Our Common Agenda Policy Brief 6

REFORMS TO THE INTERNATIONAL FINANCIAL ARCHITECTURE: SUMMARY WITH A FOCUS ON VULNERABLE COUNTRIES AND SIDS[1]

The international financial architecture (IFA), crafted in 1945, is undergoing a stress test of historic proportions – and it is failing.

Plagued with inequities, gaps, and inefficiencies, it: has not supported mobilization of stable and long-term financing at scale for climate and SDG investments; does not provide equal voice and opportunity for all countries; and has generated a finance divide between developed and developing countries.

It is in the interest of all countries to recraft the IFA to proactively support implementation of the SDGs, rebuild trust, and prevent further fragmentation of financial and economic relations. For this, we need ambitious reform, starting with more inclusive, representative and effective global economic governance.

I. Reform and strengthen global economic governance

Global economic governance structures have not kept pace with changes in the global economy. Developing countries remain underrepresented in decision making bodies, and lack of coherence and coordination has led to disjointed crisis responses and exacerbated challenges. Reforming and strengthening governance must be at the heart of architecture reform.

The IFI boards should:

- *Make voting rights and decision-making rules in international financial institutions more democratic, e.g., through a double majority rule.*
- *Of particular relevance for SIDS and other vulnerable countries, separate access to resources from ability to pay, and instead determine access by both income and vulnerability (e.g., by drawing on the MVI).*

Member States should:

- *Set up a coordinating body on economic decisions that works towards a more sustainable, inclusive, and resilient global economy; this could be in the form of a Biennial Summit*.

II. Lower the cost of borrowing and create a lasting solution on debt

It is time to close long-standing gaps in the sovereign debt architecture. High borrowing costs curtail countries' ability to invest in the SDGs; when needed, debt restructurings are too little and too late, resulting in protracted crises and high social costs. Debt markets must work better.

Creditors and debtors should:

- *Increase transparency.*
- *Improve debt contracts (including state contingent clauses, such as hurricane and other clauses).*
- *Update principles of responsible borrowing and lending to reflect the changing global environment.*

The IMF and credit rating agencies should:

- *Improve debt sustainability analysis and credit ratings -- distinguishing between liquidity and solvency crises, taking long-term risks and investments in the SDGs and resilience into account, and considering SDG needs.*
- *Make debt sustainability assessments and credit ratings and their methodologies publicly available in a timely manner.*

Donors should:

- *Scale up debt management capacity support.*

To make restructurings more effective and fairer, Member States should:

- *Implement a two-step solution to support both low-income and vulnerable middle-income countries in need.*
- *Create a debt workout mechanism to address slow progress in the Common Framework, tasking debt treatment to an expert body and facilitating comparable treatment, and providing access to all vulnerable developing countries.*
- *In the medium-term, establish a sovereign debt authority, independent of creditor and debtor interest to anchor an efficient insolvency system.*

III. Massively scale up development and climate financing

MDB lending is low relative to GDP by historical standards – despite investment needs to combat the climate crisis and achieve the SDGs, which are orders of magnitude higher. MDBs must massively scale up lending and impact.

MDBs shareholders should:

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[1] *While all recommendations in the SG's Policy Brief are pertinent to SIDS concerns (as they would reorient the global financial system to support climate action and the SDGs, enhance global financial stability and scale up development financing), recommendations highlighted in blue in this note are of immediate relevance to SIDS.*

- *Scale up MDB lending to 1% of global GDP ($500 billion–$1 trillion a year), supported by an increase in paid-in capital, more efficient use of their balance sheets, and SDR re-channelling.*
- *Improve MDB borrowing terms, by offering ultra-long affordable financing, with state-contingent repayment clauses, and increase local currency lending.*
- *Fully align MDB business models with the SDGs; phase out fossil fuel finance.*
- *Scale up climate finance in vulnerable developing countries, additional to development finance, with new accounting to better measure additionality.*
- *Increase concessional resources, including IDA contributions, and consider permanent international funding mechanisms (e.g., levies on shipping); systematically consider vulnerability in all its dimensions in allocation criteria, going beyond GDP and ad hoc exceptions.*
- *Develop new frameworks for when and how to scale up leveraging private finance to maximize sustainable development impact.*
- *More effectively use the system of development banks to increase lending and impact.*

IV. Strengthen the global financial safety net

Access to the global financial safety net remains grossly uneven. The new allocation of special drawing rights (SDRs) in 2021 was inefficient in fighting crises – G7 countries, with a population of 772 million people, received $280 billion, while LDCs, with population of 1.1 billion, received only $8.2 billion. The global financial safety net must be strengthened to reduce volatility.

The IMF Board of Governors should:

- *Revamp SDRs so they are issued more automatically and counter-cyclically in response to shocks.*
- *Allocate SDRs based on need and vulnerabilities to target countries that truly need liquidity.*

The IMF Executive Board should:

- *Make IMF lending more flexible, end surcharges and set up a multilateral currency swap facility.*

To address volatility in capital markets, major economies should:

- *Strengthen macroeconomic coordination, e.g., by elevating it to meetings of G-20 finance ministers and central bank governors.*
- *Play an active role in reducing volatility of capital outflows when they are the source.*

All countries should:

- *Have access to the full capital account management toolbox.*

V. Reset the rules for the financial system to promote stability with sustainability

The private financial system is too short-term oriented and volatile to support sustainable development. Stability and sustainability are mutually reinforcing: stable markets encourage greater investment, while long-term investment in sustainability can be stabilizing.

Regulators should:

- *Reset regulation to address financial stability and integrity risks from both bank and non-bank financial institutions.*
- *Overcome excessive short-termism embedded in tax incentives and compensation.*
- *Reduce greenwashing by strengthening and mandating company sustainability disclosure; and update market regulations, standards and practices to place the SDGs, and climate, at the heart of markets.*

Market participants should:

- *Create long-term indices and credit ratings that reflect the SDGs and resilience.*

Policymakers should:

- *Require clear SDG-oriented transition plans from each institution within the IFA.*
- *Develop policies to appropriately reflect externalities in prices.*
- *Fully integrate financial integrity into regulatory systems.*

VI. Redesign the global tax architecture for equitable and inclusive sustainable development

Gaps and mismatches in tax rules allow tax avoidance and evasion at large scale, with countries with the greatest needs not benefitting from recent development of international tax norms. Slow progress has led to renewed calls for inclusivity in tax cooperation frameworks, and for a fair and effective international tax system that reflects the concerns and capacities of all countries.

Member States should:

- *Explore options to make international tax cooperation fully inclusive and more effective, including the possibility of developing an international tax cooperation framework at the United Nations.*
- *Simplify global tax rules and adopt a higher global minimum corporate income tax rate, which can benefit under-resourced developing country tax administrations.*
- *Create global tax transparency and information sharing frameworks that benefit all countries.*