T20 Brasil 2024
Let's rethink the world

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Task Force 03 Statement

TF03
Reforming the international financial architecture

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ORGANIZING COMMITTEE:

CEBRI

FUNDAÇÃO ALEXANDRE DE GUSMÃO

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Introduction to the Task Force's mission and priorities

The existing international financial architecture (IFA) is increasingly obsolete and ineffective in addressing evolving development challenges and achieving the Sustainable Development Goals (SDGs). Initially designed by and for developed countries, the system now struggles with issues such as climate change, social inequality, and systemic crises. Today's IFA must also contend with interconnected financial markets, rapid demographic and technological changes, global interest rate hikes, and frequent financial institution failures. Fundamental reforms are necessary to address these structural deficiencies and new challenges. The current system fails to meet the needs arising from escalating climate risks, geopolitical tensions, income and wealth disparities, and entrenched gender and racial biases. A reformed global financial system must prioritize the needs of developing countries in every decision and mechanism.

As representatives of the world's major developed and developing economies, the G20 leaders face a precious moment in global governance. 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 has worked in developing diagnosis and recommendations on the following issues:

1. Financial system rules and regulations and global finance safety nets to promote stability, sustainability, and equity;

2. Multilateral Development Bank (MDB) reform: what better, bigger and more effective entails?;

3. Addressing debt burden of developing countries and facilitating their access to concessional resources;

4. Ensuring a fairer global tax architecture that facilitates domestic and international resource mobilization;

5. Overall SDG financing needs: pathways and the role of the reform of the international finance architecture.

2 Diagnosis of main problems

1. The International Monetary Fund's (IMF) lending policy faces several key challenges. First, it imposes an effective annual interest rate of up to 8% on borrowing countries, exacerbating financial instability during economic stress. Second, its procyclical nature burdens nations already dealing with crises like climate emergencies or conflicts. Additionally, the IMF's heavy reliance on lending income, which constitutes about 95% of its projected revenue for 2023, deviates from the intended income diversification. These issues undermine the IMF's role in stabilizing global finance and assisting distressed economies.

2. Multilateral Development Banks (MDBs) propose a more effective approach to address high borrowing costs, debt burdens, SDG tracking, and climate challenges in less developed countries. One major barrier is the currency risks that Lower- and Middle-income countries (LMICs) have limited capacity to hedge, which could make such lending more costly despite lower interest rates. MDBs' aversion to currency risk, driven by legal and shareholder requirements, and the added cost of hedging further complicate the issue. Therefore, strategies must aim to reduce currency risks and hedging costs.

3. Current sovereign debt negotiations focus almost exclusively on creditors' contractual rights, neglecting the debtor's obligations to public social areas, human rights, or environmental treaties. This approach is incompatible with the broader responsibilities of both creditors and debtors. The G20 Common Framework has significant shortcomings: it excludes middle-income countries, relies on flawed debt sustainability analyses, does not compel all creditors to negotiate,

lacks fair treatment across creditor classes, and is not linked to climate and development goals.

4. To combat tax evasion and avoidance and address the imbalance in taxing rights between developed and developing countries, the international tax cooperation architecture needs strengthening. Wealthy individuals and multinational corporations exploit loopholes, shifting profits to low- or no-tax jurisdictions, hampered by bank secrecy, increasing digitalization, and lack of tax transparency. The OECD/G20 Base Erosion and Profit Shifting (BEPS) framework prioritizes developed countries' interests, limiting developing countries' participation. The United Nations (UN) is better suited to represent both developed and developing countries inclusively.

5. Achieving the SDGs by 2030 requires doubling development spending to $5.4 trillion annually for developing countries. This necessitates a comprehensive financing strategy involving domestic and international, public and private funds, reducing capital costs, and aligning all finance with sustainability. The financial system must support new funding pathways to bridge the SDG financing gap. The IMF's Special Drawing Rights (SDRs) offer potential solutions, with proposals to rechanneling unused SDRs through the IMF or MDBs, which are well-suited for this role given their development mandate.

