G20 BRASIL 2024

BUILDING A JUST WORLD AND A SUSTAINABLE PLANET

1st Finance and Central Bank Deputies (FCBD) Meeting

SESSION V: ALIGNING MEANS AND AMBITIONS: FINANCIAL ARCHITECTURE REFORM FOR THE 21ST CENTURY AND GROWING DEBT RISKS (IFA)

KEY OBJECTIVES:

- present the priorities of the Brazilian Presidency of the G20 for the International Financial Architecture (IFA) Working Group in 2024;
- consider ways to expedite resources to countries most in need and reduce global stability risks; and
- explore additional steps to strengthen the international financial landscape.

Brasília, December 2023

I. OUTLOOK AND STRATEGIC VISION

As the world economy continues to adjust to the post-pandemic norm of low growth, higher financing costs and higher public and private indebtedness, a strong, flexible, and responsive international financial architecture is needed more than ever. Under the Brazilian Presidency of the G20 in 2024, the IFAWG will aim to continue playing a key role in strengthening international financial architecture, while supporting post-pandemic recovery and safeguarding global economic and financial stability.

To this end, in 2024 the IFAWG will deepen, broaden, and accelerate reforms. It will work to ensure that international financial institutions have adequate governance, lending capacity, and operational frameworks to contribute to the urgent achievement of the Sustainable Development Goals (SDG) while addressing new global challenges in a balanced and effective manner. The IFAWG will build upon the discussions and accomplishments of the last G20 Presidencies. The group will continue to encourage the implementation of the Capital Adequacy Framework (CAF) review and the debate on measures to strengthen multilateral development banks (MDBs) to make them better, bigger, and more effective. This will require revamping their operations and instruments and assessing capital requirements under a long-term perspective.

The IFAWG debates will also include a structural approach to securing sustainable capital flows to low- and middle-income countries and those under vulnerable financial conditions. In those countries, domestic resource mobilization cannot be dissociated from a stable and long-term flow of international public (concessional and non-concessional) and private resources to address debt distress and climate change challenges, among other urgent development priorities.

Under the Brazilian Presidency, the IFAWG will continue to work on debt challenges that affect highly indebted low- and middle-income countries and will explore alternatives to reduce existing debt burdens, including through innovative financial instruments. It will also continue to work on strengthening the Global Financial Safety Net (GFSN), on resilient capital flows, and on integration of fast payment systems and central bank digital currencies (CBDCs).

II. PRIORITIES FOR THE IFAWG IN 2024

Priority 1: Making MDBs better, bigger, and more effective

To eliminate poverty, reduce inequalities, promote sustainable development, and combat climate change, it is essential to establish a robust, country-led, and country-owned system of financing for development supported by strong MDBs.

The unique capacity of MDBs to leverage resources, mitigate risks, offer anticyclical financing, mobilize knowledge, and support long-term sustainable development makes them key players in the provision of financing for development and to face new global challenges. The international community needs to address the financial and operational constraints faced by the MDBs system, debate strategies and timing for recapitalization, and connect MDBs with other stakeholders to make them more impactful.

The G20 plays a key role in propelling the MDB system into a new era. India's Presidency of the G20 in 2023 made great efforts to build on the work done by its predecessors on issues such as the CAF review. It also delivered two reports by the Independent Expert Group on strengthening MDBs.

Building upon the previous work of the G20 on the CAF review and on strengthening MDBs, the Brazilian Presidency of the G20 aims to establish a G20 Roadmap for **better**, **bigger** and **more effective** system of MDBs. The Roadmap will benefit from a three-pillar approach and closer dialogue with MDBs.

The three-pillar approach focuses on three key main characteristics for MDBs:

- **Better:** in consultations with MDBs, the IFAWG will conduct an operational review with broad recommendations for improvements, taking into consideration the specific mandates of each MDB, but also in light of a vision of MDBs as a system.

- **Bigger:** the focus will be both on CAF review implementation (establishing a template for regular voluntary reporting) to stretch balance sheets and reassess risk management, and on debating the size and timing of new rounds of capitalization.

- **More effective:** Explore MDB impact assessment methodologies and how they could be better integrated into their strategic processes and complement beneficiary countries' own development strategies and platforms. The analysis will examine the effectiveness of project development by tackling operational issues and studying untapped instruments such as foreign exchange risk mitigation, and use of local currencies.

To further deepen the effectiveness of MDBs, the Brazilian Presidency of the G20 will aim to establish a dialogue with credit rating agencies (CRAs) regarding their risk assessment of

MDBs, especially on how better to incorporate callable capital and review assessment of guarantees.

