Task Force 3 Reforming the International Financial Architecture

Concept Note[1]

Chairs: Ana Garcia and Haihong Gao

Co-chairs: Gülbin Sahinbeyoglu, Maria Antonieta Del Tedesco Lins, Marina Zucker Marques, Ernani Torres Filho, Artem Levenkov, Priyadarshi Dash, Ulrich Volz, Pablo Nemiña, Daniel Bradlow, Martin Kessler, Iyabo Masha, Abdul Muheet Chowdhary, Miguel Otero, Nilanjan Ghosh, Amar Bhattacharya and Fernanda Feil

Task force assistants: Lucas Carames and Wanting Xiong

Introduction

The existing international financial architecture (IFA), established in the aftermath of World War II, is increasingly showing signs of obsolescence and has been ineffective in addressing rapidly evolving development challenges and facilitating the achievement of the Sustainable Development Goals (SDGs). Designed by and for developed countries at a time when issues such as climate change, social inequality, and systemic crises received little attention, today's system is also characterized by highly interconnected financial and economic markets, rapid demographic and technological developments, global interest rate hikes, and repeated failures of financial institutions.

Thus, fundamental reforms are needed to address the IFA's structural deficiencies inherited from its design and the new challenges posed by adverse shocks. The system is failing to meet the needs created by escalating climate risks, growing geopolitical tensions, widening income and wealth gaps, and entrenched gender and racial biases. To address today's global challenges, we need a global financial system that puts the needs of developing countries at the center of every decision and every mechanism.

These vexing new trends and emergencies are compounded by long-standing challenges, making it imperative to reform the current IFA. Pressing issues that need to be addressed include, but are not limited to:

1) **Widening financing gap for SDGs and debt distress in the Global South**: Developing countries face rising borrowing costs and reduced access to global

[1] This concept note is jointly prepared by the Task Force 3 members: Ana Garcia, Haihong Gao, Gülbin Sahinbeyoglu, Maria Antonieta Del Tedesco Lins, Marina Zucker Marques, Ernani Torres, Artem Levenkov, Priyadarshi Dash, Ulrich Volz, Pablo Nemiña, Daniel Bradlow, Martin Kessler, Iyabo Masha, Abdul Muheet Chowdhary, Miguel Otero, Nilanjan Ghosh, Amar Bhattacharya, Fernanda Feil, Lucas Carames and Wanting Xiong.

financial markets as a result of monetary tightening; high debt service burdens crowd out public investment in SDG-related areas, especially in low-income countries; the Paris Agreement's goal of mobilizing $100 billion per year to support climate action in developing countries has not been fully met. The agreement between the G20 and the Paris Club on a common framework for debt treatment is important, but still falls short of a fair and effective solution for countries in debt distress.

2) **Sluggish governance reform**: The current voting power and governance structure of the international financial institutions does not reflect the shift in global economic power. In particular, the importance of emerging market and developing countries (EMDCs) is severely under-represented, and voting reform in the IFIs lags far behind in terms of gender, racial and regional balance. The lack of balance of power not only undermines the fairness of the IFA, but also reduces its relevance to new challenges.
3) **Volatile financial markets and recurrent financial crises**: Highly integrated financial markets are vulnerable to cross-border contagion, and technological innovations pose challenges to financial regulation. The gap between available crisis financing resources and demand is in the trillions of dollars. There are wide disparities in countries' access to liquidity in times of crisis, with only a small share of Special Drawing Rights (SDRs) allocated to vulnerable developing countries. The multi-layered global financial safety net (GFSN) designed to ensure global financial stability is fragmented and inadequate.
4) **Unfair international tax architecture:** While it is essential for countries to rely on domestic resources to finance their sustainable and equitable development, global tax evasion and avoidance are hampering their ability to raise funds. To combat tax avoidance and evasion and other illicit financial flows, as well as to address the imbalance in the allocation of taxing rights between developed and developing countries, the architecture for international tax cooperation needs to be strengthened. Bank secrecy, increasing digitalization and lack of tax transparency have allowed wealthy individuals and multinational corporations to exploit loopholes by shifting profits to low- or no-tax jurisdictions. The OECD/G20 inclusive framework on base erosion and profit shifting (BEPS) suffers from governance deficits which result in its work prioritizing the interests of developed countries and preventing effective and inclusive participation of developing countries.

