THREE ESSAYS ON INTERNATIONAL COOPERATION, CENTRAL BANK SWAP LINES AND BENCHMARK INTEREST RATES

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Abstract

This dissertation comprises three essays that contribute to a deeper understanding of the Global Financial Crisis (GFC), the Federal Reserve’s international response, and the U.S. government’s campaign for benchmark interest rate reform, shedding light on the implications for effective monetary policy transmission and the evolving landscape of the international financial system.

The first essay analyzes the role of currency swap lines by the Federal Reserve during the GFC, the European debt crisis, and the Covid-19 crisis. It argues that LIBOR’s integration into the U.S. domestic financial system prompted the revival of swap lines to address eurodollar interbank market dysfunction and influence LIBOR. Empirical analysis reveals that a USD LIBOR panel bank in a foreign central bank’s jurisdiction significantly predicts a dollar swap line extension from the Fed. The essay also argues that LIBOR explains why only certain central banks were granted unlimited drawing access to Fed swap lines and eventually converted into standing arrangements.

In the second essay, an instrumental variable regression is employed to address whether Fed swap line drawings by foreign central banks are responsive to dislocations in the foreign exchange market as proxied by covered interest parity (CIP) deviations versus dislocations in the eurodollar interbank market as proxied by LIBOR. The results indicate little empirical support that swap line drawings significantly respond to CIP deviations but do respond to LIBOR deviations from the Fed funds rate consistent with the narrative of the first essay.

The third essay explores the political economy of international benchmark interest rate reform. The GFC and the LIBOR scandal emphasized the need for reform and new regulatory standards, particularly in monetary transmission mechanisms. U.S. agencies spearheading the reform efforts exercising extraterritorial jurisdiction in prosecuting foreign banks for LIBOR manipulation, effectively discouraging their participation. The reform replaced LIBOR with central bank-administered benchmark reference rates, strengthening monetary control and financial stability. The essay examines the power dynamics and welfare redistribution resulting from this transition, with the United States benefiting from increased influence over global dollar credit conditions through the widespread adoption of its replacement rate, the secured overnight funding rate (SOFR).