The Presidency also aims to advance the technical and political discussions on SDR rechanneling to MDBs, taking into consideration the reserve asset nature of the SDR and countries' legal frameworks. After the 2021 SDR allocation, the international community has successfully responded to the aim of rechanneling USD 100 billion to the most vulnerable countries through the Poverty Reduction and Growth Trust (PRGT) and the Resilient and Sustainability Trust (RST). Now is the time to explore options for rechanneling SDRs to boost the lending capacity of MDBs and continue supporting countries most in need. A good starting point for this discussion has already been developed by the African Development Bank (AfDB) in collaboration with the Inter-American Development Bank (IDB).

Finally, in line with a key priority of the Brazilian Presidency of the G20, the IFAWG will discuss ways to reform global economic governance by making MDBs more diverse. Better representing the diversity of membership is a way to strengthen MDBs, particularly concerning the historic lack of representation of emerging countries at the highest levels in Bretton Woods institutions. The IFAWG will discuss representation criteria and ways to make the leadership and top staff positions in MDBs more diverse.

Priority 2: Addressing sovereign debt issues

The debt outlook of low-income countries continues to deteriorate. Amid low global growth, volatile terms of trade, increasing financing costs, and low availability of concessional financing, the G20 needs to continue monitoring the sovereign debt landscape. According to IMF and World Bank data, more than half of low-income countries are either at high risk of or in debt distress. High sovereign indebtedness also affects some middle-income countries. To over-indebted countries, the current situation means lower investment capacity, jeopardizing their long-term growth prospects.

Against this backdrop, the Brazilian Presidency of the G20 in 2024 will advance in the debt treatment for low- and middle-income countries, benefiting from the permanent membership of the African Union in the G20 and the need to continue building on the current framework with a bolder, balanced, more transparent, long-term, and structural approach, in which debt distress should not only receive faster treatment, but also be prevented. The various experiences under the G20 Common Framework (CF) reveal important—albeit still relatively slow—progress. The G20 will continue to address the current CF cases and others that may emerge in the context of a deteriorating global debt landscape.

In parallel, the launching of the Global Sovereign Debt Roundtable (GSDR) in 2023 established an encouraging forum to facilitate dialogue and enhance understanding of debt restructuring challenges among key stakeholders, including the private sector. The Brazilian Presidency of the G20 aims to continue to deepen the GSDR agenda and foster discussions on structural factors underpinning the enduring debt crisis.

With the intertwined sovereign debt and climate crises in low- and middle-income countries, debt-for-climate swap schemes have reemerged as a viable option to address both issues. The Brazilian Presidency of the G20 in 2024 will explore how debt-for-climate and debt-for-nature swaps can be implemented to increase climate and biodiversity conservation-related spending while providing debt relief to countries in need. Options for debt-for-hunger and debt-for-health swaps that benefit low-income countries will also be assessed. In parallel, the IFAWG will continue discussions and monitor progress on the use of climate resilient debt clauses (CRDCs) on new debt issuances.

Priority 3: Making the GFSN more effective, representative and resilient

The conclusion of the 16th General Review of Quotas (GRQ), with a 50 percent increase in quotas and no realignment in quota shares, leaves important issues on the GFSN agenda that must be addressed during Brazil's Presidency of the G20. It is broadly recognized, including in the final report of the IMF Executive Board to the Board of Governors, that the realignment of quota shares to better reflect members' relative positions in the world economy is both urgent and important. While the Executive Board has been mandated to develop possible approaches as a guide for further quota realignment by June 2025—including through a new quota formula—the G20 has a key role in building consensus and agreeing with the desired outcomes, as in the last successful IMF governance reform that took place in 2010, during Korea's Presidency of the G20.

Among other important governance issues for enhancing the legitimacy and representativeness of the Fund, there is also a sense of urgency regarding two initiatives: the creation of a 25th chair at the Executive Board for sub-Saharan Africa and the election of the Managing Director. The IFAWG could help build consensus to ensure that the hurdles for the 25th chair can be properly overcome in a timely manner, delivering on this widely supported measure for the next biennial regular election of Executive Directors, in the second half of 2024. Regarding the election of the Managing Director, to take place next year, it is important to ensure an open, transparent, and competitive process. To this end, the G20 can also discuss and reach an agreement in support of broader regional participation in the election process for leading positions in Bretton Woods institutions.

Other non-governance issues relevant to the resilience of the GFSN could also garner important momentum from the IFAWG, such as policies for charges and surcharges, which should be reviewed to align with the changes in the global economic environment and with developments for IMF income and precautionary balances. As an increasing number of countries have been resorting to the Fund to help them cope with balance of payments pressures in recent years, IMF net operational income has presented substantial results, leading to a solid accumulation of precautionary reserves. A more balanced approach to charges and surcharges policy is now warranted to avoid placing an excessive burden on countries that are already in financial distress.