As representatives of the world's major developed and developing economies, the G20 leaders face a precious moment in global governance. For the first time, countries of the Global South have a chance to lead the G20 agenda-setting process in consecutive years. The time has come to rethink the principles of economic governance and to expand, both discursively and practically, the possibilities for governments of low- and middle-income countries to pursue economic development. The Brazilian Presidency of the G20 has defined three priorities: 1) fighting inequality, promoting social inclusion and fighting hunger; 2) combating climate change, promoting energy transition and sustainable development; and 3) reforming global governance institutions. In line with this, the Finance Track has identified its priorities and the issues it will work on. How can the G20 build the financial and economic governance that will enable the world to address its multidimensional crisis and find common ground to tackle pressing environmental, geopolitical and social challenges?

Composed of experts and academics from various think tanks, international organizations and universities in different countries, the main objective of this Task Force is to support the work of the G20 in discussing and effectively reforming the international financial architecture. It will develop conclusions and recommendations, based on specialized policy briefs, on the following sub-topics:

Sub-topic 1: Financial system rules and regulations and global finance safety nets to promote stability sustainability and equity

On December 15, 2023, the Board of Governors of the IMF approved an increase of IMF members' quotas by 50 percent. Such move will enlarge the size of IMF's permanent resource. However, there has been no change in the quota formula which is key to determine not only voting power in the IMF but also the distribution of resources. In addition, the current quota formula also ignores countries' contributions to the climate emergency. To break the circle and create a more equal and resilient system, it is urgent to rethink how to align quotas with the current economic reality.

Apart from governance concerns, international financial institutions are slow and small to fulfill their "serve everyone" mandate, particularly the most vulnerable countries. The GFSN – the pool of resources that helps to prevent a temporary balance of payments stress - is insufficient and unequally distributed. Despite offering various forms of finance in a global level– including the IMF at the center, regional financing arrangements, bilateral swap arrangements and countries' own foreign exchange reserves – research reveals that the higher a country's income level, the more diverse the crisis insurance available. Advanced high-income countries (HICs) -and partly emerging HICs- can have a wide access to currency swaps, whereas, constrained by their slower economic recovery from COVID-19 and increasing debt burdens, low-income countries (LICs) and lower middle-income countries (MICs) have to rely more on conditional IMF lending. In addition, regional reserve funds played a marginal role in the pandemic.[2] Another example of the inequality is the access to SDRs, which compose foreign reserves. Even though the IMF allocated USD 650 billion in SDRs in 2021, because distribution depends on quota shares, it meant that developing countries received only about one third of the total allocation, with the most vulnerable countries receiving much less (European citizens received 13 times more than African citizens).[3] Meanwhile, the digital payments instruments issued by central banks (Central Bank Digital Currencies, CDBCs) are

[2] Muehlich et. al (2022). "No One Left Behind? COVID-19 and the Shortcomings of the Global Financial Safety Net for low- and middle-income countries". UNCTAD, DA-COVID-19 Project led by DDFB/DGDS
[3] UN (2023). "Reforms to the International Financial Architecture," Our Common Agenda - Policy Brief 6, May 2023.

becoming wide spreading practices and have the potential to revolutionize the financial landscape including the GFSN. However, there is still a knowledge gap when it comes to the economic and financial impacts of CDBCs, requiring efforts to address regulatory requirements for a efficient and equitable GFSN.Finally, the current IMF charges structure further exacerbates inequalities, as they are contracyclical and overburden those nations that need resources the most.

G20, being the premier forum for policy coordination among major economies and the advancement of reform policies, plays the key role in building consensus and agreeing on scaling up and improving liquidity financing. In 2023, G20 leaders decided to increase the redistribution of SDRs to USD 100 billion to provide vulnerable countries with additional resources and minimize the effects on debt. In addition, to strengthen the impact of the SDRs allocation, they approved to scale up the Poverty Reduction and Growth Trust (PRGT), created the Resilience and Sustainability Trust (RST) and remained open to rechanneling SDRs through MDBs. However, for a more effective, representative and resilient GFSN more is needed and important issues are left on the agenda that must be addressed during Brazil's Presidency of the G20. Building upon the accomplishments of the last G20 Presidencies, research and discussions will focus on strengthening GFSN by tackling issues on governance, lending capacity and operational frameworks of the international financial system.[4] Building a better GFSN is essential to mitigate the systemic inequalities in the international financial system, allowing developing countries to build long-term development strategies without being jeopardized by short-term external crisis.

