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REFORMS FOR A 21st CENTURY GLOBAL FINANCIAL ARCHITECTURE

INDEPENDENT EXPERT REFLECTIONS ON THE UNITED NATIONS 'OUR COMMON AGENDA'

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Reforms for a 21st century global financial architecture:
Independent expert reflections on the United Nations 'Our Common Agenda'

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Overview[1]

As nations around the world grapple with enormous, diverse, and interlocking global challenges, the multilateral system is struggling to rise to the occasion. The disastrous effects of climate change—extreme heat, floods, and fires—pose an existential threat and are damaging economic and social systems. Geopolitical tensions and violent conflict are worsening, leading to devastating humanitarian crises. Highly integrated financial markets are increasingly vulnerable to cross-border threats. Extreme social inequalities are eroding human rights as well as inhibiting progress on social and economic development. Furthermore, the collective challenges of the modern world are straining the multilateral system.

The COVID-19 pandemic reminded nations around the world that global problems require global solutions. Amid the pandemic and on the United Nation's (U.N.) 75th anniversary, U.N. member states adopted a resolution pledging to reinvigorate international cooperation. Member states also asked the U.N. Secretary-General António Guterres to report back with recommendations to advance a common agenda that responds to current and future global challenges. The Secretary-General responded with his vision-setting report "Our Common Agenda," which calls for an inclusive, networked, and effective multilateral system to respond to global challenges and turbocharge action on the Sustainable Development Goals (SDGs). The report also calls for a U.N. Summit of the Future; the summit is scheduled for September 2024 during the 79th session of the U.N. General Assembly. At the summit, member states are expected to agree to an action-oriented "Pact for the Future" outlining how to respond to interconnected global challenges.

In preparation for the summit, the United Nations has issued 11 policy briefs that elaborate on proposals contained in Our Common Agenda. An inclusive and effective international financial system is central to strengthening multilateralism. In recognition of this significance, Our Common Agenda Policy Brief 6 on the international financial architecture puts forth a series of recommendations to reform the system.

The Global Economy and Development Program (Global) at the Brookings Institution has undertaken an inclusive, multistakeholder process to discuss the reform of the international financial architecture. Forty experts representing over 25 institutions from across the Global North and Global South convened through a series of four roundtables on: global economic governance, climate and development financing and sovereign debt restructuring, global tax architecture, and the global financial safety net. Among other questions, the experts explored: What are the strengths and weaknesses of the proposed reforms? What is missing? How can the proposed reforms be strengthened? The four chapters presented in this report reflect the independent expert views from each roundtable. The chapters present medium- and long-term recommendations to move forward reforms on the international financial architecture and, ultimately, strengthen the multilateral system.

The first chapter on reforming global economic governance focuses on how to make the international financial institutions (IFIs)—the International Monetary Fund (IMF) and World Bank—more inclusive and effective. Reforms that change the allocation of voice in the governing bodies of the IMF and World Bank are critical to enhance the legitimacy and efficacy of these institutions. This view is shared by many experts and is echoed repeatedly in the U.N. policy brief. However, voice reforms may take time to build consensus.

[1] Brahima S. Coulibaly and Wafa Abedin are the lead authors of the overview.

In the interim, the chapter recommends a 10-point program that could move reforms forward. A central feature of the 10-point program is modernizing the board of directors of the IFIs to reflect best practices in corporate governance; these reforms would enhance the voice of the Global South while retaining sufficient oversight of major creditors and improving the function of the two institutions.

The second chapter addressed the twin challenges of mobilizing development and climate financing and creating lasting solutions to help countries facing debt distress. The developing world is facing unsustainable sovereign debt levels. The U.N. policy brief echoes many longstanding recommendations to reduce debt risks and enhance the debt crisis resolution framework. The chapter makes some recommendations to address challenges with the Common Framework, proposes a complementary market-based solution to address private sector debt, and a debt-relief for climate mechanism that incentivizes creditors to participate in debt workout processes. Debt relief is critical to help countries free up much-needed fiscal space to finance climate. The world is falling behind on meeting the Paris Agreement's target to limit global warming to 1.5°C. The U.N. policy brief presents compelling reforms to massively scale up development and climate financing. The chapter adds nuance to the discussion on climate financing and presents additional proposals to sharpen the recommendations in the U.N. policy brief. These include replacing 62 multilateral climate mitigations funds with one Green Bank and developing a strong, global carbon market.

Modernizing the global tax architecture is essential to boost public sector revenues to finance development agendas and global public goods. The third chapter on reforming the global tax architecture presents a comprehensive agenda to promote more equitable and progressive global tax structures. With the U.N. General Assembly's adoption of a resolution commencing work towards a U.N. Tax Convention, the U.N. has assumed a new, central role in strengthening international tax cooperation. The chapter reinforces the critical areas the U.N. policy brief identifies as essential to global tax reform, while also encouraging the U.N. to pursue a broader reform agenda. In addition to strengthening rules and norms for corporate taxation, the U.N. should extend international cooperation to prevent tax evasion by wealthy individuals and appropriately tax carbon emissions.

In times of multiple shocks and crises, ensuring the global financial system is resilient and provides a buffer to the most vulnerable countries is critical. The fourth chapter on reinforcing the global financial safety net (GFSN) focuses on strengthening liquidity provision for emerging market and developing economies that might face financial difficulties during periods of global market stress. The U.N. policy brief recommends expanding all layers of the GFSN but does not evaluate the merits and potential costs of each pillar of the GFSN. The chapter builds on the U.N. policy brief recommendations and calls for specific reforms to strengthen the GFSN at the IMF, the most important institution at the center of the global financial system. Proposed reforms include reforming the IMF quota formula, revamping the role of Special Drawing Rights, and delinking quotas and resource contributions from lending.

It is not lost on the participants of the roundtables that the current global environment characterized by heightened geopolitical tensions, great power competition, and wars around the world present challenges to the reform agenda. Mindful of this context, the chapters split the recommendations into those that can be implemented in the current geopolitical context and those that should be addressed over the medium- to long-term. Even so, significant progress on the reform agenda will require strong political will, and a shared understanding of the imperative to modernize the global financial system for the benefit of all.

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Chapter 1
Modernizing global economic governance[2]

Introduction

The global economic governance system, developed in 1945, does not reflect today's realities. Many important economic actors—countries of the Global South as well as private sector and civil society actors—feel excluded and not heard. The U.N. Our Common Agenda policy brief on reforming the international architecture proposes reforms to develop a more inclusive system of global financial governance while also recognizing that donor countries have a right to ensure adequate oversight of the way resources are managed. This chapter reflects discussions at a roundtable convened by the Brookings Institution in November 2023 with experts from the Global South and Global North to discuss the U.N. policy brief recommendations to reform global economic governance. Roundtable participants made suggestions on how to start implementing the proposed reforms and particularly how to garner broad international support which is necessary for successful implementation.

This chapter is divided into four sections. Section one describes the U.N. policy brief's key governance recommendations, section two presents some reflections on those recommendations based on the roundtable discussion, section three presents 10 actions that can be taken together or separately to move this important agenda forward, and section four concludes with a discussion on implementation.

UN policy brief recommendations on global economic governance

The U.N. policy brief starts from the widely accepted premise that the system of global economic governance, which was created after World War II, is outdated. Only 44 delegations attended the Bretton Woods Conference compared to 190 members of the International Monetary Fund (IMF) and World Bank today. Among others, Derviş and Ocampo (2022) argue that the current voting weights at the Bretton Woods Institutions are unreasonable as a few small European countries are given more weight than some of the largest countries in the Global South.

How should the international financial governance system be reformed to make the system more reflective of the world of the 21st century and better deal with new challenges and transformations? The

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[2] Hafez Ghanem is the lead author of this chapter. The lead author and editors thank without implicating Colin Bradford, Rob Floyd, John McArthur, and Landry Signé for incisive and helpful comments on an earlier draft.

U.N. policy brief proposes two recommendations: (1) transform the governance of International Financial Institutions (IFIs), mainly to provide greater voice to countries of the Global South reflecting their increased share of the world's economy and population; and (2) create a representative apex body to systematically enhance coherence of the international system.

The U.N. policy brief proposes five reforms to transform the governance of IFIs. First, update the IMF quota formula to reflect the changing global landscape. A concrete proposal is to add a population component in the quota formula. Second, reform voting rights and decisionmaking rules to make them more democratic. For example, the U.N. policy brief suggests the use of a double majority rule (majority of voting rights and majority of member countries). Third, delink access to IMF resources from quotas with access determined by both income and vulnerability, through a multi-dimensional vulnerability index or "beyond GDP" indicators. Fourth, boost voice and representation of the Global South on boards and impose institutional transparency. The U.N. policy brief suggests that the number of board members (currently 24 at the IMF and 25 at the World Bank) be increased to about 52. Fifth, strive for gender-balanced representation in all the governance structures of these institutions, particularly at the leadership level.

The U.N. policy brief argues that U.N. member states should use the opportunity of the Summit of the Future to agree on a coordinating body for economic decisionmaking in the form of a biennial summit at the level of heads of state and government. The proposed biennial summit would bring together leaders of the G20, the 54 member states of the U.N. Economic and Social Council (ECOSOC), the Secretary-General, and the heads of IFIs. It would help achieve a more sustainable, inclusive, and resilient global economy. It would also work to reduce incoherencies in the rules governing trade, aid, debt, tax, finance, environmental sustainability, and climate action. The U.N. policy brief also argues that a coordinating body through the biennial summit (an economic security council) would be a natural venue to address immediate issues as well as some longer-term issues such as making the international financial architecture fit for purpose and resilient to global crises.

Reflections on the UN policy brief recommendations

Implementing global economic governance reforms that involve providing more voice to some countries is difficult in the current geopolitical climate. The zero-sum mindset is predominant: more voice to some implies less voice to others. It is hard to get countries to accept a dilution of their voice in international fora, as witnessed by the failure to agree on increasing the number of permanent members of the Security Council. This is especially true now as competition between global powers intensifies and relationships become more adversarial.[3] Hence, there is a need to work on the design of the reforms and its implementation in order to maximize and ensure political support.

Governance reforms are necessary to enhance the IFIs' legitimacy. This is especially true for the IMF, which is the most important IFI responsible for supporting countries during crises.[4] Coulibaly and Prasad (2023) argue that the IMF has an inadequate resource base and an archaic governance structure. Permanent (quota) contributions cover less than 50% of total IMF financing. The rest is covered by New

[3] One approach to implementing governance reforms is presented by Prasad and Songwe (2022). They argue for a grand bargain where reforms of the IFIs are carried out together with reforms of the World Trade Organization and maybe the Security Council, so countries can balance loss of voice in one organization by gains in another.
[4] Insights on the IMF quota formula, new resources, and delinking quotas from lending is taken up in the fourth chapter on reinforcing the global financial safety net in this report.

