



## **Geo-Economic Fragmentation and the Future of Multilateralism**

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SHEKHAR AIYAR, JIAQIAN CHEN, CHRISTIAN EBEKE, ROBERTO GARCIA-SALTOS, TRYGGVI GUDMUNDSSON, ANNA ILYINA, ALVAR KANGUR, TANSAYA KUNARATSKUL, SERGIO RODRIGUEZ, MICHELE RUTA, TATJANA SCHULZE, GABRIEL SODERBERG, AND JUAN PEDRO TREVINO

### What does this SDN do?

- Proposes a working definition of GEF, highlighting what it includes and what it doesn't (Section I)
- Provides evidence of early signs of GEF (Section II)
- Discusses GEF transmission channels and provides a range of possible impacts from recent studies (Section III)
- Discusses the implications for the International Monetary System (Section IV)
- Lays out a "pragmatic approach"—'A way forward'—to preserve the benefits of globalization, rebuild trust and make progress on upgrading multilateralism (Section V)

## Outline

I-II: Introduction and Early Signs of FragmentationIII: Transmission ChannelsIV: The International Monetary System (IMS)V: A Way Forward

### **Economic integration slowing, restrictions on the rise**



Sources: IMF Balance of Payments, World Bank and IMF staff calculations.

**Global Flows of Goods, Services and Finance** 

Sources: Global Trade Alert (2022), updated as of December 7, 2022

**Trade Restrictions Imposed** 

### Signs of geo-economic fragmentation emerging

**Geo-economic Fragmentation (GEF):** A <u>policy-driven</u> reversal of global economic integration, often guided by <u>strategic considerations (e.g., national security, sovereignty, autonomy). It does <u>not</u> include reversals due to autonomous changes (e.g., shifts in technology / preferences), or policies motivated primarily by prudential concerns (e.g., macro-prudential measures).</u>

#### Mentions of "National Security" in IMF AREAER Reports (number)



Source: IMF Asia and Pacific Department Regional Economic Outlook (2022).

#### **Mentions of Key Terms in Corporate Presentations**

(number)



Source: IMF Asia and Pacific Department Regional Economic Outlook (2022).

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### The economic consequences of GEF could be transmitted through several interconnected channels

- Trade
- Technology diffusion
- Labor flows
- Capital flows
- Global public goods
- Uncertainty



# Fragmentation could impede trade-driven income catch-up and poverty reduction

Looking back: Trade has 1

- promoted catch-up in incomes by less developed countries, and poverty reduction
- reduced prices in AEs, disproportionately helping low-income consumers

**Recently:** Trade restrictions (e.g. US-China trade dispute) have <sup>2</sup>

- raised prices for consumers
- imposed costs on growth and employment
- reduced efficiency

**Looking ahead:** Model-based estimates show **sizeable global welfare costs** of trade fragmentation (slide 11)

## A strong positive link between trade and GDP growth has obtained.



<sup>1</sup> See e.g. Frankel & Romer 1999; Dollar & Kraay 2002,2004; Jaravel & Sager 2019; Bhagwati & Srinivasan 2002.

rch <sup>2</sup> See e.g. Cavallo et al. 2021; Amiti et al. 2019; Flaaen & Pierce 2019; Barattieri & Cacciatore 2022; Barattieri et al. 2021.

### **Technological fragmentation could harm innovation and productivity spillovers**

Looking back: Global technology diffusion has <sup>3</sup>

- improved technology adoption and knowledge transfers
- enhanced the skill base of the workforce
- created innovation spillovers, e.g. to mitigate climate change

**Recently:** Fragmentation has inflicted costs through <sup>4</sup>

- market distortions from strategic subsidies
- rising restrictions on data flows...
- ..curbing productivity & raising prices

Looking ahead: Technological decoupling could result in

- less innovation
- reduced productivity spillovers
- supply shortages, and higher prices

<sup>3</sup> See e.g. Branstetter et al. 2018; Bloom et al. 2016; Acemoglu et al. 2017; UNCTAD 2018
 <sup>4</sup> See e.g. OECD 2021; Evenett & Fritz 2021; Cory & Dascoli 2021; Drake et al. 2016

# Several other channels showcase the transmission and potential harm of fragmentation

- Barriers to migration could reduce knowledge diffusion and risk-sharing <sup>5</sup>
- Reduced capital flows could hinder financial deepening and constrain investment <sup>6</sup>
- Intrinsic uncertainty about the future of multilateralism and policy uncertainty would amplify channels of fragmentation <sup>7</sup>
- Failure to coordinate on global public goods, such as climate change and pandemic preparedness, would involve substantial costs to humanity <sup>8</sup>



<sup>&</sup>lt;sup>5</sup> See e.g. Clemens et al. (2018); Acemoglu (2010); Mayda et al. (2018); Abramitzky et al. (2022); Glennon (2020); Mandelman & Zlate, (2012)

<sup>&</sup>lt;sup>6</sup> See e.g. Caldara & Iacoviello 2022; Breinlich et al. 2020; World Bank 2022

<sup>&</sup>lt;sup>7</sup> See e.g. Basu & Bundick 2017; Baker et al. 2020; Handley & Limao 2017, 2022; Bloom et al. 2019; Constantinescu et al. 2019; Baker et al. 2016; Hassan et al. 2019; Cieslak et al 2022 <sup>8</sup> See e.g. Linsenmeier et al. 2022; UNEP 2022; IMF 2021; Black et al. 2021; Adrian et al. 2022; Boustan et al. 2012; Cattaneo & Peri 2016; Agarwal & Gaule 2022

### The deeper the GEF scenario, the larger the estimated losses

- Layering technological decoupling on top of trade fragmentation leads to bigger GDP loss estimates
- Estimates are heterogeneous across countries, in particular AEs vs. EMs / LICs
- Short-term elasticities are likely to be smaller than long-run elasticities, implying considerable transition costs.