3 Key recommendations

1. Reform IMF lending policy

The G20, as the IMF's major shareholders with significant voting power, should work to reform the IMF's lending policies. First, it should advocate a cap on the SDR interest rate. This measure could protect borrowing countries from rising borrowing costs during periods of financial stress, thereby ensuring that IMF support doesn't deepen financial distress. In addition, a countercyclical design of the surcharge system should be promoted. That is, the surcharge rate should rise when SDRs fall and vice versa. The above adjustments would not only align the IMF's practices with its mandate to promote financial stability, but also demonstrate the G20's leadership in promoting a more resilient and equitable international financial architecture.

2. Enhance local currency lending by MDBs

The G20 should work with MDBs to scale up and improve opportunities for hedging currency risks. MDBs can explore diversifying sources of local currency hedging to include international banks and onshore banks in local markets where possible. The Currency Exchange Fund (TCX) could be capitalized to enable a much larger MDB local currency portfolio, reducing hedging costs through portfolio risk guarantees and interest rate subsidies. In addition, MDBs should be able to promote local currency capital markets in middle-income countries to strategically help mitigate local currency lending risks. To promote pooling and risk-sharing among MDBs, the G20 should work to diversify MDB portfolios across a broad range of low- and middle-income currencies through an off-balance-sheet fund to pool local currency assets and diversify credit and currency risk. Finally, the G20 should encourage MDBs to reassess and take calibrated currency risk by reassessing and taking some calibrated currency/exchange rate risk through currency diversification.

3. Improving the G20 Common Framework

The G20 should call on the IMF to consider critical development investment needs and climate and other shocks in its current Debt Sustainability Analysis (DSA) reviews. In addition, the G20 should stipulate that all private financial institutions must issue social responsibility and/or human rights policies and publicly explain how they are applied in negotiations with sovereign debtors. The G20 must also create incentive mechanisms that compel all creditor classes to participate and provide the level of debt relief necessary to mobilize financing for climate and development goals, and ensure fair comparability of treatment across creditor classes. It should also provide credit enhancement to lower the cost of capital and liquidity support for countries that are not in debt distress but lack fiscal space. Finally, the G20 should encourage all sovereign debtors to explain in debt negotiations how they intend to meet all their legal obligations, including environmental, social and human rights obligations. In addition, a set of international principles should be developed to guide both sovereign debtors and creditors in meeting their environmental, social and human rights obligations in an equitable manner during these negotiations.

4. Push to expedite work on the UN Framework Convention on International Tax Cooperation (UNFCITC)

The G20 must ensure that the UNFCITC has a democratic and inclusive governance architecture. It must ensure that it is able to effectively address current and future international tax challenges, in particular the taxation of cross-border transactions and high-net-worth individuals, with the aim of making international tax rules fairer and simpler for all stakeholders. G20 members need to expand the scope of existing information exchange efforts and significantly improve tax transparency, in particular public country-by-country reporting. It is necessary to advance measures to exchange information on different classes of assets and to advance the creation of a public Global Asset Register within the UNFCITC. G20 members must support, within the UNFCITC, the creation of a global minimum tax on wealthy individuals and families, with political guarantees that the resources raised through this mechanism will be used for the realization of human rights, particularly in impoverished countries of the Global South.

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

The G20 must push for reforms of the IMF to make the IMF's trusts, the Poverty Reduction and Growth Trust (PRGT) and the Resilience and Sustainability Trust (RST), more accessible by relaxing strict economic conditions and eligibility criteria to provide affordable long-term financing to low- and middle-income countries. In addition, the G20 should work to reform the IMF's quota system to ensure that a larger share of Special Drawing Rights is made available to developing countries in future allocations. Allow new issuance for countries in need to invest immediately in development and climate policies and to help weather shocks and crises, ensuring steady support where it's needed most.

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