Sub-topic 2: Multilateral Development Bank (MDB) reform: what better, bigger and more effective entails

Emerging markets and developing countries (EMDCs) are facing growing financing needs, high borrowing costs, mounting debt service burden, the need to achieve SDGs and combat climate change, and challenges for the domestic financial sector to provide long-term investment. MDBs should play a leading role in solving such issues in the form of financial support as well as providing advisory, research, and capacity building for sustainable finance. Mobilizing resources and fostering cooperation is crucial. This challenge raises the question of coordination among the IMF, MDBs, and other donors in providing timely support.

The G20 plays a fundamental role in propelling the MDB system into a new era. Building upon previous work on the CAF review and strengthening MDBs during the Indonesian and Indian Presidencies, the Brazilian Presidency of the G20 aims to establish a Roadmap for a better, bigger, and more effective system of MDBs. Multilateral banks should explore co-financing opportunities, create quality and resilient infrastructure,

[4] G20 Brasil 2024 (2023). "Session V: Aligning Means and Ambitions: Financial Architecture Reform for the 21st Century and Growing Debt Risks (IFA)," 1st FCBD Meeting, December 2023.

target ESG goals, particularly social inclusion, and help EMDCs find a better position in international value chains which, in turn, will create jobs and help alleviate poverty. The reformed MDBs (if we say, new-generation MDBs) need to align the best development financing perspectives taking on board the private investors, blended finance, philanthropy, impact investments, and other innovative sources and instruments of financing.

Sub-topic 3: Addressing debt burden of developing countries and facilitating their access to concessional resources

The debt burden of developing countries has been growing at a rapid pace in the past decade and a half. The series of economic and political shocks – from COVID-19 to the war in Ukraine – have transformed vulnerabilities into a deep crisis. In some cases, this remains a "silent crisis": low-income countries continue to service their debt obligations but are forced into austerity. Other countries have defaulted and are in the process of restructuring their debt, negotiating with their official and private creditors. Yet, those processes are slow and unpredictable: Zambia has been in default for more than three years, Sri Lanka almost two, and Ghana for 18 months. The lack of a legal and sustainable binding mechanism for negotiations forces sovereigns to rely on voluntary processes in which at least a critical mass of creditors are willing to participate. Domestic creditors often end up bearing large costs – paying in effect twice, through austerity and restructuring. In addition, these processes tend to focus almost exclusively on the creditors contractual rights and to preclude comparable consideration of the debtor's broader legal obligations and responsibilities. A more holistic approach is needed that, while paying appropriate attention to the creditors' contractual rights, also takes into account debtors' legal obligations and responsibilities relating, for example, to climate and the SDG needs, and whether these countries need debt restructuring, or simply to widen their fiscal space.

In the past, the Paris Club could coordinate the creditors holding most of the official, bilateral claims. This is not the case anymore because of the rapid changes in creditor composition and the rise of new creditors on emerging countries. Currently, since most of the new creditors are members of the G20, it is the most appropriate forum for official creditors. The Common Framework was an important G20 milestone in this regard, but its implementation has stalled and let middle income countries out. Leaders and their finance ministers are well aware of the need to reform it, but different traditions, incentives, domestic practices and regulations, have led to protracted negotiations without any resolution until now. As the cases Sri Lanka (whose debt restructuring has been negotiated outside of the Common Framework) and Zambia demonstrate**,** the urgent needs of developing countries, therefore, should be at the forefront of all efforts to reform the sovereign debt architecture.

The Brazilian G20 presidency can - and should - play a leading role in these reform efforts. Reducing the pressure of the debt burden on developing countries is completely consistent with Brazil's role leading role in food security, poverty and inequality reduction, and in dealing with climate change. It can utilize existing international and regional institutional arrangements and standards to ensure that reduced debt service can be allocated to development's needs. It is also a key area where global governance needs to be reshaped to give more voice to the debtors in the overall architecture. The Global Sovereign Debt Roundtable could be an opportunity in this regard to raise the voice of debtors.

Sub-topic 4: Ensuring a Fairer Global Tax Architecture that Facilitates Domestic and International Resource Mobilization

Never has the reform of the international tax system become more relevant. Globalization and corporate consolidation have resulted in Multinational Enterprises (MNEs) accounting for an increasingly larger proportion of global corporate profits. Indeed, the turnover of some of the largest MNEs in the world is more than the GDP of several countries combined. At the same time, cross-border profit shifting, intensified tax competition between countries, and the impact of globalization and digitalization are eroding the revenue accruing to many countries. Effective international tax cooperation can provide much needed revenues to countries to fight hunger, poverty and inequality, all priorities of the Brazilian G20 Presidency.

