The Upside of a Messier Global Financial Architecture

Ilene Grabel

Don't get me wrong. I'm not a theorist who thinks crises are justified despite the suffering they cause, provided they bring about some beneficial outcomes. And by no means am I hoping for another one. But in all of the commentary on the global financial crisis—on its origins, the devastating spillover effects in the wealthy countries where it emerged, the lessons learned and ignored—little attention has been paid to the one beneficial effect. The crisis has led to the emergence of a less streamlined, buttoned-up, and unipolar—or as I think of it, a less coherent—global financial architecture (GFA).

It might seem strange for a social scientist, and especially an economist, to celebrate incoherence. Economists in particular are trained to discover and advocate for theories, models, and institutions that are coherent and parsimonious. And in any case, how could incoherence in the GFA (or anywhere else) be beneficial when each day brings neck-snapping incoherence from the White House and beyond?

The GFA is the web of institutions and networks at the heart of the international financial system. It governs among other things a range of financial flows and institutional relationships. Most observers of this system emphasize continuity with the pre-crisis financial landscape rather than discontinuity. They rightly note that the United States, the dollar, the Federal Reserve, and the Bretton Woods institutions—that is, the International Monetary Fund (IMF) and the World Bank—continue to play critically important roles in the GFA, as they've done since the end of World War II. Moreover, those emphasizing continuity point out that plans for radical restructuring of the GFA that were advanced as the global crisis unfolded in 2008–9 faded quickly in the face of political and economic realities and inertia. By and large, they are disappointed with the extent of post-crisis reform.

The continuity view misses a fundamental point. Change is typically understood as epochal ruptures of the sort that occur infrequently in historical terms, but nevertheless receive disproportionate attention from scholars and other observers. That is a mistake. Meaningful transformation more often follows the path of ad hoc and disconnected evolutionary adjustments. And that is just what has happened to the GFA over the past decade or so.

Although the United States and the Bretton Woods institutions still play central roles in financial governance, substantial discontinuities have emerged in the GFA. Things are different today, and the difference matters. This is especially the case for developing nations, which now look out on a new kind of GFA that provides substantially greater opportunities for autonomy in economic policy.

My view is that emergent incoherence in the GFA should be understood in large measure as a good thing, conducive to development and financial stability. I use the term incoherence to capture the complex, dense, messy, and redundant aspects of the GFA. Incoherence holds promising and generally overlooked opportunities for developing economies—opportunities that were not available in the coherent financial environment of the past few decades, when the Bretton Woods institutions were monolithic and the only game in town.

New players

The roots of evolution in the GFA can be traced to the East Asian financial crisis of the late 1990s. That crisis renewed interest among developing-world policy makers in creating institutions that would supplement and, in some cases, substitute for the Bretton Woods institutions. Most prominent among the proposals developed at the time was the quickly aborted Japanese call for an Asian

Ilene Grabel *is a professor of international finance at the University of Denver. Her latest book is* When Things Don't Fall Apart: Global Financial Governance and Developmental Finance in an Age of Productive Incoherence *(MIT Press, 2018).*

Monetary Fund, intended as a regional alternative to the IMF.

A decade later, the global crisis incentivized a drive toward institutional innovation, which bore significant fruit. The resources necessary to sustain new experiments had become available to rapidly growing developing nations in the interim between the two crises. By 2008, several had amassed substantial reserves that they were willing to invest in new financial governance institutions and in economic development.

A crucial legacy of the global crisis is the willingness and ability of developing nations to undertake ad hoc, uncoordinated innovation in institutions that provide long-term loans for infrastructure (and other large projects) and those that disburse support to countries in crisis. These two forms of finance have traditionally been the domain of the World Bank and the IMF, respectively. The global crisis motivated policy makers from developing nations to establish entirely new subregional, regional, and transregional institutions and to build out older institutions.

Many institutions that disburse crisis support (and other forms of liquidity) and whose existence predates the global crisis have expanded their scale of activity and geographic reach; some have introduced novel mechanisms. Examples include the Latin American Reserve Fund, the Arab Monetary Fund, and the Chiang Mai Initiative of the Association of Southeast Asian Nations plus Japan, China, and South Korea. All but the latter have disbursed funds to member nations.

