEs (see for example Ocampo 2006a; UNCTAD 2007). Following the lead of Asia, which launched the Chiang Mai Initiative (CMI)[2] in 2000, South American countries alliances also revived and created new mechanisms for regional monetary and financial cooperation, such as the Structural Convergence Fund for MERCOSUR (FOCEM) (2005), the Local Currency Payment System in MERCOSUR (SML) (2008), and the Banco del Sur (2009).

While the world recognised the growing weight of EMEs in the global economy, this was not accompanied by an equivalent participation of EMEs in the traditional IFIs, notably the IMF and the World Bank. Even before the 2008 global financial crisis, attention began to be drawn to the necessity of reforming the international monetary and financial system and increasing EMEs' quota in the Bretton Woods Institutions (BWI). The 2008 meltdown created the political momentum to boost EMEs' influence in this system. This was both because EMEs were much more resilient in comparison to previous crises, and because the 2008 crisis originated in developed countries, affecting their economies and financial systems relatively more than developing countries.

The 2008 crisis to an extent created an inflection point for greater political participation of EMEs, which was well illustrated by the replacement of the G7/8 by the G20 as the main forum for international macroeconomic coordination. The G20 can be regarded as the most significant change that came in the wake of the crisis, and that contributed to a better balance between global economic and political power. Following the G20 discussion at the 2009 London Summit, the Financial Stability Forum (FSF) was expanded to include all members of the G20 who were not members of the FSF, which then became Financial Stability Board (FSB).

Nevertheless, as the worst of the crisis passed, the pace of reforms began to slow down. Following the 2008 reform of the IMF's quota and vote of allocation in November 2010, the Fund agreed wide-ranging governance reforms to acknowledge the rising importance of EMEs. With the reform, Brazil, China, India and the Russian Federation will be among the top 10 IMF shareholders, together with the US, Japan, France, Germany, Italy and the UK. Yet, this second reform is currently blocked in the US Congress.

Given the limited prospect for significant changes in the current international monetary and financial system, particularly regarding the BWIs and the centrality of the dollar as the main international reserve currency, emerging countries began to work on their own alternatives. First, they began to invest more in initiatives such as the NDB, the CRA, and the AIIB. In Asia, the CMI was expanded in 2010 to become the Chiang Mai Initiative Multilateralisation (CMIM). Another manifestation of EMEs' dissatisfaction with the current global monetary and financial architecture, including the dollar's role as key currency, was not only the announcement of China intentions to internationalise its currency, but also other initiatives in this direction.

BRICS leaders at the 6th BRICS summit 2014
Photo credit - Kremlin.ru

In summary, the last 15 years have witnessed a process of strengthening the EMEs and lowering of their traditional dependence on the BWIs for funding. Pulled by China, these countries have increased their share in global growth, trade and financial flows. To that extent, they have become economically more influential. However, this increased economic power has not been matched by equivalent political influence in the existing BWIs. This became critical particularly after the 2008 crisis, when there was a momentum to make the required reforms.

Following this brief introduction, the remainder of this document will focus on how this changing global geopolitical environment is influencing the BWIs. In the first section, it discusses how it is affecting the traditional role played by the WB and the IMF. The second section looks at key changes in the influence of the BWI in terms of (a) global leadership and key policy areas; and (b) strength when negotiating with individual member states for the provision of finance. The final section draws conclusions.

2. How did the rise of the South affect the roles traditionally played by the World Bank and the International Monetary Fund?

In general, the main consequence of the developments described above was a greater resilience of EMEs when facing the 2008 crisis, which meant they did not need to be rescued by the BWIs in contrast with previous episodes of crises. In fact, public debt managers in several EMEs improved their countries' debt portfolios in the period preceding the crisis, thereby reducing the exposure to changes in exchange and interest rates and increasing the focus on domestic debt financing (for an analysis of EMEs see Anderson, Silva, and Velandia-Rubiano 2010; for a detailed analysis of Brazil see Cunha, Prates, and Ferrari-Filho 2011). Thus, when most EMEs' currencies depreciated during the crisis, public debt fell instead of rising, allowing governments to pursue counter-cyclical measures. For instance, they could expand the role played by their national development banks, as the Brazilian government did with the Brazilian National Development Bank (BNDES). This represented a structural change in some EMEs to break out of a negative shock cycle.

