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Report of the Secretary-General

Summary

The present report, submitted pursuant to General Assembly resolution 77/152, provides a review of the implications of the coronavirus disease (COVID-19) pandemic and new and emerging challenges, including from non-economic risks, for the international financial system. The report contains proposals for reforming the international financial architecture in support of sustainable development, sustained by enhanced international cooperation. It includes sections on (a) enhancing debt sustainability; (b) multilateral development bank reforms for scaling up financing for the Sustainable Development Goals; (c) strengthening the global financial safety net; (d) addressing systemic financial stability risks; (e) the international monetary system; and (f) strengthening global governance and policy coherence.

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I. Introduction

1. The coronavirus disease (COVID-19) pandemic, the war in Ukraine, sharp increases in food and energy prices and rapidly tightening global financial conditions have exacerbated challenges for developing countries, increasing poverty and reversing progress on the Sustainable Development Goals. The situation is particularly bleak for many of the poorest countries, which are facing elevated risk of debt distress. In addition, climate change continues to disproportionately affect already vulnerable countries and populations.

2. Against a backdrop of continued global tightening of monetary policy, persistent dollar strength, protracted geopolitical uncertainty and a fragile economic outlook, capital flows to developing countries remain highly susceptible to shifts in sentiments. A sharp increase in the magnitude and volatility of capital flows has potentially adverse impacts on countries' access to finance, exchange rates, debt sustainability and financial stability. Many developing countries, in particular those with underlying vulnerabilities, lack access to affordable market finance, as reflected in elevated credit spreads.

3. The global financial system has failed to deliver the financing or stability needed to achieve the Sustainable Development Goals. The international financial architecture, which was initially designed in 1945 and refers to the governance arrangements that safeguard the stability of global monetary and financial systems, has not kept pace with a changing global landscape characterized by deeply integrated financial markets, poly-crises with cascading effects, growing systemic risks, a climate emergency, shifting trade and financial relations, and rapid technological change.

4. The need for deep reforms is increasingly recognized and is prominent on the global agenda. It was acknowledged in the *Financing for Sustainable Development Report 2023* that reforms in the international financial architecture were ongoing in nearly all action areas of the Addis Ababa Action Agenda of the Third International Conference on Financing for Development. Reforms are being discussed in multiple forums, including informal country groupings, such as the Group of 20, the Group of Seven, the Bridgetown Initiative and, most recently, at the Summit for a New Global Financing Pact, at meetings of the boards of the World Bank and the International Monetary Fund (IMF), as well as at the United Nations, and will be further discussed at the Summit of the Future, in 2024. Such efforts could culminate in international consensus on long-awaited and urgently needed changes to the international financial architecture at a fourth international conference on financing for development in 2025.

5. To support the aforementioned discussions, the Secretary-General recently published two complementary sets of proposals. In the Sustainable Development Goal stimulus,[1] he called on the international community to raise at least $500 billion annually to scale up affordable long-term financing for countries in need. He also highlighted three priorities to be urgently addressed, namely (a) tackling the high cost of debt; (b) rapidly scaling up affordable long-term financing for countries in need, including through strengthening the system of development banks; and (c) expanding contingency financing. In the policy brief on reforms to the international financial architecture,[2] the Secretary-General complements the ideas in the Sustainable Development Goal stimulus by putting forward bold and ambitious recommendations for creating a stable, sustainable and inclusive international financial architecture.

[1] United Nations, "United Nations Secretary-General's SDG stimulus to deliver Agenda 2030", policy brief, February 2023.

[2] A/77/CRP.1/Add.5.

The present report contains analysis on most of the issues covered in the policy briefs.[3]

II. Enhancing debt sustainability[4]

6. Sovereign borrowing is an important way for countries to finance investments in sustainable development. For many developing countries, however, global shocks since 2020 have compounded debt vulnerabilities that had been building up over the previous decade. An estimated 52 developing countries, home to half of the world's extreme poor, suffer from severe debt problems and extremely costly market-based financing. About 60 per cent of the least developed and other low-income countries are assessed as being at high risk or in debt distress, twice the level in 2015.

7. Rising debt service burdens further diminish the fiscal space that countries need for investing in the Sustainable Development Goals. In 2022, 25 developing countries dedicated more than a fifth of their total revenue to servicing external public debt, which is the largest number of countries crossing that threshold since the debt relief initiatives of the early 2000s.[5]

8. Continued global tightening of monetary policy is likely to exacerbate debt sustainability challenges for many developing countries by reducing liquidity, raising borrowing costs and weakening domestic currencies. Even for countries that are not at immediate risk of debt distress, high borrowing costs constrain their ability to invest in recovery and sustainable development, and raise the risk of future debt crises. Recent analysis has found that most countries that have had costly debt crises would have been solvent if they had had continuous access to financing at the rates paid by developed countries.[6]

9. The international community should take several steps to enhance sovereign debt markets in order to support the Sustainable Development Goals. First, existing principles of responsible borrowing and lending should be updated to reflect the changing global environment and to incorporate the Goals.

10. Second, the methodologies of debt sustainability analysis and credit rating should continue to be improved and made more transparent, for example by incorporating climate risks and the positive impact of investment in actions towards achieving the Sustainable Development Goals on a country's long-run projections; IMF is currently working on this with regard to debt sustainability analysis. There is also a need for debt sustainability analysis to better distinguish between liquidity and solvency crises. The distinction is important in the context of scaling up official lending as part of efforts to grow the multilateral development bank system, for example as part of the Sustainable Development Goal stimulus. A possible proxy for calculating "solvency" debt sustainability analysis would be to run existing models using borrowing rates for multilateral development banks, rather than market rates. Comparing this "solvency" outcome with the outcome of traditional debt

[3] The policy brief on reforms to the international financial architecture includes a section on international tax cooperation, which is covered in the report of the Secretary-General on the promotion of inclusive and effective international tax cooperation at the United Nations (A/78/235).

[4] For a more in-depth analysis of debt sustainability, see the report of the Secretary-General on external debt sustainability and development (A/78/229).