Arrangements to Borrow (NAB)[5] and by Bilateral Borrowing Agreements (BBA),[6] which are temporary in nature. Moreover, the distribution of quotas among IMF member countries, which determines access to resources as well as voting rights, does not reflect today's economic realities. For example, India's GDP is larger than that of the U.K. Yet India's quota is only 2.75% while that of the U.K. is 4.23%.

IMF member countries are aware of the problems and are trying to resolve them. The Board of Governors of the IMF completed the 16th General Review of Quotas on December 15, 2023. They agreed to increase quotas by 50%. This would allow the IMF to reduce NAB and phase out BBA. The governors also asked to develop, by June 2025, possible approaches for quota realignment, including a change in the formula that is being used to determine quotas. Thus, the discussion of quota realignment, necessary for improving governance, has been deferred to the 17th General Review of Quotas which will take place in June 2025.

Agreement on changing how the IMF quotas are allocated and/or shareholding and voting rights at the World Bank will take some time. It is hard to build consensus around a change in voice in international fora, especially during this period of mounting geopolitical competition. Most of the alternative formulas that are being recommended for calculating quotas and voting rights imply a big increase in China's voice mostly at the expense of Europe and Japan. China's economy is larger than that of Germany, Japan, and the U.K. combined. Yet China's quota at the IMF is only 6.4%, while the total of the other three countries' quotas is 16.3%.[7] Fixing this anomaly would be a hard sell to Europeans and Japanese at the best of times and nearly impossible at a time of mounting tensions and rivalry. That is why change would probably only happen gradually, bearing in mind political feasibility.

While agreement on IMF quota realignment will take time, other important reforms do not need to wait. For example, it should be possible to immediately agree on **a double majority rule for some IFI decisions**. Such a reform would not change the various countries' shares and voting rights. Moreover, it will still mean that countries holding a majority of shares in an IFI could veto a decision even if most member states support it. The concept of double majority is already applied at the IMF: A super double majority is required to change its articles of agreement.

While a double majority rule could slow decisionmaking, it would increase the IFI's credibility as it gives more weight to smaller and weaker members. The Council of the European Union applies a double majority (qualified majority) rule for some of its decisions. For a decision to pass under the qualified majority rule it needs the support of 55% of EU member states representing at least 65% of the EU's population. In the case of an IFI, to minimize delays in decisionmaking, the rule could be a simple majority of shares and a simple majority of member states.

The U.N. policy brief recommendation to **de-link access to IMF borrowing from quotas** reflects today's realities and could be easily implemented. In addition to determining country contributions and voting rights, IMF quotas provide a nominal ceiling on a country's access to resources beyond which it must pay higher charges, and its program becomes subject to more oversight. This system made sense at the time the IMF was created since its main mission was to support the gold standard and the fixed exchange rate system by providing balance of payments financing to countries to protect their exchange rate. Under a fixed exchange rate system, larger economies would need more support than smaller economies. Hence,

[5] NAB is a standing set of credit agreements under which participants commit to provide supplementary resources to the IMF when available quota resources are low relative to demand.
[6] BBA are agreements between the IMF and a number of member countries that allow the IMF to borrow to ensure sufficient lending capacity. BBA serve as a third line of defense after quotas and NAB.
[7] See Coulibaly and Prasad (2023).

linking access to IMF support to a country's quota, which is determined by the size of its economy, made sense. But countries got off the gold standard in the early 1970s and major currency exchange rates are now flexible. It is the smaller and middle-sized economies that need more support from the IMF. That is why access to IMF lending should now be based on a country's needs and its creditworthiness (i.e., its ability to repay the IMF) rather than on its quota. This also means that the policy of surcharges, which penalize countries who need more support, should be cancelled.

The recommendation to double the size of the boards of the IMF and the World Bank would be difficult to implement. Boards of directors of 50 members or more are hard to manage. The objective of this recommendation is to provide more voice for countries of the Global South. This could be achieved without a huge increase in the number of board members. An alternative would be to consider what role the boards should play. The boards of most large corporations focus on overall strategies, distancing themselves from day-to-day operations. They also play a supervisory/oversight role. They typically meet about six times a year. There is a clear division of responsibility between the board and the company's executives, and the roles of chief executive and chair of the board are usually played by different people. In the U.K. and continental Europe, the two roles are always separated. In the U.S. the trend is for separating the two roles. The percentage of S&P 500 companies with a unified CEO and chair has fallen from 56% in 2013 to 43% in 2023. [8] The general view is that for most companies in normal times, best practice is to have an independent chair of the board.

At the World Bank and IMF (the executive head of the institution is also the chair of the board)[9] the board members reside in the institution, and board membership is a full-time job. The boards meet two to three times a week, and they must approve each operation. Thus, the board ends up focusing on the details of daily management while neglecting its core duties of setting country and thematic strategies and assessing institutional performance. Each board member is supported by technical staff who are in quasi-permanent contact with the executive staff of the institution, which implies a high cost of maintaining and servicing this board. The World Bank's board costs about $100 million per year.[10] Moreover, continuous interference in the daily work of the institution blurs the boundaries between the board and the executive. Since board membership is a full-time job, countries rarely send their most senior and experienced people to sit on the boards of IFIs, which deprives the IFI of the talent and political weight that more senior representatives would have brought.

Prizzon, Bains, Chakrabarti, and Pudussery (2022) describe the discussions at the Bretton Woods Conference that led to this situation. They explain that the U.K. delegation, led by John Maynard Keynes, felt that the boards of IFIs should focus on strategy rather than day-to-day operations. Keynes argued for part-time, non-resident board members who would be high profile, responsible people in the heart of their institutions to provide the board with the technical skills and political capital that the position needs. However, Keynes' vision was not shared by the representatives of the United States, led by Harry Dexter White, who wanted a resident board who would be a political counterweight to management through the representatives of creditor shareholders.

[8] See MacLellan (2023).

[9] While they do chair their respective boards, the two heads of the institutions do not have voting rights.

[10] See the FY24 IBRD/IDA budget (2023).

The United States' position was adopted, and today the key IFIs have resident boards that meet several times every week and must approve each operation no matter how small.[11] A major negative consequence of this is that the boards are seen as injecting political considerations in what should be technical decisions by IFI management, reducing the institutions' credibility. Some in the Global South argue that the IFIs are instruments used by the major creditor countries to pursue political objectives. At a time of rising geopolitical rivalries, the major IFIs should provide platforms for countries to cooperate to achieve common objectives. To play this role, IFIs should be kept as apolitical as possible.

The qualifications of board members are important factors defining the quality of governance of an institution. Members of the board of directors of IFIs should not act as ambassadors representing the narrow interests of one country or of a group of countries. They have a responsibility towards the institution and its mission. To be successful, they need to have the right qualifications, and they should bring to the institution a wealth of experience and political weight. There is a need to clearly define the terms of reference of board members and the minimum qualifications required which is in line with best practice governance standards.

The same is true for the leaders of the major IFIs. Some voices, mostly from the Global South, call for a change in the selection process of the leaders of the World Bank and IMF, where the president of the World Bank is always an American, and the Managing Director of the IMF is always a European. While a selection process that is based completely on merit without regards to national origin is clearly the best approach, it is probably not politically feasible in the short run. An alternative—second or third best—would be to agree on the qualifications required for the leadership position and carry out a search process limiting it to U.S. citizens in the case of the World Bank, and Europeans for the IMF. The idea would be to make the selection process more meritocratic and less political, while maintaining the privileged position of the U.S. and Europe. The long-term objective should be to have a selection process based exclusively on merit.

Achieving gender balance in the governance structures of the IFIs, especially at the leadership level, is an important objective. Countries select their own representatives on the IFI boards and elect the leaders of the institutions. Hence, it is necessary to sensitize the governors representing the countries, typically ministers of finance, of the need to seek and nominate female talent as their representatives. This applies to countries in the Global North as well as the Global South. So far, Europe has nominated two female heads for the IMF, but the United States is yet to nominate a female head of the World Bank.

The U.N. policy brief does not question the basic intergovernmental structure of the IFI's governing bodies. But this current structure is not well adapted to the realities of the 21st century, for at least two reasons. First, as IFIs start getting more involved in financing global public goods, having members of boards of directors that represent shareholder governments may not be desirable. Board members of IFIs who focus on global public goods should be people whose objective is the planet rather than the interest of a specific nation state or a group of nation states as is the case today. Second, even if an IFI continues to only focus on national public goods, there is a need to bring in voices other than those of government officials who may not always represent the views of project beneficiaries or the priorities of different groups of citizens.

[11] Interestingly, the newer institutions (the Asian Infrastructure Bank, and the New Development Bank) have chosen to have non-resident boards. At the World Bank some operations are approved through a non-objection process that does not require a board meeting.

The role and importance of non-state actors is being increasingly recognized. For example, Derviş and Ocampo (2022) argue that cooperation with civil society and the private sector has helped improve the credibility of the U.N. itself. Kharas and McArthur (2023) argue that transparent and effective governance of an outcome-oriented institution should include representation from a relevant mix of stakeholders, including public and private funders, recipient country officials, technology leaders, independent experts, and civil society leaders. The experience of the Global Fund shows that bringing in the voice of beneficiaries in the governance of IFIs tends to increase their effectiveness.[12] Private businesses, philanthropies, and civil society organizations are important developmental actors and key players in the provision of global public goods such as addressing climate change and fighting pandemics. A more democratic and transparent global economic system should provide voice to those actors. A reform of global financial governance in the 21st century needs to consider ways of better involving civil society and the private sector in the governance of IFIs.

Even an IFI that deals only with macroeconomic questions, like the IMF, would benefit from having board members who represent civil society and the private sector. IMF programs are often criticized for neglecting the social dimensions. Also, macroeconomic policies have a direct impact on private activities. That is why the participation of civil society and private sector representatives in IMF board meetings would enrich the discussion by drawing attention to issues of social justice and private sector development.

The role of regional organizations has increased significantly over the last decades. They provide voice to smaller countries who may have little voice in global institutions. Coulibaly and Sidiropoulos (2022) show how they can be more effective than global organizations in dealing with certain issues that require a deeper knowledge of the context of the region. A more formal relationship between regional organizations and IFIs could be envisaged by giving regional organizations a voice in the governance of IFIs and vice versa.

The U.N. policy brief's recommendation of creating a coordinating body on economic decisions in the form of biennial summit between members of the G20 and of ECOSOC may be hard to implement. ECOSOC includes 54 states, and therefore the sheer size of this meeting will make it hard to agree on concrete actions. The same objective could be achieved through reforms of the G20. The G20 is a group that is working to achieve consensus on key economic issues, despite competition and rivalries among its members. A possible alternative to the U.N. policy brief's recommendation would be to add two or three more members to the G20. The recent decision to invite the African Union to join the G20 is a good step forward. But Africa remains grossly under-represented within the G20, with South Africa being the only member state. An expansion of the G20 to make it more inclusive while avoiding it becoming too large may be easier to implement than the U.N. policy brief's proposal.