Sources: Individual papers and authors' calculations.

Notes: Estimates of long-run losses (% of GDP) from Global Trade Fragmentation from various studies. Numbers refer to GDP losses that are not directly comparable across papers as some refer to global GDP while others refer to specific regions or countries. Numbers in brackets represent ranges of losses based on severity of fragmentation assumptions and /or geographical ranges. NTBs denote non-tariff barriers to trade. The height of each bar corresponds to the upper limit of the range.

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### Geo-Economic Fragmentation could affect the functioning of the International Monetary System (IMS)



### **GEF could lead to a more shock-prone global environment**

Creditor Base for the PRGT countries: 1996 vs 2020 (in percent of total external debt)

Non-Paris

WB-IDA

21%

African Dev.

Bank IMF 6%

5%

Other

8%

WB-IDA

21%

#### Club 1996 8% Private 8% **Bilaterals** 48% Paris Club Multilaterals 39% 45% Others 12% Bondholders 2020 Non-Paris 9% Club 22% Private Bilaterals 17% 33% Paris-Club 12% Multilaterals 50% Other IMF Asian Dev. 7% 14%

Sources: World Bank IDS and staff calculations

Bank

### **Risks and possible implications:**

- Financial fragmentation → weaker international risk sharing → higher macro-financial volatility
- More fragmented international payment system → higher cost of cross-border financial transactions
- Less international policy coordination → weaker crisis prevention and management capabilities
- Less creditor coordination (especially if creditors were to split along geopolitical lines) → more challenging sovereign debt resolution

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### **GEF** could strain the Global Financial Safety Net (GFSN)

#### **Risks and possible implications:**

- Higher Demand for GFSN resources due to higher macro-financial volatility, potentially higher risk/severity of crises
- Lower Supply of GFSN resources due to reconfiguration along geopolitical lines, weaker coordination between different layers

 $\rightarrow$  greater reliance on self-insurance, new regional or bloc-specific arrangements

#### Evolution of the Global Financial Safety Net,1995-2021 (Percent of Global GDP)



Notes: see the <u>IMF Staff Discussion Note</u> 2023/001 for details . Sources: Central Bank websites; RFA annual reports; and IMF staff estimates.

# **Over time, GEF could lead to shifts in international currency configurations...**



Sources: BIS, IMF, Society for Worldwide Interbank Financial Telecommunication (SWIFT) and ECB calculations. The latest data for FX reserves, international debt and international loans are for the fourth quarter of 2021. Foreign exchange turnover data as of April 2019. SWIFT data as of December 2021.

## Role of Major Currencies in the International Monetary System

#### Central Banks' Demand for Gold and Foreign Holdings of US Treasury Securities (tons, and percent, index Mar-2012=100)



Sources: World Gold Council, TIC data

Notes: "Other major EMs" include countries with data consistently available for all years 2012-2022 (Brazil, Chile, Colombia, India, Iraq, Kuwait, Mexico, Peru, Philippines, Saudi Arabia, Thailand, UAE)

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### A New Global Landscape and The Return of Geopolitics

- Structural shifts since the 1990s: rebalancing towards large EMs, the rise of China
- Shocks: Global Financial Crisis, US-China trade tensions, Covid-19 pandemic, War in Ukraine
- Policy priorities:
  - national security
  - economic security
  - rebuilding industrial capacity
  - increasing resilience of the global value chains
  - maintaining competitiveness in high-tech sectors



Sources: see the IMF Staff Discussion Note 2023/001 for details .

### **The Future of Multilateralism – A Pragmatic Approach**



### **Application to the Global Trade System and the IMS**

I. Multilateral engagement	II. Plurilateral engagement	III. Guardrails on unilateral actions
on issues of common interest - such as climate change mitigation, food security, pandemic preparedness, stability of the IMS/GFSN, sovereign debt restructuring	<ul> <li>when multilateral negotiations stall:</li> <li>on issues such as green subsidies, trade in environmentally friendly goods, trade in services</li> <li>Safeguards: "open" and "non-discriminatory"</li> </ul>	<ul> <li>to limit damaging cross-border spillovers from unilateral actions:</li> <li>Multilateral consultations: ex ante notification, explanation of the rationale, assessment &amp; discussion of cross-border spillovers &amp; ways to address them.</li> <li>Other mechanisms: commonly agreed "norms of conduct"; "protected areas" to ensure a min level of cross-border flows in critical goods, services, finance</li> </ul>
E.g.: The Global Sovereign Debt Roundtable	E.g.: WTO Plurilateral Agreements and "deep" Regional Trade Agreements that tackle behind-the-border trade distortions E.g.: Initiatives on developing digital cross- border payment systems and related guidelines and standards	E.g.: "Safe corridors" for food, medicine E.g.: <u>To consider</u> A consultation framework on subsidies (2022 IMF-OECD-WB-WTO report) E.g.: <u>To consider</u> A multilateral platform on Strategic Trade Policies (related to new industrial policies, security considerations)

### The Role of the IMF

I. Multilateral engagement II. Plurilateral engagement III. Guardrails on unilateral actions

- provide analysis of policies and cross-border spillovers to help calibrate policy measures, to support policy coordination and the design of "guardrails"
- use convening powers to bring members together to share information, discuss issues of common interest and develop common approaches
- play a bridging role between different plurilateral initiatives
- strengthen the GFSN

#### To be effective the IMF should be

Representative of its global membership

Evenhanded and impartial in its operations and policy advice

<u>Adequately resourced</u> for a more shock-prone global environment

## Thank you