EQUALFIN – Finance and inequality in times of polycrisis – Doctoral Program

Research Area 1: Financial sector and inequality from a global perspective

Increasing instability has an impact on national financial systems and their global interdependencies, which are characterized by asymmetric relationships and are reflected in a hierarchical order of currencies (Paula et al. 2017, Fritz et al. 2022). Changes in the financial sector and monetary policymaking, particularly in hard currency countries, have *spillover* effects on the Global South, but also on the EU periphery (Han and Shang-Jin 2018, Stann and Grigoriadis 2020). This can reinforce existing income and wealth inequalities between and within countries and thus restrict economic policy options, with corresponding consequences for economic development and employment.

The *spillover* effects of the monetary policy of major central banks such as the Federal Reserve, the ECB or the central banks of Switzerland, England and Japan on the rest of the world are a growing field of research in international and comparative macroeconomics (see Rey 2015, among others) and have led to regular publications by the IMF as part of its so-called *spillover reports* and *spillover notes* particularly following the Global Financial Crisis and recession. More recently, *spillover* effects were discussed by the Bank for International Settlement (BIS, see below).

In this context, this research area addresses the impact of monetary policy changes on the economies of the global South (Asia, Latin America, Africa and the Middle East). These shocks can include both conventional and so-called unconventional monetary policy, i.e. both longer phases of low interest rate policy and significant interest rate increases. For example, the IMF has noted that appreciations of the US dollar have often led to financial and currency crises in emerging markets in the past. These countries appear to have become more resilient, at least in the late 2010s (Chow et al. 2016).

On the one hand, we are interested in the global dimension of inequality, such as the varying resilience of individual countries to global monetary shocks. On the other hand, we want to investigate possible effects on the distribution of income and wealth within the countries of the Global South. In this way, the Graduate School aims to identify transmission channels of monetary policy in major advanced economies on countries in the Global South. Channels can include changes in trust in the creditworthiness of countries and consequently in their rating. Effects are reflected in the amount and composition of international capital flows. The fiscal scope for policies of redistribution and the provision of public goods such as education and health can shrink as a consequence.

Additionally, various recent developments should be considered when examining **these North-South impact channels**. For example, emerging economies are increasingly able to refinance themselves on the international capital market in their domestic currency. This represents at least a partial reversal of the previously dominant "*original sin*", understood as the inability to borrow internationally in domestic currency, as identified by Eichengreen et al. (2005) as a structural feature of international financial markets. This reversal initially leads to a redistribution of devaluation risks from the debtor side to the creditor side. Nevertheless, Carstens and Shin (2019) argue that international creditors try to limit their losses, which they refer to as "*original sin redux*" (see also Bertaut et al. 2023). However, there is a lack of systematic research to identify the channels of action of this new phenomenon (see also Paula et al. 2020), as much as the consequences of foreign debt to rather poor developing countries (Prates et a. 2023).

Another ongoing field of research is **the rise of reserve currencies alongside the US dollar**. Not only has the international use of the Chinese renminbi increased in recent years (e.g. Arslanalp et al. 2022, Perez-Saiz and Zhang 2023, Prasad 2019). Various regional initiatives have also emerged recently, including in the context of financial sanctions against countries such as Russia due to the war against Ukraine. Examples include the idea of using their own currencies for trade between the BRICS countries (Cunha and Peruffo 2023) and the criticism of this by US Treasury Secretary Yellen (FT, 23. 6. 23); the idea of a common Mercosur currency was also taken up again in the context of the South American trade agreement Mercosur (Fritz 2023). In the MENA region, the currencies of large countries such as the United Arab Emirates, Saudi Arabia and Qatar are playing an increasing role. An innovative research agenda of the Graduate School will therefore be to investigate the possibilities and limits of the Global South's own monetary policy agenda and its influence on global monetary and financial inequalities.

One field of research that can also be supervised as part of the doctoral program is the so-called g**lobal financial safety net**. This network consists of global (IMF), regional (regional stabilization funds) and bilateral institutions (swap agreements between central banks), which currently provide largely uncoordinated short-term liquidity for countries in crisis situations. One problem is the unequal access of countries to these different sources of financing (see Mühlich et al. 2022). In this context, the rise of the relatively new bilateral instrument of currency swaps between central banks, which are primarily offered by the *US Federal Reserve Bank* and the *People's Bank of China*, can be examined. What criteria do these two countries use to award their swaps? Do economic factors such as trade and financial interdependencies dominate here, and what role does the geopolitical proximity of the partner countries play? What impact does this have on the ability of the IMF and other multilateral institutions to coordinate the debt restructuring of over-indebted countries?

Increasing financing opportunities via **cryptoassets** raise a whole range of new questions, especially for the Global South. Although research on these markets has increased (e.g. Prasad 2021, Shin 2021, Ahnert et al. 2022), little research has been done on the reasons why some countries such as Nigeria, Thailand and the Philippines are increasingly using cryptoassets (UNCTAD 2023: 4) and what impact this has on financial inclusion. The fast spread of cryptoassets and the associated reduced transaction costs have the potential to create new instabilities in the financial system (BIS 2023). The possibility of using cryptoassets for global transactions also challenges previous thinking on how to deal with changing global capital movements. Capital controls, which have officially been regarded by the IMF since 2012 as a last resort in response to excessive capital inflows (IMF 2012, see also Ostry et al. 2010 and IMF 2022), can easily be circumvented via cryptoassets. The regulation of these markets could also become a challenge, especially for the central banks of poorer countries (UNCTAD 2023, IMF 2021, Joebges et al. 2022, Adrian et al. 2023). The introduction of digital cryptocurrencies by central banks, on the other hand, has the potential to change the previous global impact of the monetary policy of major central banks such as the Federal Reserve, the ECB or the central banks of Switzerland, England and Japan. This comes especially as China, a country in the Global South, appears to be playing a pioneering role and is also using the digital renminbi as an element to reduce its dependence on the US dollar (Bansal and Singh 2021).

Possible research questions for this research focus are:

- To what extent does the economic policy space of central banks depend on their position in the currency hierarchy? How do these asymmetries change in a multipolar world with new regional hegemons such as China? For these research questions, we can draw on the accompanying expertise of, for example, Luiz F. de Paula (UFRJ, Brazil) and Annina Kaltenbrunner (Leeds, England) as cooperation partners.

- How does China's increasing influence as a long-term and short-term creditor affect the financial vulnerability of low-income countries? Here we can draw on our established cooperation with UNCTAD (Geneva).
- Under what conditions can capital controls expand the space for economic policy in Latin American countries?
- Are new forms of transnational payment options, e.g. through decentralized cryptoassets, changing the effects of the financial sector to the detriment of countries in the Global South?
- What are the consequences of increasing inequality for central banks and financial systems? How do central banks deal with the conflicting goals of stabilization and distributional effects?

Potential supervisors:

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