10-point program for immediate implementation

The U.N. policy brief is right in pointing out that "global economic governance has not kept pace with changes in the global economy, the rise of the Global South and other geopolitical changes." Its recommendations are ambitious, and it will probably take time to build consensus around them. In the meantime, given the urgency of the moment, it is important that action be taken to move towards the objectives of the U.N. policy brief. The 10-point program described here would improve the governance of

[12] The board of directors of the Global Fund includes non-governmental organizations, representatives of communities affected by HIV, TB, and Malaria, the private sector, and private foundations as voting members.

the international financial system, while building political consensus around the U.N. policy brief's important recommendations.

First, there is a need to redefine the role of the boards of directors of the IFIs. The boards should focus on setting strategies, providing oversight for implementation, and monitoring institutional performance. Boards of directors should remain above the day-to-day management of the institutions, and the role of board members should be clearly differentiated from the role of the institutions' executives. Approvals of individual operations should be left to management.[13] The boards would review management decisions ex-post and agree on corrective actions if management decisions are not consistent with the overall strategies and guidance previously set out by the board.

This reform would help reduce political interference in the day-to-day management of the IFIs. Hence, it would improve their efficiency and enhance their credibility. At the same time, the countries providing most of the financing would continue to exercise oversight and make sure that their taxpayers' money is well spent.

Second, the roles of the executive head of the institution and chair of the board should be separated. There needs to be an arm's length relationship between the board and the executive. Hence, the head of the executive cannot also be the chair of the board. This only adds to the confusion between the roles of the executive and of the board.

In the case of an international institution, it would make sense to have the chair of the board of a different nationality from the executive head of the institution. This reform could have a big impact on the credibility of the IFIs if it is agreed that the executive heads of the institutions continue to be recruited from the Global North (an American at the World Bank and a European at the IMF) but that the chairs of the boards would be from the Global South.

Third, there is a need to define board members' terms of reference and their qualifications. In this new set up, board members will have to do more than represent their constituencies' interests. They need to develop the institution's sectoral, country, and financial strategies and be capable of carrying out oversight responsibilities and holding management accountable. This means that board members need to have experience in development, economics, or finance. Assignments to the boards of IFIs should not be seen as a way of rewarding political allies or former diplomats. Moreover, board members should be able to ensure their constituencies' support for the international institution. Therefore, it is best if they are senior members of their financial or economic administrations.

Ensuring that countries select people with the right profile to sit on the boards of IFIs is important. Knowledgeable and experienced board members with strong links to their administration can guarantee that the voices of their constituencies are heard and that they have a significant input in determining the strategy of the institution. Some may even argue that the capacity of a board member is more important than the number of votes they control.

Fourth, IFIs should move to a system of nonresident part-time boards. In addition to helping ensure that the board refrains from meddling in day-to-day management—and thus reducing the level of political interference in technical decisions—moving to a nonresident board would help countries with limited capacities make sure that they have strong representation without weakening their administrations. Part

[13] A possible compromise would be to set a dollar threshold above which prior board approval is required. However, the threshold needs to be high enough to be meaningful.

time nonresident board members can continue with their jobs in their countries' administrations while attending six or eight board meetings a year. Board members could be also provided with a budget to engage a small nonresident team of consultants to support their work and carry out the necessary research.

Fifth, IFI boards could be expanded to include two to three independent directors representing civil society and the private sector, as well as representatives of regional organizations. Participation of representatives of civil society and private business at board meetings is desirable to enhance transparency and to get their inputs in decisionmaking. A process for selecting the civil society and private sector representatives will need to be developed. And a decision on whether those non-state actors would be full voting members of the board or just observers/advisors will need to be made. Similarly, inviting representatives of regional organizations, including regional development banks, to participate in IFI boards would help strengthen relations and improve coordination between the global and regional institutions.

Sixth, as in the case of board members, it is important to clarify the roles of the IFIs' executive heads and their required qualifications. As stated earlier, the role of the executive head should be separated from that of chairperson of the board, and a clear terms of reference should be developed for each role. Moreover, selection of the head of the executive—World Bank President or IMF Managing Director—should not be solely based on political considerations as it appears to be the case now. A few minimum qualifications need to be developed and adhered to. For example, the president of the World Bank should have some prior experience in development, and the managing director of the IMF should have some prior experience in macroeconomic management.

Seventh, a clear and transparent process for the selection of the IFIs' executive head needs to be developed. The tradition of having an American head of the World Bank and a European head of the IMF could be maintained for the time being. However, the selection process could be improved to make it more inclusive and meritocratic and less political. For example, instead of having the U.S. administration presenting only one candidate for the position of president of the World Bank, they could present two or three candidates and let the World Bank's board of directors choose among them. The current process where the U.S. nominates one candidate who is then automatically selected by the board of directors after some token interviews has had mixed results. It has produced some great World Bank presidents, but it has also produced some not-so-great presidents. It is time to try to improve that process. The same is true for the IMF.

Eighth, a system of double majority could be adopted for some board decisions, such as the approval of the institution's budget or the adoption of new strategic directions. The importance of this reform would be in the signal and message it gives—that the voices of smaller and weaker economies should be heard and respected.

Ninth, formally de-linking a country's access to IMF financing from its quota would be a simple recognition of the IMF's evolving role, and the fact that its main clients are countries in the Global South whose quotas are much smaller than countries of the Global North.[14] The IMF has been the main provider of emergency financing for low- and middle-income countries during times of crisis. Naturally, rules relating to exposure and creditworthiness will continue to be respected to protect the IMF's balance sheet and its preferred creditor status. De-linking lending from quotas would clearly imply the end of the surcharge policy that penalizes countries in need.

[14] The IMF's two largest borrowers now are Argentina and Egypt.

Tenth, expand membership of the G2O. The G20 is already playing the role of an economic security council. It includes all members of the G7 and all members of the BRICS, as well as Argentina, Mexico, South Korea, Saudi Arabia, Indonesia, and Turkey. It recently added the African Union as a full member, but the African continent remains underrepresented with South Africa being the only African country member of the group. An alternative to creating a new apex body, or a new group, as suggested by the U.N. policy brief would be to add two or three more African countries to the G20. Obvious candidates would be Nigeria, Egypt, and Ethiopia.

Towards implementing global economic governance reforms

There was a consensus among the experts who participated at the roundtable that governance of the international financial system is outdated and needs to be reformed, and that the recommendations of the U.N. policy brief were pointing to the right direction. But there was also a sense that while the U.N. policy brief was a strong advocacy document that presents an excellent long-term vision for the reform of the international financial system, it did not focus enough on the political and practical constraints to reform. Hence, the following are suggestions on how to move this important agenda forward.

The objective of the reform is to render the global financial system more credible and therefore more effective in tackling the big issues facing the world today, such as eliminating extreme poverty and hunger, dealing with the drivers of fragility and conflict, helping to deal with the impacts of pandemics, and financing the fight against climate change. This is an objective that everyone—whether from the Global North or the Global South—would be happy to buy into.

The problem occurs when achieving this shared objective requires sacrifices from some countries—such as asking countries to dilute their voice while at the same time increasing their financial contributions. When reform turns into a zero-sum game, it is usually blocked. The best—or worst—example is the reform of the Security Council which has been under discussion for more than a decade without any results.

Based on the above, the 10-point reform program presented here has three characteristics. First, each of the 10 points has been designed to enhance the system's credibility and effectiveness while minimizing any sacrifice. The program tries to balance the Global South's demands for more voice with the Global North's requirement for sufficient oversight on how money is being used. It tries to avoid being trapped into a zero-sum game. Second, each of the 10 points is useful on its own, and the partial implementation of some of the points presented here would move the reform process forward. This allows reform implementers to be opportunistic and to move ahead with the aspects that are agreed to without waiting for an agreement on the entire program. Third, the 10 points constitute a program of gradual reform that does not lose sight of the final target which is to achieve all the objectives outlined in the U.N.'s report.

The first overarching message of Secretary-General António Guterres' report, "re-embrace global solidarity and find ways of working together for the common good," is worth repeating especially as we face multiple global crises. Nation states, civil society, and the private sector need to work together to mobilize resources and to use them efficiently to deal with the challenges facing humanity today.

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Chapter 2
Addressing sovereign debt problems and scaling up development and climate financing[1]

Introduction

More and more countries are facing debt distress at a time when the world is falling behind on achieving the Sustainable Development Goals (SDGs), and in reaching the Paris Agreement's target of limiting global warming to 1.5°C. More fiscal space for countries in the Global South to finance development and climate is needed. Therefore, recommendations in the U.N. Our Common Agenda policy brief on reforming the international financial architecture pertaining to dealing with the debt problem and mobilizing additional financing for development and climate is important and timely. This chapter reflects discussions at a roundtable convened by the Brookings Institution in December 2023 with experts from the Global South and Global North to discuss the U.N. policy brief recommendations on resolving debt sustainability problems and raising climate and development financing.

The U.N. policy brief makes many important recommendations for dealing with the sovereign debt problem. It calls for strengthening countries' debt management capacities, enhancing debt transparency, and improving debt contracts by introducing state contingent clauses. It also proposes a debt workout mechanism which could be complemented by: (1) the introduction of a market-based solution for dealing with bondholders—like the Brady initiative of the 1980s—and (2) a debt relief for climate mechanism. The U.N. policy brief's proposal to create a sovereign debt authority is important but will probably require time to garner political support. In the interim, much could be achieved through statutory reforms in key market centers such as New York and London.

Similarly, the U.N. policy brief makes a strong case for massively increasing development lending and climate finance. Its proposals could be sharpened further by: (1) considering replacing the large number of small and uncoordinated climate mitigation funds by one large "green bank" that could be independent or part of the World Bank Group; (2) placing more emphasis on non-debt sources of financing for climate such as carbon markets; (3) underlining the importance of domestic resource mobilization both for achieving the SDGs and for climate action; and (4) emphasizing the importance of ensuring that all resources for development and climate are used effectively.

[1] Hafez Ghanem is the lead author of this chapter. The lead author and editors thank without implicating Rosalind McKenna, John McArthur, and Homi Kharas, for incisive and helpful comments on an earlier draft.

This chapter is divided into seven sections. After this introduction, section two describes the problems being addressed by the U.N. policy brief. Section five describes the U.N. policy brief's recommendations on development and climate financing, and section six presents some reflections on the recommendations based on the roundtable discussions. Section seven provides concluding thoughts.

