T20 Commentary

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Reforming the International Financial Architecture: Commentary from Club de Madrid

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Introduction[1]

The international financial architecture faces mounting challenges in addressing the needs of countries affected by climate change, debt distress, and development hurdles. In response, the T20 has put forth several key recommendations through its Task Force 3 (TF3) on reforming this architecture. However, the scale of current global challenges, including climate risks and the evolving economic landscape, calls for enhancements to these recommendations to ensure they are more comprehensive, equitable, and aligned with Sustainable Development Goals (SDGs).

This commentary by Club de Madrid (CdM) builds on existing recommendations by the TF3, focusing on key areas that require additional consideration. The objective is to propose a more inclusive and equitable financial system that not only addresses financial instability but also incorporates climate adaptation, debt sustainability, and global tax

[1] The recommendations presented in this document are drawn from the work of the Club de Madrid's Policy Dialogue, *Driving Sustainable Futures for All on Financing for Sustainable Development*. They reflect insights and proposals developed by the following Working Groups:

Working Group 1: Scaling Up Funding and Reforming Financial Institutions, led by Prof. Kevin P. Gallagher of Boston University.

Working Group 2: From Debt Relief to Development, led by Joseph Upile Matola of the South African Institute of International Affairs.

Working Group 3: International Tax Cooperation, led by José Antonio Ocampo, Co-Director of the Economic and Political Development Concentration at Columbia University's School of International and Public Affairs, and Advisor to Club de Madrid.

cooperation, which are critical for long-term stability and development.

CdM has consistently played a significant role in advancing financing for development, advocating for inclusive and sustainable financial systems that address the needs of vulnerable countries. As a global leadership organization composed of former heads of state and government, CdM brings a wealth of experience and political insight to international development discussions. It has been at the forefront of promoting equitable financial governance, pushing for reforms in debt relief, climate finance, and multilateral financial institutions to ensure that the global economy supports sustainable development goals.

Within the T20, CdM's involvement as part of the International Advisory Council underscores its commitment to shaping progressive financial policies at the highest level. The organization's expertise and leadership have contributed to key recommendations on reforming the international financial architecture, with a focus on addressing debt vulnerabilities, enhancing climate resilience, and ensuring that financial systems are aligned with long-term development objectives.

The Commentary builds upon the organization's work, following its 2023 Annual Policy Dialogue 'Rethinking Social Development for People and Planet', and the coming Annual Policy Dialogue "Driving Sustainable Futures for All". This event will focus on Financing for Sustainable Development addressing the following areas: the role of Multilateral Development Banks (MDBs), international monetary reforms, the governance of international financial institutions, sovereign debt issues, and new approaches to international tax cooperation.

In 2024 and 2025, critical discussions will shape the global agenda on financing for development. Key moments include the ECOSOC Forum on Financing for Development in April 2024, the United Nations Summit of the Future (SoTF) in September 2024, the G20 presidencies of Brazil and South Africa in 2024 and 2025, the 4th International Conference on Financing for Development in Spain in July 2025, and the Second World Summit for Social Development in 2025. This international policy-making landscape offers a unique opportunity for CdM and its partners to engage proactively, amplifying the voice and agency of CdM Members in these crucial decision-making spaces.

Policy recommendation overview

The analysis and commentary focus on five key areas of the T20 TF3 recommendations:

1. Reforming IMF Lending Policy
2. Enhancing Local Currency Lending by Multilateral Development Banks (MDBs)
3. Improving the G20 Common Framework
4. Expediting Work on the United Nations Framework Convention on International TaxCooperation (UNFCITC)
5. Improving the Allocation of IMF Resources to Achieve the SDGs

The rationale behind these recommendations is to ensure that the international financial systemis better equipped to support countries in crisis while promoting climate resilience and sustainable development. The proposals outlined aim to increase the financial autonomy of vulnerable countries, promote responsible lending practices, and ensure that financial reforms prioritize long-term goals over short-term economic stabilization.

Implementation pathways

1. Reform IMF lending policy

Strategic recommendations to reform IMF lending policies include:

- Capping the SDR interest rate: While TF3 proposes capping SDR (Special Drawing Rights) interest rates during financial stress, we recommend extending this to include criteria for climate and development needs. This cap should also apply during times of environmental crisis, where climate-vulnerable nations need additional fiscal space to address recovery.
- Rechanneling SDRs for climate finance: SDR allocations should not only offer financial relief but be rechanneled to fund critical investments in climate resilience, biodiversity protection, and social infrastructure. This would ensure SDR resources are used to meet the urgent demands of climate-vulnerable countries.
- Debt relief measures: The inclusion of debt cancellation for low-income countries is vital. A framework that includes a 10-year debt servicing holiday, substantial debt write-offs, and support for state-contingent debt instruments (SCDIs) could prevent future debt crises and reduce the financial vulnerability of these countries.

2. Enhancing local currency lending by MDBs

MDBs play a crucial role in reducing currency risk and promoting local market development. To enhance this, the following should be considered:

- Prioritizing local currency lending for green projects: MDBs should scale up local currency lending specifically for green infrastructure and climate-related projects in middle- and low-income countries. This would not only support the just energy transition but also mitigate currency risks associated with foreign-denominated debt.