The OECD-BEPS Inclusive Framework, which is the exclusive focus of the G20 Issues Note on International Taxation, is a step in the right direction, but the revenue yield is inadequate, relative to the development needs of countries. Indeed, revenue estimates under Pillar One, especially Amount A, show negligible benefits for developing countries, especially when contrasted with alternatives such as Article 12B of the UN Model Tax Convention or Digital Services Taxes. As rightly called for by the Brazilian Presidency, revenue estimates are required on the final version of Amount A as a prerequisite for informed decision making by G20 countries on whether to sign it or not. Furthermore, Pillar Two is complex to administer and has questionable benefits for developing countries, as MNEs can continue to pay zero tax even under the GLOBE Rules due to its design features. According to the Global Tax Evasion Report 2024, profit shifting by MNEs amounted to $1 trillion in 2022 and the minimum corporate tax of 15% regime has been substantially weakened. Finally, the absence of a global wealth tax means countries risk capital flight if they introduce domestic wealth taxes; this perpetuates revenue challenges and inequality.

Reforms outside of the OECD-Inclusive Framework can ensure greater inclusivity and effectiveness in the international tax architecture, particularly when it comes to agenda-setting and decision-making, and fairer international tax rules would facilitate the much needed domestic and international resources for all countries. Some of these reforms include the recent United Nations General Assembly resolution that could result in a UN Framework Convention on International Tax Cooperation; the work of the UN Tax Committee, especially on developing a Fast Track Instrument (FTI) which can update multiple bilateral tax treaties simultaneously; and the UN Tax Committee's ongoing work on wealth tax, which can be used to design domestic laws to address wealth inequality. Another issue for consideration is the development of national and global financial assets registries. Other UN related issues which could benefit from further G20 engagement include the taxation of international shipping, digital nomads, and services taxation more broadly. The Task Force will propose the conversion or incorporation of these guidelines into UN tax cooperation agreements or conventions to accelerate their implementation. The work of the Task Force will emphasize the need for European countries to team up with developing countries on this matter because they are also heavily impacted by tax avoidance. As matter of fact, US companies represent 40% of global profit shifting and Continental European countries appear to be heavily affected by this practice.

Sub-topic 5: Outlining pathways to fulfil overall Sustainable Development Goals (SDG) financing requirements

Overall development spending to reach the SDGs will need to more than double from the pre-pandemic level to around $5.4 trillion per year by 2030 for developing countries. The scale of the investments needed will require a financing strategy and lead to a major expansion and revamp of both domestic and international finance, public and private. An overall financing strategy must utilize the complementary strengths of different pools of finance to ensure the right scale and kind of finance and reduce the cost of capital. It must embody a holistic and comprehensive approach as it aligns all finance with sustainability, and creates the necessary partnerships to deliver concrete results. In addition, the financial system must facilitate new funding pathways that are not only responsive to the emerging challenges of a sustainable and just transition but also capable of bridging the financing gap that currently hampers the achievement of the SDGs.

To bridge the financing gap of SDGs, non-state (private and quasi-state) capital could be moblized and leveraged, especially in the form of infrastructure and development investments. Reforms in the IFA would be needed to optimize the risks and incentive structures for longer term non-state capital. Given that more than 80% of the world's private and quasi-state capital are in G20 countries, G20 can play a pivotal role in the reforms of IFA within which massive non-state capital could be effectively leveraged for the global development agenda. In addition, the need for reform in sustainable development financing demands that state regulators implement public policies and regulations aimed at directing investment flows towards a sustainable green transition. Such a transformative approach must encompass regulatory measures designed to 'green' the financial system. This involves not only incentivizing investments in green assets but also implementing policies that either withdraw financial support from or increase the cost of brown assets, which are detrimental to environmental sustainability. Least-developed countries – many of whom are not only vulnerable to forces of climate change, but are also bearing the brunt of escalating debt burden – need international support to meet the SDGs. The development gap is widened by low investment in these areas, and delaying development finance will result in missing the 2030 Agenda, leading to future financial burdens.

The G20's advocacy for a financial system focused on sustainable development is crucial in reducing poverty and inequality. By directing funds towards sustainable initiatives, they promote not only economic growth but also ensure its inclusiveness and equity. This strategy is vital in tackling poverty and hunger at their roots by fostering investment in key areas like sustainable agriculture and renewable energy. Additionally, this approach aligns with the environmental focus of the Brazilian Presidency's agenda. The G20's efforts also align with the reform of global governance, a Brazilian presidential priority, aiming to create a financial system that is more inclusive, transparent, and accountable.