Older institutions that provide long-term finance—so-called development banks—also expanded their roles and capacities during the crisis, while some took on the new role of disbursing crisis support. They include Brazil's National Bank of Economic and Social Development, the Development Bank of Latin America, the Export-Import Bank of China, and the China Development Bank.

A number of entirely new institutions were created during the global crisis. Some focus on crisis support, others on the provision of long-term loans, and some do both. Among them are the Eurasian Fund for Stabilization and Development (part of the Eurasian Economic Community), the Contingent Reserve Arrangement and New Development Bank of the BRICS (Brazil, Russia, India, China, and South Africa), and the China-led Asian Infrastructure Investment Bank. There are also at least 13 funds that China has created to support the ambitious Belt and Road Initiative.

Many of these institutions have signed cooperation agreements with one another. In contrast to its earlier opposition to the Asian Monetary Fund proposal, the IMF has encouraged the expansion of these institutions and connections among them. In a further departure from past practice, the IMF is now exploring options for cooperation with them and considering a funding instrument to be used for such purposes.

Emergent incoherence and the redundancy associated with financial institutions that duplicate and complement some of the functions of the Bretton Woods institutions offer new and expanding opportunities for developing nations. It is in this sense that incoherence and redundancy are productive, which is not to say without risk.

Possibilities and perils

The new institutions do not coalesce around a singular, grand new global architecture that might replace the Bretton Woods institutions. Indeed, they are explicitly not intended to do so. For relatively large economies, the IMF is still the only institution that is sufficiently well resourced to provide a vast support package, such as the $50 billion loan Argentina recently sought and received. In October, Pakistan also approached the IMF, seeking a loan of up to $7 billion.

Nor do the new institutions amount to a potent challenge to US financial hegemony and that of other advanced economies. But displacement is the wrong standard by which to measure their significance. Instead, this is an expansion of disparate, overlapping, and interconnected institutions that productively complement the IMF and the World Bank. Taken together, they are diversifying the financial landscape in developing nations and introducing the possibility of a transition to a more decentralized, heterogeneous, and pluripolar GFA. Pluripolarity, as I use it here, refers to increasing diversity, heterogeneity, and even inconsistency within the landscape of global financial governance.

One advantage of incoherence and pluripolarity is that they provide developing nations with a degree of insulation from the spillover effects of a noxious global policy environment that features destructive economic nationalism, conflict, erratic policy changes, and high levels of financial fragility. An unintended consequence of a streamlined, coherent, centralized GFA is that negative spillovers can be more powerfully and directly transmitted from country to country and from region to region.

In addition, a more densely populated institutional landscape expands the ability of developing nations to pursue policies of their choosing (usually referred to as "policy space") and to achieve ambitious targets such as those associated with the United Nations' Sustainable Development Goals (SDGs). There are increased opportunities for problem solving and learning by doing and from others; for new partnerships, networks, and coalitions; and for "forum shopping" by smaller countries that traditionally have had the fewest options to secure external financing while also facing the greatest constraints on their policy space.

Greater availability of long-term loans and crisis support fills gaps in the GFA. Unfolding architectural innovations are complicating the terrain on which the Bretton Woods institutions operate, and pressuring them to reform their internal governance and practices to address long-held concerns of developing nations.

This increasingly dense institutional landscape holds the potential to increase the robustness of the global financial system. Greater density could yield productive redundancy that would increase opportunities to finance development, reduce instability, and contain and ameliorate crises. A collection of institutions that have some degree of autonomy from each other may be able to dampen crisis contagion across countries. Moreover, each crisis might allow for learning that induces new innovations better able to prevent or limit the scope of future crises.

The global crisis incentivized a drive toward institutional innovation.

That's the upside; I believe it is substantial. But we must also recognize that incoherence, redundancy, and pluripolarity entail unique and important risks. Institutions may work at cross-purposes, especially during crises, undermining each other's efforts and causing cross-border spillovers that disrupt each other's economies. Destabilization may deepen when there are uncertainties about where responsibility lies during crises.