The problems of debt sustainability and financing development and climate

Debt sustainability risks have increased in countries of the Global South, and it appears that the world may be heading to a debt crisis similar to the 1980s. Over the past decade, a combination of high investment needs, low domestic revenue, low interest rates, a greater availability of credit from private lenders, and the emergence of China as an important new lender has contributed to debt accumulation in the Global South. The COVID-19 pandemic induced economic slowdown and rising commodity prices following the Russian invasion of Ukraine, and higher interest rates raised the cost of debt financing and countries' debt vulnerabilities. According to the World Bank (2023a), about half of the world's poorest countries are currently either in debt distress or are at a high risk of debt distress.

As the U.N. policy brief points out, preventing debt crises and resolving them quickly and efficiently when they arise have been longstanding concerns of the international community. Efforts at avoiding debt crises have not been particularly successful as evidenced by the large number of countries who are currently in debt distress. Dealing with today's debt problems is proving to be more difficult than the crisis of the 1980s. This is, in large part, due to the importance of new official lenders who are not members of the Paris Club (e.g., China), and because a significant share of the debt is held by private bondholders. Coordination among those different groups of lenders is difficult. As a result, implementation of the G20's Common Framework for Debt Treatments (CF) has so far been disappointingly slow. The CF's implementation problems explain why only four countries (Chad, Ethiopia, Ghana, and Zambia) out of a total of 37 eligible countries, who are either in debt distress or at a high risk of debt distress, have applied for treatment under the CF.

Rising debt service costs limits countries' fiscal space at a time when there are huge needs to finance development and climate action. According to the Independent High Level Expert Group on Climate Finance (IHLEG) countries of the Global South (excluding China) will need to invest $2.4 trillion a year by 2030 just for climate action, with total investments being around $5.4 trillion of which about $1 trillion will have to be externally financed (Bhattacharya, Songwe, Soubeyran, and Stern 2023). According to the Organization for Economic Co-operation and Development (OECD) (2023), official development assistance (ODA) in 2022 was $204 billion, far below the $1 trillion that is needed. Moreover, the $204 billion figure includes in-donor refugee costs of $29.3 billion and assistance to Ukraine of $16.1 billion, in addition to donor agencies' administrative expenses and payments to foreign consultants. That is, actual ODA that went to the Global South, the so-called country programmable aid, was much less than $200 billion. Funding for climate will need to be additional. It will be difficult—and probably counterproductive as well as unethical—to get countries of the Global South to cut education, health, and social spending to finance climate.

There are more than 60 multilateral climate funds operating in the world today. The funds are not coordinated, and their total disbursements vary between $3 billion to $4 billion a year. Obviously, there is not enough public financing available for both development and climate. A large portion of the

investment needed for climate (e.g., in renewable energy) will have to come from the private sector. According to the U.N. policy brief, amounts mobilized from the private sector by official flows have been ranging between $45 billion to $55 billion per year—clearly not sufficient.

Unless the debt problem is resolved and much more resources are made available to countries in the Global South, neither the SDGs nor the Paris Agreement's target of limiting global warming to 1.5°C will be reached. That is why the U.N. policy brief is making urgent recommendations to deal with debt and massively increase financing for development and climate.

UN policy brief recommendations on debt

The U.N. policy brief has two overarching recommendations on debt: (1) reduce debt risks and enhance sovereign debt markets to support the SDGs, and (2) enhance debt crisis resolution through a two-step process: a debt workout mechanism to support the common framework and, in the medium term, a sovereign debt authority.

The U.N. policy brief suggests four reforms aimed at **reducing debt risks**. The first reform is to update the principles of responsible borrowing and lending by bringing together existing principles and updating them to incorporate the SDGs and reflect the changing global environment. The second reform is to improve debt management and debt transparency. The U.N. policy brief calls for capacity development to improve debt management and transparency, and for the international community to develop and host a publicly accessible registry of debt data by strengthening and coordinating existing data collection initiatives. Third, the U.N. policy brief argues that debt sustainability analysis (DSAs) and credit ratings, including their methodologies, should be improved, shared in a timely manner, and made publicly available. It suggests that DSAs need to do a better job distinguishing between liquidity and solvency crises, and they should incorporate fiscal space for investments in climate and the SDGs. The U.N. policy brief also calls for complementary reforms in credit assessments by private credit rating agencies, including publishing longer-term ratings and improving transparency of sovereign rating methodologies. Fourth, the U.N. policy brief recommends improving debt contracts. In particular, it argues that lenders should consistently include force majeure and state-contingent clauses that make debt service relief automatic in the case of external shocks. The U.N. policy brief also recommends promoting the greater use of debt swaps for the SDGs and climate.

The U.N. policy brief suggests three reforms to enhance **debt crisis resolution**. First, the U.N. policy brief states the need to address well-recognized challenges of the CF, including eligibility, timeliness, and comparability of treatments. Specifically, the U.N. policy brief suggests that CF eligibility should be expanded to middle-income countries. Second, the U.N. policy brief calls for the creation of a debt workout mechanism to help speed up CF debt restructuring. The mechanism, according to the U.N. policy brief, could be housed in one of the multilateral development banks (MDBs). Under this recommendation, debtor countries would still go to the CF for relief, but the mechanism would act as the "broker" in debtor/creditor negotiations. Debt that are considered unsustainable would be swapped or sold to the mechanism. The mechanism would then negotiate debt treatment based on a set of agreed principles and aim to fulfil comparability of treatment between official and private creditors. Third, the U.N. policy brief recommends the creation of a sovereign debt authority independent of creditor and debtor interests. This authority would manage a sovereign insolvency system which would be needed to backstop and facilitate sovereign defaults. The U.N. policy brief argues that the absence of sovereign bankruptcy procedures

strengthens the hands of holdout creditors and disadvantages other claimants on sovereign resources such as pensioners and workers.

Reflections on the UN policy brief recommendations on sovereign debt

It is disheartening to see that 40 years after the debt crisis of the 1980s and after the implementation of the Heavily Indebted Poor Countries (HIPCS) initiative, the world is once more facing a sovereign debt problem. Hence, the U.N. policy brief recommendation to **update the principles of responsible borrowing and lending** makes a lot of sense. But will it be enough? Probably not.

The incentives facing borrowers and lenders encourage overborrowing and overlending. Governments typically make decisions based on short-term calculations. The benefits from borrowing in terms of investment projects or increased consumption are immediate. The costs in terms of repaying principal and interest appear in the medium term. This creates an incentive for countries to overborrow. The same is true for lenders. They get an immediate gain in terms of higher profits while the risk of default is over the medium term. Moreover, when countries are in debt distress, the IMF usually intervenes with rescue packages that protect lenders' interests. Lending to countries in the Global South is a profitable business, and there are strong incentives to overlend.

There is a need to develop notional, intertemporal fiscal rules to prevent countries from overborrowing and getting into debt crises. Hence, the U.N. policy brief is right to stress the importance of **increasing debt management capacity**. Countries need to strengthen domestic fiscal councils and debt management offices. The U.N. policy brief is also right to highlight the necessity of **enhancing transparency** of debt transactions. It is important that all the details of debt agreements be known so that the public is aware of what is being promised and can assess the costs and benefits of each transaction. For example, some recent arrangements that included mortgaging public assets or placing future export earnings in escrow accounts, may not have been politically feasible if they were publicly known.

The IMF, World Bank, the regional MDBs, and other multilateral organizations can play a bigger role in increasing debt management capacity and enhancing debt transparency. They can build on existing initiatives by the IMF and World Bank, and the OECD and Institute of International Finance (IIF). The IMF and World Bank launched in 2018 a "Multipronged Approach to Address Debt Vulnerabilities (MPA)." The MPA supports capacity development in public debt management to mitigate debt vulnerabilities and provides tools to analyze debt developments and risks. It also aims at strengthening debt transparency by working with borrowing countries and creditors to produce better public sector data.[2] In 2021, the OECD launched—at the request of the G20—an initiative to operationalize the IIF's voluntary principles of debt transparency. The objective is to enhance the transparency of private sector lending, particularly to low-income countries.[3] Going forward, in addition to implementing the ongoing initiatives, the MDBs could work on (1) strengthening domestic legal frameworks for public debt; (2) standardizing clauses that promote transparency in public debt contracts; and (3) developing frameworks for disclosure and reconciliation of loan level information by borrowers and creditors.[4]

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[2] A description of the MPA is found in IMF (2020).
[3] For more on the OECD's debt transparency initiative see OECD (2022).
[4] For more on the agenda to improve public debt transparency moving forward see IMF (2023).

There is general agreement with the U.N. policy brief recommendation to **improve debt sustainability analyses** (DSAs) and to make them publicly available, including their methodology. DSAs are produced by the IMF and the World Bank—with the IMF playing a lead role. They became operational in 2002 as a tool to better detect, prevent, and resolve potential debt crises. They are only used for low-income countries. Now that DSAs have been around for over 20 years, it would make sense for the two institutions to jointly carry out an assessment of the experience so far, and how DSAs can be improved to become more effective instruments for avoiding debt crises—and perhaps examine whether it would be useful to extend them to middle-income countries.

Similarly, credit rating agencies play an important role in informing the public about the creditworthiness of different countries. Their ratings indicate the risk level of the investing environment of a country as well as its ability to honor debt to private creditors. Those ratings often guide investment decisions and have an important impact on the demand for bonds and hence their coupon rates. The U.N. policy brief's call for **reforms in credit assessments by private credit rating agencies** makes sense as complementary to the reforms of DSAs by the IMF and the World Bank. The question is how to incentivize private agencies to reform their methodologies. As a first step, there is a need to push the agencies towards greater transparency, asking them to clearly distinguish between the model-based and discretionary components of their sovereign ratings. They need to make the formulas they use for the quantitative part of their analysis public and disclose the guiding principles for the discretionary adjustments they make.

The U.N. policy brief recommendation to **improve debt contracts by incorporating state contingent clauses** is well adapted to the current world situation of "polycrisis" (e.g., pandemics, climate, fragility, and conflict). Tying debt service payments to economic and non-economic shocks could be done without reducing the net present value of repayments and would help lower the risk of crises. It would make sense to ask the MDBs to develop and test this new debt instrument.

The U.N. policy brief rightly acknowledges that, in addition to implementing reforms to avoid future crises, **it is necessary to deal with the legacy problem of existing debt**, particularly with the increasing number of countries who are currently in debt distress or are at high risk of debt distress. It stresses the urgent need to address well-recognized shortcomings of the G20's CF, such as eligibility, timeliness, and the comparability of treatment in a systematic manner.

