GLOBAL FINANCIAL SAFETY NET

In a more shock-prone world, strengthening the financial safety net is more important than ever

IN TIMES OF economic crisis, countries can tap various financial resources, both internal and external. The global financial safety net is a set of institutions and mechanisms that provide insurance for economies against crises to lessen their impact.

This safety net consists of four main layers: countries' own international reserves, bilateral swap lines whereby central banks exchange currencies to provide liquidity to financial markets, regional financing arrangements by which countries pool resources to leverage financing in a crisis, and the IMF.

International reserves are the first line of defense in a crisis; however, because of their high cost, they are unevenly distributed, with most held by advanced economies and larger emerging market economies.

A more efficient way of insuring against crises is through pooled resources, such as the IMF, swap lines, and regional financing arrangements. Although the latter two have grown considerably over the past two decades, they are still available only to a limited group of countries.

This is why the IMF is so important to this system. It is the ultimate global crisis lender and insurer of the uninsured. Yet the IMF's lending capacity as a share of global external liabilities has gradually diminished over time. And the share of borrowed resources has increased.

To continue to play this critical role at the center of the global financial safety net, permanent quota IMF resources need to be boosted. This will bolster the capacity to protect against future crises and, in particular, support members with smaller financial buffers, who need them most. F&D

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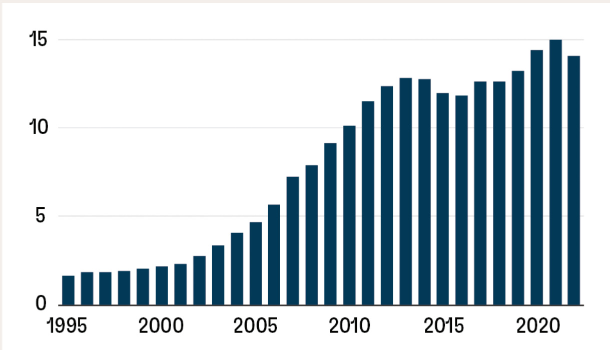
First line of defense

Countries prepare for and respond to shocks by building up foreign exchange reserves, but these reserves are very costly.
(international reserves, trillions of US dollars)



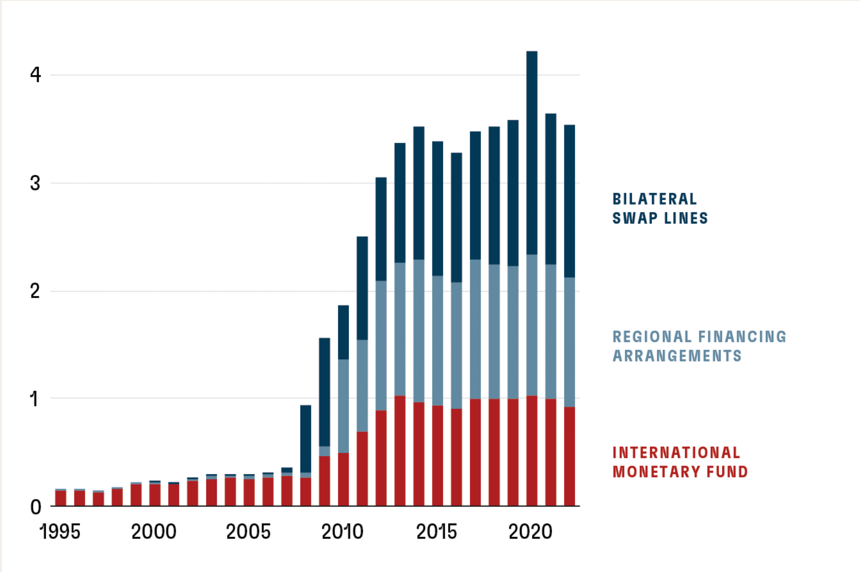
SOURCE: IMF.

97%

of international reserves are held by approximately half the world's economies, with a group of about 90 vulnerable emerging market and low-income countries accounting for the remaining 3%.

International insurance mechanisms

Pooling reserve holdings between countries and drawing on them when needed is more efficient; this is where the other components of the global financial safety net come in.
(trillions of US dollars)



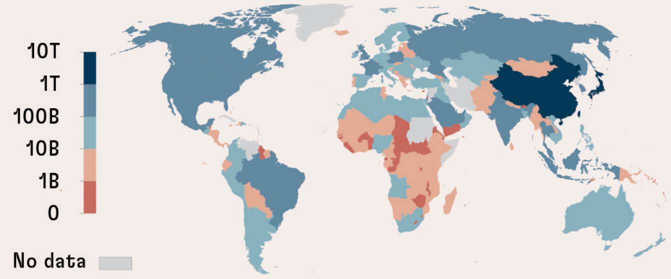
SOURCES: Central bank websites; regional financing arrangements' annual reports; and IMF staff estimates.
NOTE: Since the safety net is composed of various currencies, its US dollar value fluctuates with exchange rates.