Similarly, uncertainties and conflict over rules of engagement and leadership can worsen instability during a crisis. That was the case with the "Troika" of the IMF, the European Commission, and the European Central Bank as they responded to the Eurozone crisis. Such experiences have surely driven the IMF's recent efforts to negotiate rules of engagement with developing-nation institutions before the next crisis.

The present conjuncture of international forces is fraught with risks. Across the Atlantic, these include the risks associated with a disorderly British exit from the European Union and the electoral success of nationalist parties. In the United States, a multiplicity of risks emanate from the Trump administration. Among them are the administration's attack on the rule of law and the Federal Reserve's independence; its efforts to dismantle the institutions, norms, and practices of multilateralism; its dogged commitment to rolling back the anemic financial regulations enacted after the global crisis; and its erratic and self-defeating trade policies.

Globally, the financial environment is no less fraught. Particularly worrisome are risks emanating from shadow banking, cryptocurrency markets, high levels of corporate debt in many nations (particularly in developing nations), and rising interest rates in advanced economies. Rising rates induce capital outflows from developing nations and consequently cause currencies to depreciate. Currency depreciation, in turn, raises the cost of servicing corporate debt, since much of it is repayable in dollars and euros (as Turkey's current situation reveals). In the face of this combination of political and economic risks, it is not at all difficult to imagine a deglobalized world marked by a proliferation of nationalist beggar-thy-neighbor policies and contagious economic instability.

INTO THE VOID

Despite all the incoherence, financial fragility, and conflict in the world, it is naive to think that coherent regimes—such as the monolithic GFA centered on the United States and the Bretton Woods institutions—must be the model to which we aspire. After all, would it be better for developing nations if the Trump administration had at its disposal a streamlined financial architecture through which it could leverage its power to constrain policy autonomy, frustrate progress on the SDGs, and otherwise wreak havoc and play out petty grudges?

As damaging as Trump's impact has been so far—and the worst may be yet to come—it's at least arguable that he lacks the levers under the evolving GFA to impose his vision on others. A Trump in, say, 1990—at the height of the coherent neoliberal GFA—might well have posed a more immediate threat to developing nations. It is implausible to think that their aspirations would be better served by a return to the institutionally sparse financial architecture of past decades.

It is best, I think, to consider the present moment as an interregnum between an era dominated by a dysfunctional Bretton Woods neoliberal monoculture that underserved developing nations and the emergence of something else, the parameters of which are as yet unknown and unknowable. The evolving landscape is not likely to settle into a new, coherent GFA that resembles the orderliness of the era before the global crisis. The leverage of larger developing nations in global and regional financial governance is increasing, especially as institutions led by China come to play a more prominent global role.

The array of China-led institutions is complementing, competing with, reshaping, and above all complicating the traditional Bretton Woods landscape, where the line between advanced-economy lending and developing-nation borrowing used to be clearly drawn. The vacuum created by the recent US rejection of multilateralism suggests that there will be both greater space and a more urgent need for China and others to step into the void. This of course presents opportunities and risks for developing nations, for US power and relevance, and for the shape of multilateralism.

The emerging productive redundancy threatens the streamlined, top-down, centralized Bretton Woods order, which promised efficiency but in fact generated extraordinary risks, created vulnerabilities to contagious crises, and badly underserved developing nations. Redundancy and networks of cooperation among developing-nation institutions and between them and the IMF may boost overall financial resilience by increasing the size and range of crisis support options while also providing new avenues to secure finance for infrastructure (and other necessary investments) and to make progress toward some of the SDGs.

Engineers understand the need for redundancy in safety systems to ensure that they hold up under intense stress. The increasingly dense and networked GFA is prudent in the same way, even if it is by no means adequate in its current form to maintain stability during the next big financial crisis.

Nothing I've said implies that things won't fall apart—indeed they can and inevitably will. But when they do, will a denser, pluripolar GFA prove better situated to respond to the needs of developing nations in a world in which the Trump administration is unlikely to allow the Bretton Woods institutions to perform their traditional roles? Present conditions suggest that we may learn the answer to this question sooner rather than later. ■