But the U.N. policy brief does not clearly explain that the problems with the CF are mainly caused by the difficulty of coordinating different classes of creditors. The structure of the debt (public and publicly guaranteed) of low- and middle-income countries (LMICS) today is very different from the structure of the debt in the late 20th century. At the time, in addition to multilateral creditors, the debt was held mainly by bilateral creditor members of the Paris Club and by private bank members of the London Club. Today the situation is very different. Paris and London Club creditors hold less than 25% of the debt of LMICS. About 45% of LMICS' debts are in the form of bonds, and new non-Paris Club bilateral creditors are increasingly important. About 31% of LMICS' official bilateral debt is held by China, and that share is even higher in sub-Saharan Africa where China holds 55% of the bilateral debt.[5]

Debt rescheduling which in the past only required an agreement with the Paris and London Clubs is now extremely hard to obtain. It requires an agreement with many disparate bondholders with widely different interests and constraints. Their incentives are very different from those of London Club

[5] Debt data is from the World Bank's International Debt Report (2023b).

members. And it also requires an agreement with China, in addition to the Paris Club. China's geopolitical interests and its domestic financial and institutional constraints are very different from those of the Paris Club members. This may explain why China has so far refused to join the Paris Club. It also implies that it is important to pay special attention to China's needs to get its support for debt restructuring agreements.

The **debt workout mechanism** proposed in the U.N. policy brief could help accelerate debt treatment under the CF, but it needs to be complemented by two other initiatives, one that deals with the large stock of outstanding bonds and another that would provide sufficient incentives for China to participate in the debt workout.

Coulibaly and Abedin (2023a) propose a **market-based solution to deal with outstanding bonds**—similar to the Brady Plan of the 1980s with some adjustments to reflect today's realities. They recommend the creation of a special purpose fund to be capitalized by the IFIs and official bilateral donors. This fund would be used to secure collateral against new tradeable bonds to be issued by the debtor countries. The collateral, which implies a credit enhancement, would allow the new bonds to be issued at better terms—longer maturities and lower coupon rates. The proceeds would then be used to reduce the outstanding balance on the current debt. The lower coupon rates and longer maturities—plus a possible haircut—could lead to sizeable reductions in debt burdens to sustainable levels.

China would be more forthcoming if debt workouts also included IFI debts, as was done under the HIPCs initiative. Canuto, Dinh, Aynaoui, Ghanem, and Mandri (2023) propose a "**debt relief for climate initiative**" that includes reductions of both bilateral and multilateral debt to finance climate mitigation and adaptation. Their proposal had been developed for Africa, but it could be easily extended to other parts of the world. Under this proposal, eligible countries would be provided with partial debt relief in exchange for their commitment to investing the savings from debt service into climate-related projects such as renewable energy or forest protection on the mitigation side or irrigation and food security on the adaptation side. A list of eligible projects would be agreed upon at negotiations, and the World Bank could be tasked with monitoring implementation. The interest of this proposal is that it requires sacrifices from all classes of creditors—even those with a preferred creditor status—and it provides financing for the most important global public good of the 21st century. It could garner support from all types of creditors.

The shift away from syndicated bank loans toward traded securities as the principal instrument for sovereign financing—and the greater diversity of claims and interests—has made it more difficult to secure collective action from creditors when a sovereign debt is unsustainable. The U.N. policy brief's recommendation of creating a **sovereign debt authority and a sovereign insolvency system** is an appropriate response to this situation. It echoes the IMF's 2002 proposal to create a sovereign debt restructuring mechanism, which was developed by Anne Krueger when she was first deputy managing director, as well as the recommendation of the 2009 Stiglitz Commission on reforms of the international monetary and financial system.[6] The goal is to facilitate the orderly and rapid restructuring of unsustainable debt to support the debtor country while also protecting the rights of creditors.

The idea of a centrally managed sovereign bankruptcy regime has been around for more than 20 years now but is yet to be accepted by the international community. The U.N. policy brief is right to return to the idea and explain why it is needed. But it could also have developed a plan B, a second-best solution

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[6] See Krueger (2002), Report of the Commission of Experts of the President of the United Nations General Assembly on Reforms of the International Monetary System (2009), and Sachs (2002).

that may be more politically feasible and would help improve the situation. There are reforms that could be implemented immediately while building the necessary political support for a centrally managed bankruptcy mechanism.

G20 countries could consider enacting legislation to encourage private creditor participation in debt workouts. Most sovereign debt is governed by laws of a few jurisdictions such as New York or England. Those key financial centers could be encouraged to enact statutory reforms that would: (1) codify a duty on creditors to cooperate in the context of sovereign debt restructuring; (2) limit the amount that a creditor can receive in a legal proceeding if an agreement is reached with a majority of creditors; (3) immunize sovereign debtors' assets from seizure where the debtor has initiated an orderly debt restructuring process; and (4) retrofit collective action mechanisms into existing instruments.[7] [8]

UN policy brief recommendations on scaling up development and climate financing

The U.N. policy brief presents five recommendations to massively scale up development and climate financing: (1) massively increase development lending and improve terms of lending; (2) change the business models of MDBs and other public development banks to focus on SDG impact and more effectively leverage private finance for SDG impact; (3) massively increase climate finance while ensuring additionality; (4) more effectively use the system of development banks to increase lending and SDG impact; and (5) ensure that the poorest can continue to benefit from the MDB system.

To **massively increase development lending and improve the terms of lending,** the U.N. policy brief recommends three actions. First, MDBs need to boost lending by $500 billion to $1 trillion (1% of global GDP), supported by an increase in paid-in capital and a more efficient use of their balance sheets. The U.N. policy brief also suggests setting up facilities to rechannel SDRs and calls for countries with unused SDRs to provide at least half of those to be rechanneled through MDB facilities. Second, MDBs to offer ultra-long affordable financing, with state-contingent repayment clauses, and ease modalities of access to such financing. Third, IFIs to increase local currency lending, while better managing risk through diversification.

To **change the business models of MDBs and other public development banks to focus on SDG impact and more effectively leverage private finance for SDG impact***,* the U.N. policy brief shares three recommendations. First, MDBs need to update their missions, policies, practices, metrics, and internal incentives to focus on SDG impact and climate action. Second, all public development banks should phase out fossil fuel financing,[9] and substantially increase the quality and quantity of finance for climate adaption and mitigation. Third, MDBs should develop new frameworks for when and how to scale up leveraging private finance to maximize SDG impact.

The U.N. policy brief suggests four actions to **massively increase climate finance while ensuring additionality**. First, consolidate and increase climate financing, aligning it with the Paris targets and better coordinate among remaining climate funds. The Green Climate Fund should be replenished and

[7] For more on the potential statutory options to encourage private sector participation in debt workouts see Talero (2022).
[8] The U.K. House of Commons International Development Committee (2023) has recommended the adoption of some of those reforms, and New York State legislators have introduced legislation along these lines. See Coulibaly and Abedin (2023b).
[9] Most policymakers and observers in the Global South disagree with the proposal to phase out fossil fuel financing. In particular, they argue that MDBs should finance gas projects since gas is a transition fuel.

function as the primary climate finance vehicle. Second, MDBs and donors need to assess and report on whether climate finance is additional to development assistance. Third, increase adaptation financing to 50% of total climate financing and massively scale up grant finance. Fourth, quickly operationalize the loss and damage fund with new sources of financing.

The U.N. policy brief makes two recommendations to **more effectively use the system of MDBs to increase lending and SDG impact**. First, set up a joint insurance or reinsurance fund to manage risk more effectively across the system of MDBs and allow for greater lending without lowering credit ratings. Second, increase collaboration among MDBs in terms of co-financing, capacity building and knowledge sharing, and increase on-lending and capacity support to national and subnational development banks.

To ensure that **the poorest can continue to benefit from the MDB system**, the U.N. policy brief proposes four recommendations. First, donors should meet ODA commitments and channel grants through efficient multidonor structures. Second, donors should commit to the principal that commitments to the least developed countries and low-income countries will continue to be met. Third, increase concessional resources, including International Development Association (IDA) contributions, and consider permanent international financing mechanisms (e.g., taxes on shipping or aviation). Fourth, systematically consider vulnerability in all its dimension in allocation criteria, going beyond GDP and ad hoc exceptions.

Reflections on the UN policy brief recommendations on massively increasing development and climate financing

The U.N. policy brief advocates for important policy changes and actions by the international community. In particular, it is clear that to achieve the SDGs a massive increase in development lending and an improvement in its terms are needed. Similarly, the massive increase in climate financing—while ensuring additionality—advocated by the U.N. policy brief is essential for achieving the Paris Agreement's target of limiting temperature increases to 1.5°C. The U.N. policy brief recommendations to use the system of MDBs more effectively and to ensure that the poorest continue to benefit from MDB financing are also important and should be implemented.

There are four areas where the U.N. policy brief recommendations could be sharpened further. These are: (1) improving the institutional structure for financing climate change and other global public goods; (2) developing non-debt instruments (e.g., carbon markets) to finance climate action; (3) mobilizing more domestic resources for development and climate; and (4) applying the rules of development effectiveness to climate financing and ensuring that resources are used efficiently.

The current MDBs' business model is country focused, and mostly demand driven. This model provides some voice to borrowers within a governance system overwhelmingly controlled by creditor countries. In this context **the U.N. policy brief recommendation to change the MDB business model to focus on SDG and climate impact raises some questions**, especially as it comes at a time when many voices in the Global North are calling for the MDBs—particularly the World Bank—to become banks for global public goods. How can additionality be assured under such a system? What would such a change mean for country priorities and country ownership?

Priorities of countries of the Global South do not always match those of the Global North who control MDB governance structures. A 2022 survey by ODI of 500 senior government officials and 73 office heads

found that the top two sectors for which countries demand World Bank support have nothing to do with climate mitigation; they are education and health (Prizzon, Josten, and Gyuzalyan 2022). The same survey found that MDB staff are much more likely than government officials to suggest that MDBs should focus their operations on climate change adaptation and mitigation. Reflecting this, Landers, Mathiasen, and Matthews (2023) emphasize the need to consider the demand side for climate finance and not simply assume that more supply will create its own demand. Moreover, they point out that a focus on climate mitigation will imply a shift in the allocation of World Bank financing away from lower middle-income countries and towards upper middle-income countries because they tend to emit more greenhouse gases. Those countries are very sensitive to the cost of borrowing. They may borrow for renewable energy projects that are efficient and profitable, but not for other types of mitigation projects unless that borrowing is somehow subsidized.

Calls for turning the World Bank into a climate bank do not sufficiently consider the priorities of the Global South. The fear is that development funding—especially for priorities like education and health—will be diverted to climate. It will be very difficult to ensure additionality. The MDB system, with its current financing structure which depends upon governments' contributions in terms of capital and grants, would only be able to raise a small fraction of the $2.4 trillion per year which—according to the IHLEG—is needed to fight climate change (Bhattacharya, Songwe, Soubeyran, and Stern 2023). It will need to be complemented by new and innovative sources of financing.