- Debt-for-Climate Swaps: MDBs should also promote debt-for-climate swaps to provide fiscal space for climate-vulnerable countries while financing crucial environmental projects without exacerbating their debt load.

- Addressing Harmful Tax Practices: MDBs can play a significant role in improving tax compliance by multinational corporations. By requiring companies benefiting from MDB financing to adhere to global tax transparency standards, MDBs can help local governments curb tax avoidance and illicit financial flows, which exacerbate financial instability.

3. Improving the G20 Common Framework

The G20 Common Framework needs to evolve to integrate climate-related risks into debtsustainability analyses (DSAs). This includes:

- Climate-related debt assessments: Debt Sustainability Analyses should consider the fiscalimpact of climate change on debt-burdened countries, providing flexibility in debt repayments for nations facing climate disasters or pursuing ambitious climate action.

- Binding principles for creditors: Private creditors must adhere to binding social responsibility policies in debt negotiations. The G20 should require creditors to consider human rights, environmental sustainability, and development priorities when negotiating debt terms.

- Independent debt authority: The establishment of an independent sovereign debt authority could fast-track debt restructuring and ensure fairness between creditors and debtors, particularly for climate-affected nations.

4. Expediting work on the UNFCITC

International tax cooperation is vital for addressing global financial inequalities. To advance thework on the UNFCITC, the following measures should be taken:

- Linking tax reforms to climate finance: The proposed global minimum tax on wealthy individuals should be explicitly tied to financing climate adaptation and biodiversity protection in developing countries. This would ensure that global tax reforms directly contribute to the SDGs and the Paris Agreement.
- Global asset register: Expanding public country-by-country reporting should be complemented by a global asset register to track wealth ownership, combat illicit financial flows, and reduce tax evasion.
- Unitary taxation of MNCs: The G20 should push for the adoption of unitary taxation and formulary apportionment for multinational corporations (MNCs), which would prevent profit shifting and ensure that developing countries receive a fair share of global tax revenues.

5. Improving the allocation of IMF resources to achieve the SDGs

Finally, the allocation of IMF resources should be more closely tied to the achievement of theSDGs. This can be achieved through:

- Expanding the PRGT and RST: The IMF's Poverty Reduction and Growth Trust (PRGT) andResilience and Sustainability Trust (RST) should be expanded to provide long-term financing for climate adaptation, biodiversity projects, and SDG-aligned initiatives in low-and middle-income countries.
- IMF Quota Reforms: The IMF quota system should be reformed to give developing countries a stronger voice in decision-making. This would ensure that

countries most affected by climate change have adequate representation in how resources are allocated.

- Concessional Financing Mechanisms: The IMF should prioritize concessional financing forlow-income countries, ensuring that they have access to affordable credit for development projects without risking long-term debt accumulation.

Potential Barriers to Implementation

Key barriers to implementation include:

- Political resistance: Some creditor nations and private financial institutions may resist changes to debt restructuring and climate finance mechanisms, particularly those involving debt write-offs and SCDIs.
- Global cooperation on tax reform: Achieving consensus on global tax reforms, including the implementation of a global minimum tax and unitary taxation of MNCs, may face significant pushback from tax haven jurisdictions and countries benefiting from the current system.
- MDB capacity: MDBs may face institutional limitations in scaling up local currency lendingand implementing mechanisms to address harmful tax practices.

Drivers for Successful Implementation

Successful implementation can be driven by:

- The G20 plays a pivotal role in global economic governance and can champion the recommended reforms by leveraging its influence to drive consensus among member states and institutions.
- Collaboration between civil society, international organizations, and the private sector can generate the necessary momentum for reforms, particularly in areas related to climate finance and tax justice.
- Developing countries, particularly those affected by climate change and debt crises, canlead calls for reform, providing moral and political weight to these initiatives.

Feasibility and Maturity Assessment

The proposed reforms are technically feasible, given existing frameworks and tools. However, their maturity will depend on political will, particularly from the G20, IMF, and MDBs. Key milestones could include the establishment of an IMF Climate Emergency Facility, expanding SDRsfor climate projects, and advancing discussions on global tax cooperation through the UNFCITC.

Conclusion

The need for a more equitable and climate-aligned international financial architecture is urgent. Enhancing the T20 TF3's recommendations with a focus on climate resilience, sustainable development, and tax cooperation, is crucial so the global financial system can better support vulnerable countries in achieving their development goals. The G20 must take decisive action to ensure these reforms are not only discussed but implemented. It is essential to integrate financial, environmental, and social considerations into the governance of the global economy to ensure a more just and sustainable future.

As we look ahead, CdM is committed to turning dialogue into action, considering key 'landing pads' like the G20 Presidency in South Africa in 2025, the 4th International Conference on Financing for Development in Spain in July 2025, and the Second World Summit for Social

Development in 2025, ensuring that the leadership and insights of its Members influence the global debate, effectively 'walking the talk' on sustainable development and financing solutions.

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