[5] *Financing for Sustainable Development Report 2023* (United Nations publication, 2023).

[6] Ugo Panizza, "Long-term debt sustainability in emerging market economies: a counterfactual analysis", Graduate Institute of International and Development Studies Working Paper, No. HEIDWP07-2022 (Geneva, Graduate Institute of International and Development Studies, 2022).

sustainability analysis could reveal whether a country would be fundamentally solvent if it had access to improved financing terms.

11. Third, amid growing climate and other systemic risks, there is a need for specific mechanisms that defer debt payments when countries are hit by external shocks. At the Summit for a New Global Financing Pact, the international community made progress in that regard by encouraging creditor countries to introduce climate resilient debt clauses into their lending instruments. Such efforts could be strengthened by encouraging development banks to introduce climate resilient debt clauses, drawing on recent efforts by UK Export Finance of the United Kingdom of Great Britain and Northern Ireland and the Inter-American Development Bank.

12. Fourth, debt-for-Sustainable Development Goals and debt-for-climate swaps should be promoted, led by the official sector. The development of a reference framework could help to standardize both official and market-based debt-for-climate and debt-for-Sustainable Development Goals swaps, reduce transaction costs and increase uptake.

13. The current international system does not have the necessary tools for facilitating sufficiently deep and rapid debt restructuring when needed. Despite some recent progress, implementation of the Common Framework for Debt Treatments beyond the Debt Service Suspension Initiative of the Group of 20 has been slow. For example, in June 2023, Zambia reached an agreement with its official creditors, more than two years after the country first applied for debt restructuring. The protracted nature of the process has undermined confidence in it, with some debtor countries reluctant to request debt treatment under the Common Framework.

14. The Secretary-General has proposed a two-step solution to facilitate sovereign debt resolutions. The first step involves setting up a debt workout mechanism housed at one of the international financial institutions, to speed up debt restructuring under the Common Framework. The mechanism would help to ensure comparability of treatment between official and commercial creditors using methods that would enforce and incentivize private creditor participation. The second step, in the medium term, would aim to establish a sovereign debt authority independent of creditor and debtor interests, in order to ensure timely, orderly, effective and fair debt resolutions in an increasingly complex debt landscape.

III. Multilateral development bank reforms for scaling up financing for the Sustainable Development Goals

15. Public development banks, including multilateral development banks, are uniquely positioned to increase lending for sustainable development to developing countries. Multilateral development banks play a countercyclical role during crises and provide long-term affordable financing, but their financial capacity remains limited. Except in the case of the African Development Bank, the size of the paid-in capital bases of multilateral development banks has not increased in line with the growth of the global economy or the growing needs for investment. The paid-in capital of the World Bank is seven times smaller than it was in 1960, relative to global gross domestic product (GDP). Capital increases for the World Bank have not been on the scale required to finance the significant investment push needed to address current challenges. Lending and incentives within the multilateral development banks are also not fully aligned with the Sustainable Development Goals, including climate action.

16. Despite calls to increase private finance mobilized by official development finance, only between $45 billion and $55 billion are being mobilized annually, which

is significantly below the amount called for by the World Bank in 2015, when it requested a move from billions to trillions. Moreover, the development impact of the current flows is unknown. The situation therefore raises questions as to whether the current model for leveraging private finance is effective, and underlines the need to develop new frameworks for financial risk-sharing, including by multilateral development banks, that focus on maximizing impact.

17. Multilateral development banks are reviewing their roles, scale and functions to enable them to adapt and be fully responsive to the Sustainable Development Goals and climate action. The World Bank has released a draft evolution paper, with the adoption of proposals planned for the Annual Meetings of the World Bank Group and IMF to be held in October 2023. It outlines three building blocks: enhancing the World Bank's mission, its operating model and its financial model and capacity.[7] In May 2023, the European Bank for Reconstruction and Development approved amendments to its statutes enabling an incremental expansion of its operations to sub-Saharan Africa and Iraq.[8] The European Investment Bank established a new development arm, EIB Global, in order to increase its development impact beyond Europe.

Increasing capacity for long-term financing

18. In the Sustainable Development Goal stimulus, the Secretary-General calls for a significant expansion in the volume of lending by multilateral development banks, from $100 billion to at least $500 billion annually. The expansion could be achieved by strengthening the capital bases of multilateral development banks and using existing capital more effectively. An increase in the paid-in capital of multilateral development banks, even if disbursed over time, is important for unlocking the additional lending capacity needed to meet heightened demand.

19. In order to further increase lending capabilities, multilateral development banks should continue to use existing capital more efficiently, including through maximizing the use of their balance sheets.[9] Although some studies have estimated that revisions to the capital adequacy policies of multilateral development banks could boost lending by $500 billion without any impact on credit ratings,[10] to date the World Bank has estimated much lower potential and has presented a package of measures to increase its lending capacity by $50 billion over the next 10 years. The measures include a revision of the minimum equity-to-loan ratio; a pilot programme for hybrid capital issuance in capital markets; removal of the statutory lending limit from the Bank's articles of agreement; and a scaled-up bilateral guarantee programme. Other measures that are being explored to further increase financing include enhancing the role of callable capital. Given the scale of financing needs, however, balance sheet optimization measures alone will not be sufficient to address growing challenges, and new injections of capital will also be needed.

20. Channelling special drawing rights through multilateral development banks would further expand their capacity for long-term financing (see sect. IV below). To date, several countries, including Japan, Saudi Arabia and the United Kingdom, have

[7] After feedback and consultation on the initial draft, "Evolution of the World Bank Group: a report to governors" was published in March 2023. The World Bank hosted a stakeholder consultation meeting in Washington, D.C., in April 2023, and online consultations are continuing.

[8] European Bank for Reconstruction and Development, resolution No. 259 of the Board of Governors, adopted 18 May 2023.

[9] Expert Panel of the Independent Review of Multilateral Development Banks' Capital Adequacy Frameworks, *Boosting MDBs' Investing Capacity: An Independent Review of Multilateral Development Banks' Capital Adequacy Frameworks* (Group of 20, 2022).