As a first step, climate activities need to be divided into two groups: a group that is closer to national public goods, and another which are pure global public goods. **Adaptation, loss and damage, and just transition could be considered as national public goods**. They also tend to be more public-sector driven. Those could easily be supported by the current country-focused model used by the World Bank and other MDBs. According to the IHLEG those activities will need more than $600 billion per year (Bhattacharya, Songwe, Soubeyran, and Stern 2023). Providing this level of financing would be a stretch for the MDBs, requiring them to carry out reforms to optimize the use of their balance sheets, as well as requiring more shareholder support in terms of capital increases and grant financing.

Mitigation is a pure global public good and the mother of all global public goods according to Bhattacharya and Derviş (2022). The main components of mitigation spending are the energy transition ($1,500 billion per year) and natural capital and agriculture ($300 billion per year). These are also activities that could be financed by the private sector with little or no public participation.

The U.N. policy brief describes the rather chaotic global institutional structure, with many uncoordinated climate mitigation funds providing very little financing—62 multilateral climate funds disbursing only $3 billion to $4 billion a year. The U.N. policy brief suggests consolidating the disperse climate mitigation funds and replenishing the Green Climate Fund (GCF) as the primary climate finance vehicle. But the total portfolio of the GCF is only $10.6 billion. Is it therefore reasonable to expect it to manage the trillions needed for climate mitigation? Is an intergovernmental body—whether GCF or the World Bank—the best suited for mobilizing private capital for the energy transition and natural capital?

A possible approach is to replace the 62 multilateral climate mitigation funds by a Green Bank that could be completely independent or could be part of the World Bank Group. This is the approach proposed by Ghanem (2023a, 2023b). A Green Bank would be different from existing MDBs in five ways: (1) it would be a public-private partnership with private and government shareholders; (2) countries of the Global South and the Global North and private actors would have equal voice in its governance; (3) it would only finance mitigation projects; (4) it would only provide financing (equity,

loans, and guarantees) to private projects without adding to governments' debts or asking for government guarantees; and (5) it would specialize in mobilizing innovative forms of financing such as the sale of carbon credits and green bonds. A Green Bank that has private shareholders and uses innovative financing instruments would be able to leverage public money and be much more effective than the existing 62 multilateral climate mitigation funds.

The U.N. policy brief makes a strong and convincing case for increasing development and climate lending and reducing its cost. At a time when many countries are in debt distress or at a high risk of debt distress, the U.N. policy brief could have made a similarly strong case for the use of non-debt instruments. **Carbon credits are potentially an important source of climate mitigation financing**. It is true that questions about the carbon market's integrity persist, and there is a concern that some developers are inflating their project's climate impact. This has been especially true for REDD projects.[10] In view of the potential benefits from a transparent and well-functioning carbon market, this should not be an argument for giving up on carbon markets altogether. Instead, governments and maybe the U.N. or another international body should play a stronger role in regulating carbon markets and imposing rules of transparency and integrity.

At the time of the signing of the Kyoto Protocol in 1997 the vision was for a single global market for trading carbon permits. This reflects the fact that a ton of greenhouse gas has the same impact on the climate regardless of where it is emitted. The Kyoto Protocol also set up the Clean Development Mechanism as a vehicle for translating emission reduction efforts in the Global South into credits that can be used to offset capped emission in the North. However, as described by Newell, Pizer, and Raimi (2013) the vision of a single global market never materialized, and instead many national and regional markets have developed.

The sale of carbon credits on a global market could potentially help finance climate mitigation efforts in the Global South without adding to debt. The creation of a single global carbon market appears to be impossible right now. An alternative would be to link the existing national and regional markets. That is, instead of building a global market from the top down as was envisioned at Kyoto, do it from the bottom up. Such an approach is recommended by Keohane, Petsonk, and Hanafi (2015). They propose the creation of a club of carbon markets that would establish common standards for carbon market infrastructure and offer mutual recognition of members' emission units. As more national and regional jurisdictions join the carbon market club, it would get closer to being a global market that promotes national and cross-border green investments.

The U.N. policy brief could have put more emphasis on **the importance of domestic resource mobilization**. According to the IHLEG, of the $2.4 trillion needed annually for climate financing $1.4 trillion will need to come from domestic resources (Bhattacharya, Songwe, Soubeyran, and Stern 2023). This means that domestic resources allocated for climate in the Global South will need to increase by nearly $1 trillion annually. Governments in the Global South will have to improve tax collection.[11] And, perhaps more importantly, they will need to reallocate spending in favor of climate action. One item of spending that could be cut is **fossil fuel subsidies**. According to IMF estimates, the total explicit fossil fuel subsidies today add up to about $1.3 trillion per year. Cutting fossil fuel subsidies and increasing their price would lead to a reduction in their use which would be a win for the planet. A portion of the funding released in this way will need to be used to provide income transfers to protect the most

[10] REDD stands for projects to reduce emissions from deforestation and forest degradation in developing countries.
[11] Effective taxation of multinational corporations is an important part of domestic resource mobilization. Reforms to the international tax system to support countries' tax efforts are discussed in the third chapter in this report.

vulnerable. If the remaining portion is used to finance climate mitigation and adaptation, it would be a double win for the planet.

The U.N. policy brief focuses on how to mobilize additional resources for development and climate. This is appropriate in view of the huge gap between the available financing and what is needed to achieve the SDGs and fight climate change. Nevertheless, it would be useful to also stress **the importance of using the resources effectively**. Projects for the SDGs and climate need to be well prepared and implemented to achieve high rates of return. Development assistance that is not used effectively could—by increasing debt and causing a real exchange rate appreciation—do more harm than good. That is why it would be useful to advocate for efficient resource use at the same time as advocating for more resources.

Conclusion

The U.N. policy brief deals with very important subjects at a crucial time when the world seems to be failing to achieve development as well as climate objectives. It makes many useful recommendations which, if implemented, would clearly improve the situation and increase the chance that the world would meet the SDGs as well as the goals of the Paris Agreement. Priority should be given to building consensus around those recommendations and developing implementation plans.

This chapter presents some nuances and proposals to sharpen the U.N. policy brief recommendations and perhaps help build consensus around them. Four of the points raised below are probably more substantive than others and may merit further discussions. These are: (1) the proposal to introduce a market-based mechanism to deal with bondholders when doing debt restructurings; (2) developing a HIPCs-type mechanism that would condition debt relief on climate investments; (3) replacing the large number of climate mitigation funds by one Green Bank and (4) developing a truly global carbon market.

In today's difficult geopolitical situation, it is important to identify areas of consensus and possible cooperation between competing superpowers. The SDGs and climate are possibly such areas. Hence the U.N. policy brief recommendations could have impacts that go beyond their immediate objectives of the SDGs and climate. By getting countries on different sides of the geopolitical divide to work together, they could also contribute to better mutual understanding and a reduction in geopolitical tensions.

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Chapter 3
Building an inclusive and equitable global taxation system[1]

Introduction

It is widely recognized that the century-old international tax system needs fundamental reforms. The system has not kept pace with the dramatic growth of cross-border activities, the rise of intangible assets and digitalization, and aggressive tax practices by countries to attract foreign investments.

Tax competition to attract direct foreign investment has led to a continuous decline of tax rates in many countries over the past three decades (Devereux, Griffith, and Klemm 2002). Base erosion and profit shifting have been significant, accounting for nearly 40% of global profits of multinationals (Tørsløv, Wier, and Zucman 2018). The United Nations (U.N.) FACTI Panel Report (2021) on illicit financial flows highlighted the $500 to $650 billion of tax revenues lost from profit shifting of corporations (Crivelli, Mooji, and Keen 2015) and the significant amount of private wealth hidden in tax havens (Zucman 2015). Factors such as these have led to significant losses in tax revenues that could have served those countries' development goals. Tax avoidance by corporations and rich individuals also unfairly imposes a greater taxation burden on middle- and lower-income people, thus increasing inequality.

This highlights a need for global action to stem those losses and promote fair taxation. Such efforts should aim to develop a functioning global tax regime to support national tax systems as they are foundational to the social contract between citizens and governments.

Fractures in the international tax system, coupled with mounting pressures on fiscal revenues due to multiple crises, have spurred collective action (Mooji, Klemm, and Perry 2021). Since 2015, the Organization for Economic Co-operation and Development (OECD), mandated by the G20, has put in place an initiative to contain base erosion and profit shifting (BEPS) by improving tax transparency while keeping the basic allocation of taxing rights intact. In 2021, 138 (of 142) members of the OECD Inclusive Framework (IF) agreed to (partially) reshape taxing rights to address the challenges of digitalization (Pillar One) and to introduce a 15% global minimum tax (Pillar Two). At this stage, both Pillars apply to only the largest and most profitable multinational corporations. IF members now are considering ratifying the multilateral agreement to implement the mandatory rules of Pillar One. Meanwhile, many countries have begun implementing the global minimum tax rate agreed upon in Pillar Two, and the process has been yielding some important lessons.

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While the IF has brought some progress to international tax cooperation, developing countries are calling for a more inclusive forum to reform the global tax system. Developing countries, such as the G-24, view the ultimate design of the 2021 global tax deal as unduly favoring developed countries while providing developing countries little in the way of revenue-raising impact. Experts, academics, and civil society have shared this view (ICRICT 2018, Stiglitz 2021, McCarthy 2022, Coulibaly and Abedin 2023, Ocampo 2023). Coalitions of developing countries in the G-24, Africa, and Latin America have expressed the need for an inclusive forum in which they can participate and discuss tax-related issues, giving weight to their own country circumstances, experiences, and levels of capacity development.[2] The African Union, supported by developing countries, has taken the lead in advocating for a more prominent role for the U.N., which would carry more weight than that of the U.N. Tax Committee.[3]

The U.N. General Assembly adopted a resolution in 2022 to initiate intergovernmental discussions to strengthen the inclusiveness and effectiveness of international tax cooperation. In December 2023, the U.N. decided to put in place a Framework Convention for International Tax Cooperation to promote a more inclusive and effective process for setting international tax rules (U.N. General Assembly 2023). Its mandate is to address the needs, priorities, and capacities of all countries, particularly developing countries, to ensure equitable outcomes and consider complementarities with other institutions involved at international, regional, and local levels. It suggests tax-related illicit financial flows and taxation on income from cross-border services in an increasingly digitalized and globalized world as two early protocols on which technical solutions can be negotiated. The Framework Convention's Terms of Reference are expected to be approved in November this year so as to guide the U.N.'s deliberations on the convention in 2025.