Shrinking safeguard

Although international reserves have risen rapidly, that increase in self-insurance has been highly uneven. Poorer countries remain underinsured, leaving them vulnerable to shocks. Meanwhile, the IMF, at the center of the safety net, has shrunk in relation to the total size of global external liabilities and is now far more reliant on resources temporarily borrowed from a few member states. The IMF's traditional quota resources, its permanent capital contributed by all member states, have decreased in relative terms.

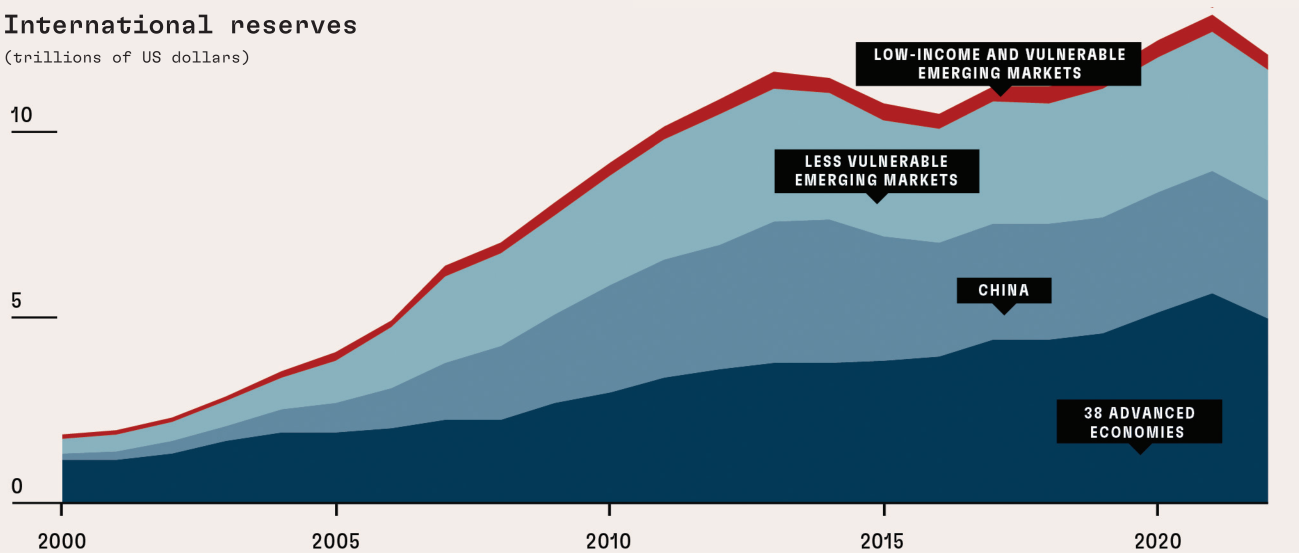
Distribution of international reserves

(US dollars, latest available data)

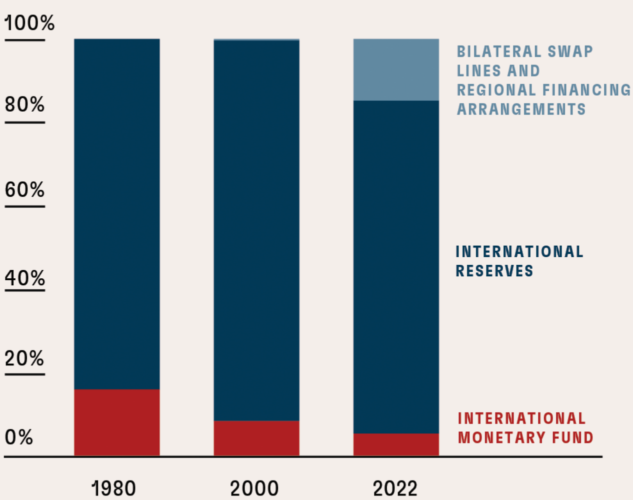


International reserves

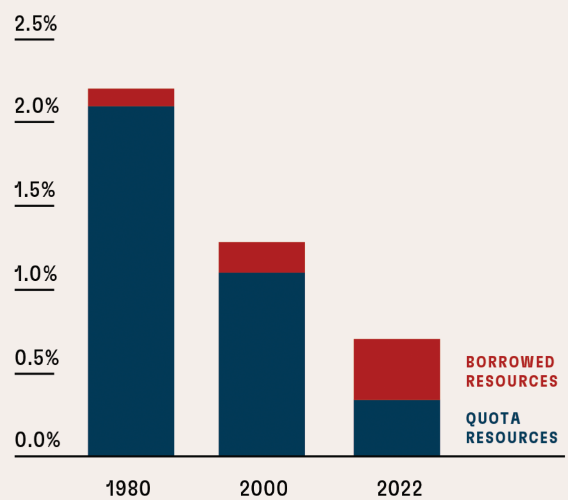
(trillions of US dollars)



Composition of the global financial safety net, share of total



IMF resources relative to global external liabilities



SOURCES: Central bank websites; regional financing arrangements' annual reports; and IMF staff calculations.

NOTE: Reserves chart and map above exclude gold. Data are not available for all economies. The boundaries, colors, denominations, and any other information shown on the maps do not imply, on the part of the IMF, any judgment on the legal status of any territory or any endorsement or acceptance of such boundaries.