An interconnected consequence of this greater resilience of EMEs was their emergence as creditors in the global economic system. Differently from previous crises episodes, EMEs not only did not need to resort to the WB and the IMF for financial help but also contributed to augment the resources available for the IMF's rescue packages. To that extent, it would be reasonable to expect at least some increase in EMEs' influence on global economic governance, since creditor countries traditionally have more power within the IMF and the WB.

In the case of the IMF, several EMEs contributed to the New Arrangements to Borrow (NAB), increasing the available resources that contributed to the IMF signing some 35 new agreements since 2010 (Nissan 2015). Also, the IMF joined the European Central Bank (ECB) and the European Commission (EC) to form the so-called Troika to rescue vulnerable economies within the eurozone. Moreover, the Fund has been branching out to act as the global thought leader on subjects such as inequality, gender, tax justice, environment, etc. (Nissan 2015). All this has contributed to put the IMF back on the core of global economic governance, after going through an 'identity crisis' since the mid-2000s, when most EMEs paid off their debts. However, despite EMEs' financial contributions and their unprecedented status as creditors in the system, so far the power of the IMF still resides with the US (Vernengo and Ford 2014).

In the case of the WB, in the 2012 presidential election there were for the first time two other serious contenders besides the US candidate, both from EMEs (The Economist 2012; Lowrey 2012). The fact that there was competition was very symbolic, and also forced the US out of a pattern of always designating someone from the State Department or a banker.[3] Nonetheless, similarly to what happened in the IMF, there were no concrete advances in terms of an increased influence of EMEs, as the US candidate ended up continuing the long tradition of an US national leading the WB.

Finally, there was the rise of the G20 as the world's economic coordinator, which has been regarded as a manifestation of the increased importance of EMEs in the global economic system.

In November 2008, the G20 leaders met in Washington D.C. at the invitation of the US president George W. Bush in response to the worldwide global financial crisis. Later, at the Pittsburgh summit in September 2009, the G20 officially replaced the G8 as the leading forum for international economic cooperation. This change puts at the table states such as Brazil, China and India.

View from the top of the Sathorn Unique Building, Bangkok
Photo credit: Just a one way ticket

At the height of the crisis, the G20 affected to some extent the role played by the BWIs. First, the G20 has been, since 2008, a meeting of heads of states, whereas the IMF and the WB bring together ministers of finance and central bank governors. So in theory, the G20 could have more decision-making power than the traditional BWIs. Second, the G20 was the forum that catalysed reforms in other financial forums. Besides the IMF and WB reforms, where voting shares of EMEs increased relatively (in theory, at least), the G20 action influenced the expansion of the Basel Committee on Banking Supervision (BCBS), coordinated by the Bank for International Settlements (BIS), to include EMEs´ members, such as Australia, Brazil, China, India, Mexico, Russia and South Korea in March 2009. Third, because it is an informal forum, the G20 tended to be more agile in their actions when compared to formal institutions such as the IMF and the WB, which is essential in a time of financial crisis.

On the other hand, because it is an informal forum, the G20's recommendations have much less influence over their members when compared, for instance, to the IMF or the WB. The low enforcement of the G20's resolutions became clearer when the worst of the crisis was over and the forum began to lose its importance. Therefore, the rise and fall of the G20 illustrates well the euphoria about EMEs' power in the international monetary and financial system. In other words, EMEs' importance was recognised during the crisis through the ascension of the G20, but in the end they remain as peripheral countries in the current system, with limited power and influence.

Insofar as EMEs did not find correspondence to their growing economic relevance in the current IFIs, they began to invest in their own alternatives. One of them consists of ad-hoc bilateral arrangements among themselves. Still at the height of the crisis, the US Federal Reserve chose four EMEs for temporary bilateral swaps agreements (Brazil, Mexico, South Korea and Singapore). Later, bilateral swap agreements were formalised among EMEs both in hard currencies (i.e. the US dollar) and in local currencies, such as the Chinese renminbi and the Korean won (Duran, 2015). This movement coincides more or less with the decline of the G20 and with the impasse regarding the IMF 2010 reform, which became more evident after 2014 (Wade and Vestergaard 2015; Harding 2014; Griffiths 2014). In July that year, during their 6th summit in Fortaleza, the BRICS (Brazil, Russia, India, China and South Africa) came good on their promise to establish the NDB and the CRA.[4] Later in October, the AIIB was launched at a ceremony in Beijing.[5] In November, before the G20 meeting in Brisbane, UK newspaper the *Guardian* said, "the leaders … will be under pressure to achieve something tangible for the gathering to prove its relevance" (Taylor 2014).