Against this background, this chapter discusses options for a way forward to strengthen international tax cooperation, while recognizing the new role of the U.N. This chapter reflects discussions at a roundtable convened by the Brookings Institution in February 2024 with experts from the Global South and Global North to discuss recommendations on the global tax architecture as put forth in the U.N. Our Common Agenda policy brief on the international financial architecture. This chapter offers suggestions on the potential scope of an agenda for the U.N. to play a key role in advancing an equitable and effective global tax regime for inclusive sustainable development.

Progress in international tax cooperation

Initial collective efforts demonstrate that international tax cooperation is possible and necessary. Efforts in the following four critical areas have yielded positive results, but significant challenges remain that will require more comprehensive collective measures.

1) The **allocation of taxing rights** for residence countries (home of the multinational), source countries (host of the inward investment), and market countries (where sales are made) is central to ensuring that corporations pay their fair share of taxes. A notable contribution of Pillar One was its allocation of a new taxing right for market countries amounting to 25% of excess profits (above the 10% routine profits) of multinationals selling in those market countries, regardless of whether the multinational has physical presence or not. Pillar One allocates these profits across countries using a formula based on sales, which departs from the longstanding transfer pricing system. This formulaic approach (or "formulary apportionment") treats a multinational as a single entity and allocates its

[2] See the G-24 (2023) statement and the U.N. Economic Commission for Latin American and the Caribbean (2023) press release.
[3] See the African Union (2023) press release.

worldwide profits in line with its activities in each country. The International Monetary Fund (IMF) estimates that Pillar One will raise global corporate tax revenues by $12 billion. Developing countries, however, are not likely to gain significantly, since Pillar One applies only to the largest multinationals and excludes many actively doing business in developing countries' jurisdictions. The revenue potential is further reduced since countries are asked to remove existing national digital service taxes and forego future ones–a condition to participation in Pillar One.

2) The introduction of a **global minimum tax of 15%** under Pillar Two was a major positive change to address concerns around tax competition. However, its implementation has been significantly weakened by loopholes (EU Tax Conservatory 2023). The OECD has consequently revised down the overall amount of additional tax revenues expected from Pillar Two, from $220 billion to $155 billion annually. So far, high-income countries are expected to receive the largest boost in revenues, followed by investment hubs (tax havens), while developing countries will see only modest gains (Agyemang 2024). Clearly it will be necessary to increase the global minimum tax rate and remove loopholes to better address tax competition issues and increase fiscal revenues, especially for developing countries.

3) **Enhancing tax transparency** has been a key pillar of the BEPS Initiative. The report of the EU Tax Observatory (2023) also shows that the introduction of the multilateral automatic exchange of information (AEOI), which entered into force in 2017 and had been applied by more than 100 countries by 2023 (OECD 2023), reduced offshore tax evasion by wealthy individuals by a factor of three over the last 10 years. That said, billionaires continue to pay effective tax rates as low as 0% to 0.5% of their wealth, facilitated by the lack of transparency on ownership of some asset categories and the ease of hiding wealth in shell companies.

4) **Administrative simplicity** remains a major concern, especially for developing countries, but is not given priority in global discussions. The IMF (2023) showed that low-income countries do not have adequate tax administrative capacities, and these will experience further strain under the two-pillar agreement. The simplified formulary approach to allocate global profits under Pillar One has limited application, and retention of longstanding complex transfer pricing approaches to determine the bulk of multinationals' profits have not eased the administrative burden. Additionally, many low-income countries are unable to adopt the common reporting and confidentiality requirements of tax transparency necessary to participate in the AEOI and do not have the capacity to use the data to contain tax avoidance or evasion.

Going forward, opportunities do exist to build on current initiatives for more equitable global tax rules as more countries participate in an inclusive forum to reshape the global tax architecture. The OECD's BEPS initiatives and the U.N. Framework Convention will be complementary processes to advance the global tax agenda. The U.N., in its new role, can introduce additional areas in which global tax cooperation can enhance progressivity and strengthen measures to reduce the erosion of tax bases in developing countries. The U.N. and the OECD will need to find ways to coordinate and collaborate in moving the agenda forward effectively. Developing countries in turn will need to find the means to engage more effectively in these discussions and to voice their common concerns. Stronger regional cooperation, international assistance in bolstering national tax capacities, and the engagement of civil society will provide strong support in this regard.

UN policy brief recommendations on the global tax architecture

The U.N. policy brief recommends three key areas of action to redesign the global tax architecture to promote equitable and sustainable development:

The first area of action is to **strengthen global tax norms to address digitalization and globalization** by exploring options to make international tax cooperation fully inclusive and more effective in ways that meet the needs and capacities of developing countries and other stakeholders. The U.N. policy brief recognizes that the U.N. initiated discussions in 2022 to strengthen the inclusiveness of international tax cooperation, including the possibility of developing a framework or instrument through the U.N. intergovernmental process, with due regard to existing international and multilateral arrangements. This culminated in the December 2023 decision by the U.N. to put in place a framework convention. Within this inclusive architecture, simplifying global tax resources to benefit under-resourced tax administrations in developing countries should be given priority. Simple approaches, such as digital services taxes or withholding taxes, rather than complex structures, will lead to a more effective international tax system that benefits all stakeholders.

The second area of action is to improve **Pillar Two of the OECD/G20 IF** so as to reduce wasteful tax incentives while better incentivizing taxation in source countries. It proposes significantly increasing the global minimum corporate income tax rate to be close to the statutory tax rates in most developing countries (about 25% in 2020), noting that the minimum rate is likely to become a maximum due to tax competition. The U.N. policy brief also argues for providing preference to source-country taxation in implementing Pillar Two and include stronger roles to eliminate tax base erosion.

The third area of action is to **create global tax transparency and information-sharing frameworks that benefit all countries**. It asks the international community to develop mechanisms to automatically provide banking and financial information on a non-reciprocal basis to countries at risk of illicit financial flows, enabling non-participating countries to benefit from tax transparency initiatives while they are building capacity to participate. The U.N. policy brief proposes reforming the country-by-country reporting of multinationals to make information publicly accessible and aims to promote the wider use of information exchanged on the basis of tax treaties to cover legitimate non-tax uses by country authorities. It seeks also to strengthen beneficial ownership information through broader coverage, automated verification, and publication of information, which would be game-changing in efforts to tax high-net-worth individuals and multinationals.

Reflections on the UN policy brief recommendations

The decision by the U.N. to develop a framework convention on international tax cooperation is a welcome development toward a more inclusive architecture. It elevates the discussions at the U.N. to a political level, such as those intergovernmental processes led by the OECD and the G20. With its global membership, the U.N. is a legitimate and inclusive forum to discuss collective efforts to improve the functioning of the international tax system. In particular, the U.N. processes give voice and representation to developing countries to express their concerns and participate in developing international taxation standards and norms. The U.N. also draws on the support of regional organizations and civil society to inform the dialogue between and within member countries.

Completion of the U.N. Framework Convention, which is at an early stage of preparation, will be critical to set the rules and processes for inclusive, transparent, and democratic participation of countries in setting the agenda and formulating rules.

Experts at the Brookings Institution roundtable broadly supported the recommendations of the U.N. policy brief. They also urge the U.N. to take a broader view of global tax reforms than the OECD. The U.N. should take the opportunity to properly define the appropriate manner to tax capital for the digital economy and beyond. Pillar One applies to only a small proportion of corporate profits, deemed as excess profits, which is a concept that does not have a sound economic foundation in taxation of capital. A principled approach would be to apply a tax on all profits and on multinationals doing digital businesses and beyond. Moreover, the tax nexus should use the concept of significant economic presence, which is based on business derived by multinationals from transactions in a country, even where they do not have physical presence. This should be applied to the digital economy and beyond. This concept is now being applied by India, Colombia, and Nigeria.

The U.N. policy brief is silent on promoting formulaic approaches to allocating global profits of multinationals, which has been a recommendation of developing countries and tax experts (G-24 2019, Clausing and Avi-Yonah 2007, Picciotto 2017) to simplify and remove from multinationals the discretion as to how and where to book their profit. This has been practiced at the national level in the U.S., for example, but not internationally. Pillar One allocates the multinationals' profits using a formulary approach, thus departing from the longstanding transfer pricing approach. But the formulary approach will be applied only to a very small portion of profits of a few, about 100, of the largest companies, thus perpetuating the use of transfer pricing rules. It will be useful for the U.N. to explore the feasibility of developing more formulary approaches in view of advances in the reporting of global profits by multinationals.

There is scope to tackle tax avoidance practices that are longstanding concerns of developing countries. Tax avoidance and evasion contribute significantly to illicit financial flows (Ndikumana and Boyce 2022). Massive profits from mineral and oil exploitation in many African countries have been channeled through offshore accounts. National actions are insufficient, so collective actions will be needed to stem these illicit flows. Taxation of profits from minerals is a future concern given the potential of many African countries to become major sources of minerals critical to new technologies to address climate change.

Additionally, the U.N. could explore solutions to ensure that bilateral tax treaties do not infringe and reduce developing countries' taxing rights. There is little evidence that tax treaties have enhanced foreign investment but their restrictions on taxing rights in developing countries are a concern (Hearson 2021). More discussions could be given to making the provisions in tax treaties—such as the nexuses used for permanent establishments, ability to tax royalties and capital gains, and caps on withholding taxes—fit for purpose and just. That said, there also have been notable collective measures in the past few years. The OECD's BEPS initiative includes measures to contain tax abuse and treaty shopping. The U.N. Tax Committee recently introduced Article 12B within the U.N. Model Double Taxation Convention to allow for taxation of cross-border payments on a range of digital services. The Committee has also updated withholding taxes as a mechanism for source countries to preserve their taxing rights.

Continued efforts to raise effective global minimum tax rates and provide preference to source country taxation is a welcome part of the U.N. agenda. Experts have expressed concern that the current global minimum tax rate of 15% under Pillar Two risks being a norm, and possibly the maximum, rather than a

minimum standard. Developing countries have long supported raising the global minimum corporate tax rates, which will also significantly increase the revenue impact of Pillar Two. The African Tax Administration Forum, for example, considered that the minimum tax rate needed to be at least 20% rather than 15% if it is to curtail profit shifting, as most African countries have statutory rates between 25% and 35%. Furthermore, there could be room for Pillar Two to provide greater preference to source country taxation. For example, the proposed design under Pillar Two of the treaty-based "subject to tax rule" (STTR) that gives source countries the right to impose withholding taxes on certain payments is unlikely to raise significant additional revenues (IMF 2023). Increasing the scope of taxable payments covered by the STTR will be particularly important for enhancing source country taxation, which has motivated the recent work of the U.N. Tax Committee on the STTR (Chowdhary and Diasso 2023).