[10] See United Nations, "United Nations Secretary-General's SDG stimulus".

expressed interest in channelling special drawing rights through multilateral development banks, although several other countries, such as the members of the European Union, have noted challenges in doing so. Nonetheless, as the methodologies for channelling special drawing rights through multilateral development banks are developed, countries are encouraged to explore doing so.

Aligning business models of multilateral development banks with the Sustainable Development Goals

21. Amid mounting challenges to sustainable development, multilateral development banks are reviewing their business practices to better support investment in the Sustainable Development Goals and climate action, including by updating mandates, policies, lending practices and internal incentives to focus on the Goals and climate impact. A more systematic use of vulnerability to guide allocations of concessional finance, such as through the multidimensional vulnerability index or metrics beyond GDP, will provide much-needed support to vulnerable countries, such as small island developing States.

22. In addition, there are calls for multilateral development banks to increase the quantity and quality of climate finance, including by honouring pledges to end financing for fossil fuel projects, as the European Investment Bank has done. There is also a need to develop mechanisms to better account for climate finance in order to ensure that an increase in financing for climate mitigation does not come at the expense of finance for domestic priorities in developing countries. With 62 separate multilateral funds disbursing a total of only between $3 billion and $4 billion, there is also a need to optimize the climate finance architecture, a process that could start with an independent review to explore the issue.

Improving terms of lending

23. Additional leverage and capital could provide the space for multilateral development banks to improve their terms of lending. Multilateral development banks could offer affordable ultra-long-term loans (with a repayment period of 30–50 years), allowing time for investments to have had an impact on economic growth and development. The inclusion of climate resilient debt clauses in loan contracts of multilateral development banks and the scale-up of contingent emergency component clauses, as encouraged in the multilateral development banks vision statement of the Summit for a New Global Financing Pact, would provide breathing space for countries hit by natural disasters or other exogenous shocks.

Strengthening the system

24. Public development banks already have a large footprint, with 528 development banks and development finance institutions together controlling assets of $23 trillion, which could be leveraged for greater impact. Multilateral development banks should deepen cooperation among themselves and with other public development banks to improve co-financing and knowledge-sharing and achieve better leverage, as also called for at the Summit.

25. Multilateral development banks and other international financial institutions are in a better position than sovereigns to manage foreign exchange risk, given their ability to diversify across currencies, as called for in the Addis Ababa Action Agenda. An expansion of local currency lending by multilateral development banks could reduce currency risks faced by Governments and lower their debt risk profiles. Public insurance or reinsurance funds across the public development bank system could help banks to better manage risks through diversification. A public fund could also offer

foreign currency guarantees or currency hedging for private investments in sustainable development in developing countries.[11]

Leveraging private finance

26. Multilateral development banks should better leverage private finance to accelerate progress towards sustainable development. A new framework for blended finance that prioritizes sustainable development impact rather than project bankability is needed. A focus on impact would highlight deals in the least developed countries and other vulnerable countries that have large development needs, although such deals will tend to have lower leverage ratios. Indicators and performance-based incentives for blending at multilateral development banks would need to focus not only on quantity but also on impact. Failure to do so could lead to a focus on the most profitable deals, overcompensation of the private partner and channelling of private finance towards sectors that are not conducive to achieving the Sustainable Development Goals.

IV. Strengthening the global financial safety net

27. Since 2020, the global financial safety net has provided increased emergency support to countries affected by crises. With IMF at its centre, the global financial safety net also includes regional financing arrangements, bilateral swap arrangements and countries' own foreign exchange reserves. Despite the multilayered nature of the global financial safety net, recent crises have exposed gaps and revealed the uneven access for countries. For example, most developing countries are not included in the global network of swap arrangements. Only 28 per cent of middle-income countries and 2 per cent of the least developed countries have access to bilateral swap lines.[12]

28. Amid growing systemic risks,[13] more countries are expected to require liquidity support in the future. There is therefore an urgent need for the global financial safety net to be strengthened and made more coherent and equitable.

Special drawing rights

29. The historic $650 billion new allocation of IMF special drawing rights in 2021 afforded some relief to member countries, allowing them to boost their international reserves and exchange special drawing rights for freely usable currencies to address their spending needs, in accordance with national legal frameworks.

30. Although the exchange of special drawing rights for other currencies does not create additional debt, countries are liable to pay interest on the difference between their special drawing right holdings and allocations, with the interest rate based on a weighted average of currencies in the special drawing rate basket. Amid tightening global financial conditions, that interest rate has risen considerably, from less than 0.1 per cent in early 2022 to above 3.8 per cent in early June 2023. Although the rate remains low when compared with costs of borrowing from other sources, it has led to significant increases in charges for countries that exchanged their special drawing rights for hard currencies.

[11] See also Avinash Persaud, "Unblocking the green transformation in developing countries with a partial foreign exchange guarantee", version 7.0, 7 June 2023.

[12] *Financing for Sustainable Development Report*.

[13] For a deeper discussion of the impact of global systemic risks on the financing for development agenda, see *Financing for Sustainable Development Report 2021* (United Nations publication, 2021).

31. The existing mechanism for allocating special drawing rights in proportion to IMF quota shares of countries led to developing countries receiving only one third of the 2021 allocation, with the least developed countries receiving less than 2.5 per cent of that allocation. By the end of December 2022, 50 of the 190 member countries, including 18 of the least developed countries, had drawn down their special drawing right holdings to below 50 per cent of their allocations. Developed countries with excess special drawing right holdings held 362 billion of unused special drawing rights (equivalent to $484 billion) as at 31 December 2022.[14]

32. To promote a stronger and more inclusive recovery, the Group of Seven and the Group of 20 have called for a voluntary rechannelling of $100 billion of unused special drawing rights to countries in need. As at 31 May 2023, countries had made total pledges in excess of $100 billion, although only $55 billion had actually been rechannelled. The vast majority of rechannelled special drawing rights were used to finance the Poverty Reduction and Growth Trust and the new Resilience and Sustainability Trust of IMF.