It is still too early to say if the establishment of new IFIs will signify a radical departure in the position of traditional BWIs, particularly of the IMF, which has been more successful than the WB in reinventing itself. Even so, in the medium/long term, the new IFIs represent potentially strong contenders for the IMF and the WB. Moreover, in the short term, the creation of new IFIs is a meaningful response of EMEs from a political/symbolic standpoint given the lack of progress – and prospects – for reform of the traditional IFIs making them truly multilateral institutions.

3. Key changes in the influence of the Bretton Woods Institutions

Having considered how the changing global geopolitical environment has affected the role traditionally played by the BWIs, this section moves on to discuss the transformations in the way the influence of the BWIs is exercised in terms of a) global leadership and key policy areas; and b) power when negotiating with individual member states for the provision of finance.

The rise of EMEs and the subsequent establishment of new IFIs contributes to more consistency between the international financial architecture and a more multipolar global economy, where economic and political power has began to be less concentrated in a few countries, notably in the US and Western Europe, than in previous times. This is significant to the extent that the new IFIs have the potential to project the perspectives and beliefs of their members in key policy areas, such as macroeconomic policies, economic development, social policies, etc. This can lead to a more balanced view about policy prescriptions in the future.

At the same time, the emergence of new IFIs can potentially strengthen the international financial architecture by complementing and by competing with the traditional BWIs. The argument made by Ocampo (2006b, 4–6) to make the case for regional financial institutions can also be used in defence of the new IFIs. In particular, given the heterogeneity of the international community, institutions led by emerging countries can play complementary roles to the ones dominated by the US and Europe. If we bear in mind that the existing institutions were unable to prevent or handle satisfactorily the 2008 financial crisis, the idea of having concurrent perspectives about global economic matters is even more interesting. Competition among institutions will potentially also favour small and medium-sized countries when negotiating the provision of financial services, which will have access to a broader menu of alternatives to choose from. On the other hand, there is also a possibility that the competition leads to a regression in terms of human rights safeguards and environment protection, since the rise of the South has been associated with a race to the bottom in those areas (Dossani 2014).

Therefore, overall it seems beneficial for the global financial architecture as a whole to count on a new set of IFIs. On the one hand, the new IFIs will boost the debate about global leadership and key policies areas, bringing the perspective of EMEs and hence ending the one-sided view on those subjects. A more comprehensive picture about global economic matters can be useful to prevent financial crises in the future. On the other hand, the new IFIs will complement and compete with the traditional BWIs, which will tend to favour particularly small and medium-sized countries.

Nevertheless, two observations must be made regarding this emerging monetary and financial architecture. First, even if the power of the IMF and the WB are to be reduced with the emergence of new IFIs, the US and the US dollar influence over the system will remain substantial in the foreseeable future. Second, while new IFIs are generally regarded as an initiative of EMEs, China's key protagonist status cannot be disregarded. Let us consider each of these matters.

There are a number of signs that indicate that the US will not lose its *exorbitant privilege* in the near future. In spite of the debates about the origin of the crisis in the US and the criticisms regarding the huge US deficits, the 2008 crisis ended up strengthening the dollar and US power in monetary matters (see for example Eichengreen 2009). While the biggest EMEs did not resort to formal multilateral or regional institutions to deal with the 2008 crisis, they made ad hoc bilateral swap agreements, notably with the Federal Reserve (Duran 2015; Chey 2012). Therefore, instead of exerting its influence indirectly through the BWIs, the US could directly decide which countries would have access to the swaps.[6] Moreover, while new IFIs recently created by EMEs are welcomed as making the international financial architecture more balanced, so far they have broken little ground in terms of being independent from the US dollar. For instance, all the start-up funding for the BRICs bank will be in dollars; in comparison, only 10 per cent of the WB's paid-in capital was contributed in dollars (Steil 2014b). Also, countries will not be able to raise big loans from the CRA without the IMF's approval, which reveals the challenge of mutual trust among countries extending credit to one another during crises without the protection of an international institution. Finally, the US dollar has increased its leverage since the euro crisis, which has harmed the hitherto most likely contender to challenge the dollar's position in the international monetary system. To be sure, the continuance of US dollar leadership is also reflective of ongoing US economic leadership, and so far neither the EU nor China seem to be willing or ready to assume or share the costs involved.