Finally, given the difficulty of mobilizing donor resources in a more stringent global fiscal context—even with the successful rechanneling of SDRs to the PRGT and RST—there is a shortage of resources for subsidizing IMF concessional lending. The use of IMF internal resources remains a viable option that should be explored further. The IFAWG can help build consensus on this key agenda as well.

Priority 4: Promoting resilient capital flows to EMDEs

Capital flows are crucial for emerging markets and developing economies (EMDEs). Nevertheless, historically, capital inflows have fallen short of the needs of EMDEs and have been marked by periods of extreme volatility, creating significant risks for macroeconomic and financial stability. Against this backdrop, recent years have seen significant changes in the global economic landscape that could profoundly alter the incentives for capital inflows and outflows. These changes include the escalation of geoeconomic tensions, the urgency to fund the green transition, and the shift away from ultra-loose monetary policies in advanced economies (AEs).

Thus, it is important to carry out an updated assessment of the factors influencing capital flows, including green transition investment flows to EMDEs, and to analyze the opportunities and obstacles that hamstring their efforts to attract stable, long-term foreign private capital investments.

The assessment will explore a wide range of factors, including global, regional, and domestic elements. This will involve discussing the impact of macroeconomic policies on international flows and financial architecture, while factoring in the diverse perspectives among EMDEs and spillover effects. For example, the assessment should examine the opening of the financial accounts of large emerging economies and the impact of higher-for-longer interest rates in AEs, as well as the lower rate of growth of EMDEs vis-à-vis AEs.

In addition, the assessment will consider key aspects related to the international financial architecture—specifically, examining how institutional and regulatory rules governing portfolio allocation decisions interact with ongoing global economic trends. A key objective of the assessment is to uncover measures capable of sustainably improving capital flows from AEs to EMDEs given the current global economic context.

Priority 5: Addressing vulnerabilities emerging from the integration of payment systems

Payment systems have been undergoing a significant revolution in recent years. With the widespread adoption of digital solutions, payments have become faster, cheaper, and more efficient. Nevertheless, these developments have been observed mainly in domestic markets. Since the endorsement of the G20 Roadmap for Enhancing Cross-Border Payments during the Saudi Presidency of the G20 in 2020, the membership has been working to promote this revolution in payments across countries as well.

With the proliferation of initiatives to promote the integration of fast payments systems and CBDCs around the world, concerns regarding the impacts on financial stability and capital flows have emerged. The Brazilian Presidency of the G20 proposes the IFAWG to deepen the understanding of the potential macro-financial implications of CBDCs, the integration of instant payment systems, and increased speed and efficiency in cross-border payments on the international monetary and financial architecture. Increased connectivity of financial systems can bring significant opportunities for trade, investment, and innovation. However, it can also amplify contagion of domestic financial shocks—such as bank runs—to other countries through capital flows, which can become faster and more volatile, or even through new channels.

Additional concerns that have been raised in the literature regarding cross-border usage of CBDCs, such as currency substitution, likelihood of financial crises, internationalization of currencies, degree of international risk-sharing, and global spillovers of shocks and policies, may also emerge due to the integration of fast payment systems.

The Brazilian Presidency of the G20 proposes the IFAWG to discuss policy recommendations to address vulnerabilities that might arise in this new environment and their effects on the GFSN. The goal is to mitigate risks and prevent amplification, including through initiatives centered on multilateral cooperation. The Presidency will also propose a discussion on the costs and benefits of enhancing existing buffers and mechanisms/arrangements to improve global safety nets, such as precautionary instruments and liquidity backstops, among others.

In addition, the Brazilian Presidency proposes the IFAWG to deepen the understanding of the coherence and adequacy of the policy frameworks (IMF’s Institutional View and Integrated Policy Framework; OECD’s Capital Movements Code; and BIS’ Macro-Financial Stability Framework) to cope with the adverse consequences of the increased connectivity of financial systems.

III. PLANNED DELIVERABLES

- A G20 Roadmap for creating a better, bigger, and more effective MDB system. The roadmap will serve as a guiding document for IFAWG work, contributing to a more regular, meaningful, and deeper engagement with MDBs, ultimately enhancing their ownership and ability to work as a system.
- Advances in the debt treatment for highly indebted low- and middle-income countries.
- Advances in governance reforms of MDBs and the IMF.
- Analytical work on international drivers of capital flows, considering ongoing global economic trends.
- Analytical work on macro-financial impacts of international integration of domestic fast payment systems and CBDCs.

IV. QUESTIONS FOR DISCUSSION

1. What are members' views on the roadmap for a better, bigger and more effective system of MDBs?

2. How do members assess the perspectives for the sovereign debt outlook, especially among low-income countries?

3. What are members' views regarding obstacles and opportunities that affect the capacity of EMDCs to attract foreign capital inflows?

4. What are members' views regarding the macro-financial impacts of international integration of fast payment systems and CBDCs?

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