33. Member States have expressed support for the option of rechannelling special drawing rights through multilateral and regional development banks, which are already prescribed holders (i.e. entities that can hold and trade special drawing rights). In February 2023, IMF approved 5 new multilateral development banks as prescribed holders, bringing the total number of prescribed holders to 20. The African Development Bank, jointly with the Inter-American Development Bank, has put forward an innovative proposal that would allow countries to provide their special drawing rights as hybrid capital, which can then be leveraged to provide long-term financing. The instrument would also have a multiplier effect, as it could leverage special drawing rights by between three and four times. The proposed hybrid capital scheme of the African Development Bank is complemented by a liquidity support agreement, a liquidity backstop modelled on the Poverty Reduction and Growth Trust. The liquidity support agreement would allow lenders to redeem their loan in case of balance of payments issues, thereby ensuring that the proposal maintains the reserve asset characteristics of special drawing rights. The Secretary-General has called for a second round of rechannelling of an additional $100 billion, focused on rechannelling through multilateral development banks.

34. The development of a mechanism that allows for a more automated process for issuing special drawing rights, either in a countercyclical manner or in response to shocks, could help to avoid protracted political negotiations and enhance the timeliness of issuances during a crisis. It took 11 months for the Board of Governors of IMF to agree on a new special drawing rights issuance following the onset of the 2008 global financial crisis, and 17 months following the COVID-19 outbreak. In addition, allocating special drawing rights on the basis of the needs and vulnerabilities of countries, rather than IMF quotas, could allow for better targeting of special drawing right issuance towards countries that truly require liquidity. This could be done either directly in the allocation of special drawing rights or through an ex ante rechannelling agreement to rechannel special drawing rights at issuance.

International Monetary Fund financing mechanisms

35. Over the past three years, IMF has increased its emergency lending and introduced new financing facilities to help countries to weather the series of global shocks. IMF agreed to 20 arrangements with countries worth $63.7 billion in 2021,

[14] IMF, IMF Financial Data Query Tool. Available at https://www.imf.org/external/np/fin/tad/query.aspx.

and 21 arrangements worth $88.8 billion in 2022. IMF lending disbursements totalled $12.4 billion in 2021, rising to $36.6 billion in 2022.

36. In April 2020, IMF established a new short-term liquidity line for countries with very strong policy frameworks and fundamentals, which was the first addition to the IMF financing toolkit in almost 10 years. Its unique design allowed IMF to proactively offer arrangements to countries under the short-term liquidity line rather than waiting for countries to request it. IMF also implemented several short-term measures, including increasing access limits for lending facilities and temporarily streamlining approval processes. From January 2022, cumulative access limits were reduced to pre-pandemic levels for most facilities.[15]

37. The Poverty Reduction and Growth Trust, which provides concessional loans to low-income and other vulnerable countries, has provided $24 billion in interest-free loans since the onset of the COVID-19 pandemic. The Trust faces growing financing strains due to strong demand for its loans and significantly higher interest rates. IMF reported that the Poverty Reduction and Growth Trust had a shortfall of 1.2 billion special drawing rights in pledges for subsidy resources and 3.5 billion special drawing rights for loan resources.[16] Additional financing, including special drawing right pledges, are needed to close the financing gap of the Trust.

38. The Resilience and Sustainability Trust, which began operating in October 2022, offers long-term affordable financing of up to 20 years maturity to help countries build resilience against external shocks, such as climate-related challenges, that pose risks to their balance of payments stability. As at 31 May 2023, the Trust had received 32.4 billion special drawing rights. IMF has so far approved seven Resilience and Sustainability Facility programmes under the Resilience and Sustainability Trust.

39. Although global food prices have eased since the onset of the war in Ukraine, they remain elevated by historical standards. Since February 2022, IMF has approved new upper credit tranche quality programmes for seven countries and augmented existing programmes for two countries that were severely affected by the food crisis, with a total additional commitment of $11.4 billion.[17] The programmes focus on strengthening social safety nets to help address the effects of the food crisis. In addition, in September 2022, IMF approved a new, temporary 12-month food shock window under its emergency financing instruments. The window provides additional support to member countries facing urgent balance of payment needs owing to the global food shock, where upper credit tranche quality programmes are not feasible or necessary. As at March 2023, requests from six countries for financing under the window had been approved, with the total support provided under the scheme reaching $1.8 billion.

40. Growing risks from more frequent and interconnected shocks will require new and innovative financing instruments to boost the availability of resources for vulnerable countries. IMF lending could be made more flexible, with low interest rates, fewer conditionalities and increased access limits to rapid credit and financing

[15] The enhanced cumulative access limits for the Rapid Credit Facility and the Rapid Financing Instrument were extended to 30 June 2023. See IMF, *Review of Temporary Modifications to the Fund's Access Limits in Response to the COVID-19 Pandemic*, IMF Policy Paper, No. 2021/077 (Washington, D.C., 2021).

[16] IMF, *2023 Review of Resource Adequacy of the Poverty Reduction and Growth Trust, Resilience and Sustainability Trust, and Debt Relief Trusts*, IMF Policy Paper, No. 2023/021 (Washington, D.C., 2023).

[17] Bjoern Rother and others, *Global Food Crisis Update – Recent Developments, Outlook, and IMF Engagement*, IMF Note, No. 2023/002 (Washington, D.C., IMF, 2023).

facilities. Suspending or at least reducing surcharges temporarily could help to ease the pressure on countries facing severe balance of payments constraints.

41. To increase access to swap lines for all, IMF could facilitate a multilateral currency swap facility,[18] with the participation of central banks that issue global reserve currency, to provide access to emergency liquidity for a broader set of developing countries.

42. The ongoing sixteenth general review of quotas of IMF, which is scheduled to conclude by mid-December 2023, provides an opportunity to recapitalize IMF and expand its lending capacity to prepare for future challenges while making progress in governance reform (see sect. VII below).