It is also significant that most of the new initiatives that indicate a greater influence of EMEs in the international monetary and financial system are actually led by China, and that they mostly reflect China's, rather than EMEs' power. China is not only the main contributor to the new IFIs, but also the only EME that has pursued the internationalisation of its currency. China is extending its monetary influence also through other channels, such as the oil-for-loan deals that it has with Venezuela and other commodity-backed loans in the region. Interestingly enough, China has emerged as a lender of last resort for countries largely shunned by Western leaders, such as Venezuela, Russia, and Argentina. In 2010, China's loan commitments to Latin American countries were more than those of the World Bank, Inter-American Development Bank, and US Export-Import Bank combined for that year (Gallagher, Irwin, and Koleski 2012). Since 2008, China has also established about $500 billion in currency swaps with some 30 countries, ensuring the counterparties have access to yuan in the case of a crisis (*The Economist* 2015). No other EME has similar financial diplomacy, and in fact no other could have because none of them has an equivalent economic power to China.

4. Concluding remarks

This summary report has shown how EMEs were more resilient in facing the 2008 crisis and how this strengthened economic position has allowed them to increase their influence in global economic governance, particularly through the G20 at the height of the crisis. It has also argued that given the lack of progress in reforming the traditional BWIs, EMEs began to invest in their own institutions. While these new institutions are reflective of a potentially more balanced international monetary and financial system, they have failed to reduce the dependence on the US dollar. At the same time, the new IFIs are largely part of China's financial diplomacy, disguised as EMEs' initiatives. To date, the international monetary and financial architecture has been reorganised from a US perspective, where Europe has lost some power and China has gained some. This implies that BWIs will potentially be challenged by the new IFIs in the future. While other EMEs have become more independent from the BWIs, they remained dependent on the US financial support and they were much less successful than China in increasing their influence in the monetary and financial system.

1. *Besides the precautionary motive, another explanation pointed out by the literature for the extraordinary accumulation of international reserves, particularly in Asia, is to hold down domestic currencies in order to improve external competitiveness and hence promote exports (mercantilist motive) (see Aizenman, Jinjarak, and Park 2010; Ghosh, Ostry, and Tsangarides 2012).*

2. *The CMI is a network of bilateral swap arrangements among ASEAN+3 countries (ASEAN members, which are Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Vietnam, plus China, Japan, and South Korea).*

3. *Jim Yong Kim is a Korean American, what makes him the first World Bank president to come from a developing economy. Also, his professional background is not in the political or financial sectors, but in tackling health issues in developing countries.*

4. *The member countries of the NDB and the CRA are Brazil, Russia, India, China and South Africa.*

5. *Currently there are 57 prospective founding members, being 37 regional and 20 non-regional countries. In July 2015 Myanmar was the first country to ratify the agreement, becoming a founding member. The other countries are Australia, Austria, Azerbaijan, Bangladesh, Brazil, Brunei, Cambodia, China, Denmark, Egypt, Finland, France, Georgia, Germany, Iceland, India, Indonesia, Iran, Israel, Italy, Jordan, Kazakhstan, Kuwait, Kyrgyzstan, Lao, Luxemburg, Malaysia, Maldives, Malta, Mongolia, Nepal, Netherlands, New Zealand, Norway, Oman, Pakistan, Philippines, Poland, Portugal, Qatar, Republic of Korea, Russia, Saudi Arabia, Singapore, South Africa, Spain, Sri Lanka, Sweden, Switzerland, Tajikistan, Thailand, Turkey, UAE, United Kingdom, Uzbekistan, and Vietnam.*

6. *In October 2008, the Fed offered access to a maximum of USD 30 billion in swap lines to Brazil, Mexico, Singapore and South Korea. As noticed by Benn Steil, "That year [2008], the Fed privately rebuffed swap-line requests from China, the Dominican Republic, Indonesia, and Peru. And two years later [2010], then the U.S. economy had become much less vulnerable to foreign financial instability, the Fed allowed its swap lines with Brazil, Mexico, Singapore, and South Korea to expire. Two years after that, in 2012, the Fed denied a swap-line request from India" (Steil 2014a, 56).*

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