Regional financing arrangements

43. Regional financing arrangements can play an important role in strengthening the global financial safety net by providing regional reserve pooling arrangements, swap lines, lending facilities and technical support. Developing countries have access to six regional financing arrangements, with a combined lending power of $1 trillion.[19] Between February 2020 and February 2023, regional arrangements disbursed $9.9 billion to member countries, partly in combination with IMF programmes, although more than one third of the total amount was provided to a single country in Europe. This amount is small compared with both IMF lending programmes and bilateral currency swaps between central banks, which stand at more than $1.5 trillion. Despite the comparatively small amounts involved, the quick disbursal of loans through regional financing arrangements has provided fast and flexible relief for countries that have accessed them. During the COVID-19 pandemic, the most commonly used regional arrangements were those that did not require an IMF programme to be in place for funds to be accessed.[20]

44. Regional financing arrangements could be strengthened to provide more resources on better terms and with more predictability, including by enhancing cooperation between regional financing arrangements and IMF to coordinate better across layers of the safety net, together with revising formal linkages to provide more autonomy to regional arrangement decisions. An expansion of the member base could strengthen the role of regional arrangements in the global financial system.

V. Addressing systemic financial stability risks

45. The aggressive pace of monetary policy tightening by major central banks over the past year has exacerbated fragilities in the financial sector, as seen in the 2023 banking turmoil in the United States of America and Europe. Although policymakers acted decisively to contain risks of financial contagion, vulnerabilities remain elevated as global financial conditions continue to tighten. In the current

[18] See also IMF, “Adequacy of the global financial safety net – review of the flexible credit line and precautionary and liquidity line, and proposals for toolkit reform”, IMF Policy Paper (Washington, D.C., 2017); and A/77/CRP.1/Add.5.

[19] The Arab Monetary Fund, the Contingent Reserve Arrangement, the Chiang Mai Initiative Multilateralization, the Eurasian Fund for Stabilization and Development, the Latin American Reserve Fund and the South Asian Association for Regional Cooperation currency swap arrangement.

[20] Laurissa Mühlich and Barbara Fritz, “Regional monetary cooperation in the developing world: taking stock”, in *South-South Regional Financial Arrangements: Collaboration towards Resilience*, Diana Barrowclough and others, eds., International Political Economy Series (Cham, Switzerland, Palgrave Macmillan, 2022).

environment, central banks face increasingly difficult trade-offs between containing high inflationary pressures and preserving financial stability.

46. A further increase in interest rates could expose pockets of vulnerability in other areas of the financial sector, including the less regulated non-bank financial intermediaries. There is a risk of further bouts of financial market turbulence, with implications for the broader financial system. Renewed strains in developed country financial markets could generate significant cross-border spillovers, exacerbating already challenging financing conditions for many developing countries. Policymakers must respond to these emerging challenges, including by updating existing regulations and risk assessment methodologies and by expanding the regulatory umbrella.

Banking turmoil in the United States and Europe

47. The rise in interest rates exposed balance sheet vulnerabilities and triggered depositor withdrawals, which cascaded into liquidity spillovers across the sector. In March 2023, the collapse of Silicon Valley Bank, the sixteenth largest bank in the United States, and of Signature Bank, as well as the Swiss government-brokered takeover of Credit Suisse, a globally systemically important bank, triggered widespread panic, which reverberated across global financial markets. In early May 2023 in the United States, the Federal Deposit Insurance Corporation took control of First Republic Bank, which had total assets of $212 billion, and sold those assets to JPMorgan Chase. Although the banks that failed each had unique weaknesses, common factors included deficiencies in both internal risk management and external supervision.

48. Swift response by regulators helped to alleviate market fears and contain risks to financial stability, including immediate action to deal with the failing banks, while at the same time enhancing liquidity to other domestic banks and central banks to mitigate spillover effects. It is unclear whether there are other pockets of risk that will be exposed by rising interest rates (such as the disproportionately large commercial real estate loans among small banks in the United States). In addition, there remain concerns about the less regulated non-bank financial intermediaries, given their unknown exposure to interest rate risks and their increasing systemic importance.

Non-bank financial intermediation

49. Since the 2008 global financial crisis, the growth of non-bank financial intermediaries, including pension funds, hedge funds, insurers and financial technology (fintech) providers that act as financial intermediaries, has outpaced growth in the banking sector and now accounts for almost half of all financial assets globally.[21] Non-bank financial intermediaries have also become more interconnected, as reflected in growing cross-border links between them and traditional banks. They increasingly provide credit and other financial services. Although they allow for more diversification of risk, they also exacerbate volatility and market stress, which could precipitate a wider-scale financial crisis.

50. There has been a build-up of vulnerabilities related to excessive financial leverage, liquidity mismatches and high levels of interconnectedness in some non-bank financial intermediaries.[22] In the event of shocks, non-bank financial

[21] Financial Stability Board, *Global Monitoring Report on Non-Bank Financial Intermediation 2022* (Basel, 2022).

[22] IMF, *Global Financial Stability Report: Safeguarding Financial Stability amid High Inflation and Geopolitical Risks* (Washington, D.C., 2023).

intermediaries tend to sell assets to cover redemptions or margin calls,[23] leading to a sell-off in asset prices and a sharp increase in demand for liquidity. This can trigger rapid deleveraging and the transmission of stress to other parts of the financial system and to the real economy.

51. Non-bank financial intermediaries, including investment funds, are also a significant driver of capital flows to developing countries, contributing to growing risks associated with destabilizing cross-border spillovers (see sect. VI below). Investment funds benchmarked to local currency bond indices in developing countries have risen fivefold since the mid-2000s to around $300 billion.[24] At the onset of the COVID-19 pandemic, sales by foreign investors led to large-scale capital outflows and contributed to local currency depreciation.[25] Studies also suggest that non-bank financial intermediaries tend to act in a more procyclical way than banks, in particular with regard to cross-border activity.[26]

52. To address growing financial stability risks from non-bank financial intermediaries, including fintech firms that engage in financial intermediation, policymakers should continue to expand the regulatory umbrella, according to the principle of "same activity, same risk, same rules". Greater regulatory coordination across sectors and jurisdictions can reduce risks of spillovers, regulatory arbitrage and market fragmentation.[27] Recent proposals from the Financial Stability Board and other standard-setting bodies for addressing systemic risks of non-bank financial intermediaries are aimed at reducing liquidity demand spikes, enhancing the resilience of liquidity supply in stress and enhancing risk monitoring and preparedness.[28]

Cryptoassets and stablecoins

53. Rapid developments in digital financial technology, which were further accelerated by the COVID-19 pandemic, have transformed financial services. Although the technologies can contribute to deepening financial inclusion and efficiency gains, they also create risks. A new range of digital assets, in particular cryptoassets and stablecoins, have proved exceptionally volatile, creating risks that, if left unaddressed, could undermine consumer protection, financial stability and market integrity. In addition, cryptoassets, in particular those designed to be anonymous, remain a vehicle for facilitating illicit transactions. To mitigate such risks, many central banks are exploring the development of central bank digital currencies as a safer alternative.

54. Cryptoassets are privately issued virtual tokens, many of which are based on decentralized networks using distributed ledger (blockchain) technology. Cryptoassets have lost over 60 per cent of their value compared with their highest recorded value, with total market capitalization declining from $3.1 trillion in November 2021 to about $1.1 trillion in June 2023. Large declines in the prices of cryptoassets in 2022 coincided with the aggressive pace of interest rate hikes in major

[23] A margin call is defined as an instance when a broker, dealer, intermediary or counterparty requires a borrower to deposit additional cash or securities to cover possible losses. Margin calls often occur when the market price of an underlying asset has changed significantly.

[24] Serkan Arslanalp and others, *Benchmark-Driven Investments in Emerging Market Bond Markets: Taking Stock*, IMF Working Paper, No. 2020/192 (Washington, D.C., IMF, 2020).

[25] Financial Stability Board, *US Dollar Funding and Emerging Market Economy Vulnerabilities* (Basel, 2022).

[26] Egemen Eren and Philip Wooldridge, *The Role of Non-Bank Financial Institutions in Cross-Border Spillovers*, BIS Papers, No. 129 (Bank for International Settlements, 2022).

[27] IMF, *Global Financial Stability Report*.

[28] Financial Stability Board, "Enhancing the resilience of non-bank financial intermediation: progress report", 10 November 2022.

developed countries and with reduced daily usage of the major cryptoasset trading apps.[29] The large fluctuations in valuation render cryptoassets unfit to fulfil the three main functions of a currency, namely as a store of value, a unit of account and a medium of exchange.

55. The sharp drop in cryptoasset valuations has been accompanied by high-profile bankruptcies. Amid allegations of fraud and mismanagement, the collapse of FTX, one of the largest cryptoasset exchanges, in November 2022 led to large losses for its clients and created significant contagion within the cryptoasset ecosystem.

56. Stablecoins share many of the characteristics of cryptoassets, including their pseudo-anonymous nature. Most stablecoin issuers promise, implicitly or explicitly, to maintain a stable value, typically relative to a single currency such as the United States dollar. Many stablecoins, however, are issued by unregistered and unlicensed entities and do not have credible mechanisms to support the promised maintenance of a stable value. Stablecoins, despite their name, can therefore be vulnerable to runs when users lose trust and rush to redeem their holdings, similar to bank runs.

57. There is a growing urgency for policymakers and international standard-setting bodies to strengthen supervision and regulatory frameworks surrounding cryptoassets, encompassing consumer protection, financial integrity and corporate governance. Given the cross-border nature of cryptoassets, regulatory responses also need to be coordinated and globally consistent, as called for by various forums including the Group of Seven, the Group of 20 and the Financial Action Task Force.

58. In May 2023, the International Organization of Securities Commissions, the umbrella group for global markets regulators, issued a set of guidelines with 18 recommendations for cryptoasset regulations, including on conflicts of interest, disclosure rules and governance.[30] In April 2023, the European Union adopted its Markets in Crypto-Assets regulation, which established a harmonized legal framework at the European Union level for the sector for the first time. The regulation covers cryptoassets that are not regulated by existing financial services, with the aim of enhancing consumer protection and safeguards against market manipulation and financial crime.[31]

59. In October 2022, the Financial Stability Board proposed a set of recommendations for the regulation, supervision and oversight of cryptoasset activities and markets, in line with the principle of "same activity, same risk, same regulation". Under the principle, IMF has identified nine elements for effective policy responses. They include enforcing prudential, conduct and oversight requirements for all cryptoasset market actors; analysing and disclosing fiscal risks and adopting unambiguous tax treatment of cryptoassets; and establishing international collaborative arrangements for enhancing the supervision and enforcement of cryptoasset regulations.[32]

60. Although cryptoassets are not yet a significant part of the global financial system, they are becoming a source of systemic risk in certain developing countries. Moreover, in a number of developing countries, dollar-denominated stablecoins are growing in popularity as a potential store of value and hedge against inflation and

[29] Raphael Auer and others, *Crypto Trading and Bitcoin Prices: Evidence from a New Database of Retail Adoption*, BIS Working Paper, No. 1049 (Bank for International Settlements, 2022).

[30] Board of the International Organization of Securities Commissions, *Policy Recommendations for Crypto and Digital Asset Markets: Consultation Report*" (International Organization of Securities Commissions, 2023).

[31] European Parliament, "Crypto-assets: green light to new rules for tracing transfers in the EU", press release, 20 April 2023.

[32] IMF, *Elements of Effective Policies for Crypto Assets*, IMF Policy Paper, No. 2023/004 (Washington, D.C., 2023).

exchange rate volatility, raising the same macroeconomic risk of dollarization.[33] In addition to the fiscal risks, the growing prevalence of cryptoassets could undermine the effectiveness of monetary policy and allow the circumvention of capital flow management measures.

VI. The international monetary system

A. Capital flows

Managing capital flow volatility

61. International capital flows continue to be driven by global risk aversion, interest rates and other factors that are beyond the control of recipient countries. Following heightened volatility throughout most of 2022, developing countries received positive net inflows in 2023 (with a monthly portfolio inflow of $17 billion, in contrast with average outflows of $3.2 billion in the first five months of 2022). Despite this, uncertainty over the scale and pace of monetary policy tightening in major developed economies could trigger renewed bouts of potentially destabilizing capital outflows from developing countries.

62. Policymakers in recipient countries should be able to draw on a full range of policy tools to effectively address the effects of capital flow volatility on their domestic economy and financial systems. The tools include monetary and fiscal policies; exchange rate policies, including foreign exchange intervention; macroprudential measures; and capital flow management measures. IMF, in its 2022 review of its 2012 "Institutional view on the liberalization and management of capital flows", recognized that the pre-emptive use of capital flow management measures could be appropriate in certain circumstances for reducing systemic risks.[34] Capital flow management policies can also be used to incentivize long-term investment while at the same time allowing capital-constrained countries to reap the benefits of tapping foreign pools of capital.

63. The integrated policy frameworks of IMF can help countries to determine the best policy mix and can be implemented as part of broader integrated national financing frameworks.

64. Source countries should also further coordinate policy interventions with destination countries and relevant international standard-setting bodies to reduce international spillovers.

B. Role of central bank digital currencies

65. Most central banks are currently exploring digital currencies, with more than a quarter developing or running related experiments.[35] The engagement of central banks in digital currency work accelerated during the COVID-19 pandemic, often in response to growing interest in cryptoassets. Central bank digital currencies could be designed to deepen financial inclusion and to address inefficiencies in some existing

[33] Parma Bains and others, *Regulating the Crypto Ecosystem: The Case of Stablecoins and Arrangements*, IMF FinTech Note, No. 2022/008 (Washington, D.C., IMF, 2022).

[34] IMF, *Review of the Institutional View on the Liberalization and Management of Capital Flows*, IMF Policy Paper, No. 2022/008 (Washington, D.C., 2022).

[35] Anneke Kosse and Ilaria Mattei, "Gaining momentum – results of the 2021 BIS survey on central bank digital currencies", BIS Paper, No. 125 (Bank for International Settlements, 2022).

payments systems, as well as to eliminate the speculative element that dominates the use of cryptoassets.

66. For developed countries, the main drivers for work on central bank digital currencies are domestic payments efficiency, payments safety, monetary sovereignty and financial stability. For developing countries, financial inclusion is an additional primary motivating factor.[36] Several developing countries have already launched retail central bank digital currencies, with other countries at the pilot stage. Some of the central bank digital currencies operate in the same way as publicly issued e-money, with agents operating gateways and onboarding customers. To date, however, take-up has been lower than expected in some markets, owing mainly to a lack of awareness, limited additional benefits for use and limited acceptance by merchants.[37]

67. Although central bank digital currencies do not directly address all the structural barriers to financial inclusion, they can provide open infrastructure and build trust in the system.[38] Payment service markets are often marked by oligopoly owing to network effects, leading to rent-seeking and high service costs. Introducing a retail central bank digital currency provides a competitive alternative that can reduce rents, improve competition and reduce costs.

68. Interoperability between central bank digital currencies in different jurisdictions could help to enhance the efficiency of cross-border payments. Currently, most cross-border payments use correspondent banking networks, which are slow and costly and are experiencing declining linkages, potentially leaving some countries underserved. Central bank digital currencies offer an alternative in which the choice of design can ensure that those currencies have efficient cross-border interoperability and cheaper means of implementing anti-money-laundering controls. Such measures would also reduce the cost of migrant remittance transfers in corridors where costs have remained high owing to declines in correspondent banking relationships.

69. Although central bank digital currencies can offer various benefits, there are also associated risks, similar to those of cryptoassets and stablecoins. Central bank digital currencies can exacerbate systemic bank runs because a digital flight to safety could occur at a significant scale and speed. From an operational perspective, risks include the possibility of fraud, cyberattacks and damage caused by outsourced functions (depending on the central bank digital currency structure). Cross-border access to central bank digital currencies could create risks involving possible currency substitution and higher capital flow volatility.

70. Design choices, however, could help to mitigate some of the risks associated with central bank digital currencies. Central banks should consider ways to better manage trade-offs between efficiency gains and systemic risks. They should also identify institutional constraints and preferences, and adjust those as needed to fulfil the desired public policy objectives for central bank digital currencies.[39]

[36] A retail central bank digital currency is intended for use by the general public, whereas a wholesale central bank digital currency is used for transactions between financial institutions.

[37] Vagisha Srivastava, “The curious case of the missing CBDC users”, Internet Governance Project, School of Public Policy at the Georgia Institute of Technology, 30 January 2023.

[38] Sally Chen and others, “CBDCs in emerging market economies”, BIS Papers, No. 123 (Bank for International Settlements, 2022).

[39] Group of central banks, “Central bank digital currencies: ongoing policy perspectives”, May 2023.

VII. Strengthening global governance and policy coherence

A. Governance reforms at international institutions

71. Governance reform is central to efforts to reform the international financial architecture and to re-establish trust in the multilateral system, as called for in the Addis Ababa Action Agenda. The current arrangements and governance of international financial institutions have been in place and remained largely unchanged for almost 80 years. They have not kept pace with changes in the global economy, including the rise of the global South and other geopolitical shifts. Despite repeated commitments to improving, and some improvement between 2005 and 2015 in, the representation of developing countries, those countries remain significantly underrepresented in international financial institutions, regional development banks and standard-setting bodies. The largest developed economies continue to hold de facto veto powers in the decision-making bodies of the institutions, with several standard-setting bodies experiencing declining representation of developing countries.[40]

72. The ongoing sixteenth general review of quotas of IMF provides an opportunity to meet the commitments in the Addis Ababa Action Agenda to strengthening the voice and representation of developing countries. IMF quotas have several functions, which include specifying a country's contribution to the core resources of IMF; determining voting rights; providing nominal ceilings on resource access, beyond which countries begin to pay higher charges; and determining members' shares in special drawing right allocations.

73. There is a need to update the quota formula of IMF to better reflect the current global landscape. Contributions based on the ability to pay should be based on national income, with appropriate adjustments and limitations. The contribution formula should also be tailored to automatically adjust the overall quota size to reflect developments over time, thereby avoiding protracted political negotiations.

74. The current formula used to guide IMF quota allocations (50 per cent based on GDP, 30 per cent on trade openness, 15 per cent on capital flow volatility and 5 per cent on reserves) attempts to balance two potentially contradictory concepts, namely the ability to pay and the likelihood of needing resources. A country's ability to pay should be separated from access to finance. There is a need to delink a country's limits on access to IMF resources and special drawing right allocations from quotas. Instead, access limits and special drawing right allocations should be based on needs and vulnerabilities, which could be established through an ex-ante rechannelling agreement. More democratic voting rights and decision-making rules should also be explored.

75. Within the World Bank Group, there was a major revision of voting rights at the International Development Association in 2021, the first major revision in over 50 years. The World Bank is currently discussing an evolution road map to adjust its mission and operational and financial models. The next World Bank shareholding review, scheduled to take place in 2025, presents an opportunity to adjust the governance of the institution to increase the voting shares and voice of developing countries.

[40] The bodies include the Basel Committee on Banking Supervision, the International Association of Insurance Supervisors, the International Accounting Standards Board and the International Association of Deposit Insurers.

B. Improving coordination and policy coherence

76. The Addis Ababa Action Agenda builds on long-standing calls to strengthen the coherence and consistency of international financial, monetary and trading systems. It broadens the call for coherence to include investment, development policy and environmental institutions and platforms. In the Addis Ababa Action Agenda, development finance institutions are encouraged to align their practices with the 2030 Agenda for Sustainable Development. Deeper coordination is also needed in the areas of tax, competition and non-economic issues such as climate change, disaster risk, human rights, gender and migration.

77. Although institutional coordination has improved since 2015, it is still lacking, in particular amid a challenging global environment, including the growing risks of global geoeconomic fragmentation. The lack of coherence and coordination in global economic management across institutions has led to disjointed responses to recent economic, financial, food and energy crises.

78. Enhancing coherence requires strengthened multilateralism that brings together various policy communities and gives a voice to the most vulnerable. A biennial summit of members of the Group of 20, members of the Economic and Social Council, the Secretary-General and heads of international financial institutions could function as a forum to address incoherence in the rules governing trade, aid, debt, tax, finance and climate action.

79. The United Nations continues to provide a fully inclusive and legitimate forum for addressing global challenges. It is uniquely positioned to advance coherent reforms to the international architecture that enhance coordination and alignment with the Sustainable Development Goals.

80. As the halfway point in the implementation of the 2030 Agenda, 2023 is a critical year, with the United Nations set to host the High-level Dialogue on Financing for Development, the Climate Ambition Summit and the Sustainable Development Goals Summit in September 2023. The events will provide opportunities to prepare for delivering ambitious structural reforms at the Summit of the Future, in 2024, and a potential fourth international conference on financing for development in 2025.

C. Women's leadership in the economy

81. The growth in the number of women in corporate leadership roles extended its recovery in 2022, following a visible slowdown at the onset of the COVID-19 pandemic. In 2022, the participation of women on corporate boards increased to 24.5 per cent (22.6 per cent in 2021) and the percentage of director seats held by women rose to 24.5 per cent (22.6 per cent in 2021). Based on the current four-year trend, it would take until 2038 to reach gender parity, four years earlier than the previous estimate.[41]

82. The pandemic, however, reversed gains in women's entrepreneurship in many countries. A recent survey showed that in low- and lower-middle-income countries, business ownership and start-up rates for women were still markedly below pre-pandemic levels.[42]

[41] Tanya Matanda, Carrie Wang and Olga Emelianova, "Women on boards: progress report 2022", 2023. Available at https://www.msci.com/documents/10199/36771346/Women_on_Boards_Progress_Report_2022.pdf.

[42] Global Entrepreneurship Monitor, *GEM 2021/22 Women's Entrepreneurship Report: From Crisis to Opportunity* (London, 2022).

VIII. Conclusions

83. **The recent series of global shocks has set back progress towards the achievement of the Sustainable Development Goals to a significant degree, in particular in the poorest and most vulnerable countries. A "great finance divide" has translated into a sustainable development divide, with many developing countries unable to invest in a sustainable recovery owing to limited fiscal space and the lack of access to affordable funding. Debt overhangs are threatening to inflict long-lasting economic scars with high social costs, including increased poverty. Although those challenges do not yet pose risks of a systemic financial crisis, they reflect a global sustainable development crisis that undermines trust in the global financial architecture and in multilateralism.**

84. **The cascading crises have laid bare the gaps, inefficiencies and inconsistencies of the international financial system and have accelerated the urgent need for bold and ambitious reforms to the international financial architecture. The Secretary-General has called for a Sustainable Development Goal stimulus to provide relief for countries in need, as well as more long-term reforms to address weaknesses and close gaps in the current financial architecture.**

85. **Multilateral development banks are at the heart of the reform agenda. Their capacity for concessional lending should be increased, including through capital replenishments and the channelling of special drawing rights through them and by making optimal use of their balance sheets. Efforts to increase the financial footprint of multilateral development banks must be accompanied by reforms that target greater sustainable development impact. Such reforms should include improved lending terms and State-contingent repayment clauses; internal incentives and business models that are fully aligned with the Sustainable Development Goals; and greater efforts to mobilize private investment, with blending assessed according to sustainable development impact.**

86. **The global financial safety net must be strengthened further and made fit for purpose to effectively respond to new and emerging challenges. The Secretary-General is calling for commitments to rechannel an additional $100 billion of unused special drawing rights to developing countries, including through multilateral development banks.**

87. **Transforming the governance of international financial institutions must be central to reforms of the financial architecture, including by strengthening the voice and representation of developing countries.**

88. **The United Nations is a unique platform for galvanizing the collective action required across all stakeholders to make progress in ambitious reforms to the international financial system. The Sustainable Development Goal Summit and the High-level Dialogue on Financing for Development, to be held in September 2023, are opportunities to build momentum for ambitious outcomes at the Summit of the Future, in 2024, and at the fourth international conference on financing for development, in 2025.**