The global minimum tax reduces the space for countries to use tax incentives to motivate foreign investment. While this is a difficult area of reform in many developing countries, rationalizing tax incentives could yield large fiscal savings. Nevertheless, a concern was raised about the impact of higher tax obligations (and lower tax incentives) on emerging foreign investments that could yield important externalities, such as easier access to technology.

The AEOI to promote tax transparency has reduced offshore tax avoidance/evasion but many developing countries, particularly low-income countries, have difficulty meeting confidentiality standards and data safeguards requirements. The U.N.'s pragmatic proposal to make the tax information accessible on a non-reciprocal basis will enable countries to realize the benefit of the information under AEOI and strengthen incentives to participate in the information exchange. This proposal is welcome but will not substitute for strengthening support for capacity building and for better adapting the AEOI standards to the administrative capacities of low-income countries. The benefits from making the information from country-by-country reporting publicly available will depend on the ability of users to use the information properly. A possible option is to put in place protocols for tax authorities among countries in the Global Forum on Tax Transparency and Exchange of Information to facilitate access to the required information for their use to boost revenue collection and deal with illicit financial transactions.

The proposal to strengthen tax transparency by expanding information on beneficial ownership for a wider range of assets, beyond existing databases, received strong support. The expanded information will be crucial to support national efforts to tax multinationals and high-net-worth individuals and do so effectively. Advocacy by the UN will be useful to catalyze strong cooperation between developed and developing countries to provide the information and the resources necessary for this huge endeavor.

Beyond its three recommended areas of action, the U.N. can expand its agenda to promote more equitable and progressive global tax structures. While there is certainly scope to improve national tax systems, international income and wealth taxation will be necessary. New data compiled by the EU Tax Observatory show the minimal taxes paid by ultra-wealthy individuals and the means with which they hide their wealth. The estimated wealth of billionaires in the world is close to $13 trillion suggesting the potential significant revenues from, and necessity for, global action. The proposed expansion of beneficial information to include a wider set of assets (including real estate) will be a useful start. There was also strong support for the U.N. to explore international mechanisms to tax wealth, such as a potential global minimum wealth tax.

The U.N.'s future agenda can also cover issues related to the international taxation of carbon emissions to address climate change. A pressing issue of concern is the potential spillover impacts of the Carbon Border Adjustment Mechanism (CBAM) of the European Union (EU) on exports from developing

countries, since their carbon prices tend to be much lower than those in the EU (UNCTAD 2021). A second area to consider is international taxation of high-emitting sectors. There are ongoing discussions on potential tax measures on international shipping and aviation (Wemaëre, Vallejo, and Colmbier 2023), whose cross-border services have expanded greatly with globalization but have been largely exempt from corporate taxation. Moreover, in 2022 international shipping and aviation both account for 4% of global energy related carbon dioxide emissions and taxing their carbon emissions can contribute to addressing climate change (Connelly 2023, Kim and Teter 2023). Improving international taxation of these high-carbon emitting sectors can have multiple benefits, by leveling the corporate tax playing field and making "polluters pay" for a globally just climate transition.

To pursue an ambitious global tax agenda, the U.N. will need to boost its capacity to inform the debate and support member countries, especially those with less-developed national tax capacities. The U.N. can take steps to further build its analytical expertise—including through a strengthened U.N. Tax Committee—and scale up peer learning and capacity building. Cooperation within regional bodies and groups of like-minded countries will help in this regard, along with engagement of civil society. The Platform for Collaboration on Tax, which is a partnership of the U.N., OECD, IMF, and the World Bank, could also play a supportive role.

To redesign the global tax architecture, the U.N. will need to find effective paths to achieving effective collective agreements and implementation. There are wide divergences to bridge in needs, priorities, and capacities among countries, and reaching consensus–and more so, unanimity–will not be easy. In this context, a U.N. Framework Convention on International Tax Cooperation provides a forum where consensus-building and a transparent voting process are both in place. Broad agreements can be complemented by pragmatic approaches to foster multilateral reforms. These could involve coalitions of like-minded countries, regional cooperation, and other multi-country initiatives. The U.N. will also need to consider processes to keep the reform momentum, in what will certainly be a long-term and incremental path to strengthening the global tax architecture. Lessons from the Conference of Parties (COP) processes on climate change could be explored on how to build on slices of significant multilateral tax reforms on which interests can converge and align. The broader U.N. discussions in the upcoming Summit of the Future and financing for development meetings can reinforce the valuable contribution of an effective global tax system to inclusive and sustainable development.

There is a clear recognition that taxation is a domestic policy issue. The interplay of corporate and national interests further complicates the political economy of tax reforms. There are important ongoing debates on tax reforms—both globally and nationally, including the U.S. and the EU—that could change perspectives on future tax and investment policies. The U.N. brings in more voices, such as civil society, that can also make an important difference in informing national policy discussions, shifting debates, and forging support for much-needed reforms. In addition, moving discussions on global taxation to the U.N. provides an inclusive forum that can encourage developing countries to resist bad agreements and engage in sound taxation.

A path towards an inclusive and equitable global tax architecture

The U.N. provides an inclusive forum to reshape a fractured global tax system to make it fit for purpose. A shared understanding of how priority issues will be identified and how decisions will be made in the U.N. Tax Convention is a critical foundation to move the process forward. Thus, agreement on the U.N.

Framework Convention is a priority deliverable. The convention will set out transparent rules and procedures for inclusive participation in setting the agenda and formulating norms and standards. Endorsement of the Terms of Reference to draft the convention is expected from the U.N. General Assembly in November 2024, after which negotiations on the convention are expected to begin.

The U.N. has identified critical areas where reforms in the global tax architecture are essential. The following outlines an agenda that reinforces the U.N.'s recommendations, encourages the U.N. to take a broader view of the reforms than previously done, and proposes additional areas where international tax cooperation is necessary to foster progressivity and tackle externalities in a globalized world.

First, the U.N. is encouraged to take a broader view in strengthening global tax norms than earlier collective efforts.

- Approaches to corporate taxation should draw on sound principles in order to properly tax capital and apply these approaches to all profits and all multinationals doing digital businesses and beyond.
- The concept of significant economic presence should be widely applied to digital businesses and beyond in order to identify who should pay taxes in various jurisdictions.
- Simpler methods to allocate and protect tax bases should be given priority. Exploring formulary approaches, withholding taxes, and digital services taxation are steps in this direction.
- Appropriate global minimum tax rates need to be set to effectively stem tax competition.
- More could be done to enable source countries to collect their fair share of taxes from multinationals.

Second, the U.N. can build on progress in tax and bank transparency to benefit all countries.

- Mechanisms to widen access to tax and banking information will enable more countries to manage risks of illicit financial flows. Reporting standards of and access to multilateral mechanisms to exchange information automatically need to be better adapted to countries with lesser administrative capacity. Providing access to countries on a non-reciprocal basis and enabling tax authorities to use information to cover non-tax financial crimes are steps in this direction.
- Multilateral automatic exchange of information will be strengthened by wider participation of countries.
- Catalyzing participation to strengthen the database of beneficial ownership information, including for non-financial assets, will be critical to further reduce corporate tax avoidance and to effectively implement wealth taxation on individuals.

Third, the U.N. can enhance cooperation to address specific tax avoidance practices that significantly affect illicit financial flows. One area of concern for many developing countries, particularly in Africa, is the significant flow offshore of the profits from mineral exploitation. Countries need to take collective action to properly tax investments in minerals exploitation and on future investments in the sector as international demand for new minerals accelerates.

Fourth, more efforts are needed to ensure that bilateral tax treaties protect participating countries' taxing rights and prevent tax abuse. There have been notable initiatives in this regard, in the OECD BEPS initiative and in amendments to the U.N. Model Double Taxation Convention. Further guidance will be needed to reshape tax treaties to meet their intended objectives. The U.N. can build on its expertise in

this area to support developing countries in strengthening their negotiating capacities as they update their tax treaties or enter into new agreements.

Fifth, the U.N. can extend international cooperation beyond corporate taxation in order to tax very rich individuals. Progressive taxation is a significant step forward since taxation in many countries has tended to be highly regressive at the top of the distribution (Zucman 2024). Evidence shows that total taxes paid by high-net-worth individuals tends to be disproportionately less than that paid by other income groups (EU Tax Observatory 2023). International cooperation will be necessary to complement national efforts since corporations and individuals can easily locate their profits and income in lower-tax jurisdictions. More work is needed to design an appropriate global wealth tax; the U.N., OECD, international organizations, academics, and civil society can contribute to this endeavor.

Sixth, the U.N. can play an effective role in global coordination in taxing carbon emissions. Two immediate concerns merit collective consideration: first, the spillover impact of the EU's CBAM on exports of developing countries and, second, the feasibility of international coordination to tax high carbon-emitting sectors such as international shipping and aviation. International coordination will be needed to level the playing field in corporate taxation and to coordinate the international taxation of their carbon emissions. The method of apportioning carbon-tax revenues across countries will be an important consideration.

Seventh, the U.N. will need to strengthen its analytical capacity and capacity building to support its new role in the global tax architecture. It can build on its longstanding technical expertise on tax matters to broaden the work on international taxation.

Finally, the U.N. will need to find a path to sustain momentum for collective reforms and implementation. Global agreements will be ideal, hopefully complemented with pragmatic multi-country actions, such as coalitions of like-minded countries and/or regional initiatives. The U.N. could also explore processes, such as the COP on climate change, that continuously build on incremental reforms emerging as interests converge. It is also important to recognize that taxation is a domestic policy issue. Including the voices of civil society, academics, and other interested organizations would help stimulate global discussion and engender informed national debates.

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Chapter 4
Reinforcing the global financial safety net[1]

Introduction

The COVID-19 pandemic has highlighted long-standing fractures in the international financial system, especially weaknesses in the financial safety net for emerging market and developing economies (EMDEs). Many EMDEs were solvent during the pandemic but faced severe liquidity crunches as tourism and export revenues dried up. They also faced, to varying degrees, sudden stops in capital inflows, downward pressures on their exchange rates, and widening interest rate spreads on their sovereign bonds. EMDEs will remain subject to capital flow, and exchange rate volatility and the reliance on foreign currency funding will continue to be a source of vulnerability.

This chapter reflects discussions at a roundtable convened by the Brookings Institution in January 2024 with experts from the Global South and Global North to discuss the recommendations on strengthening the global financial safety net as put forth in the U.N. Our Common Agenda policy brief on reforming the global financial architecture. This chapter focuses on the availability of foreign currency liquidity for EMDEs that might face transitory financial difficulties during periods of global market stress. Although, it is certainly true that liquidity problems can turn into solvency problems and add to the burdens of EMDE policymakers, this chapter does not address issues related to debt burdens and financial solvency which are addressed in the second chapter of this report.

The universal need for foreign liquidity during periods of global shocks has motivated the advanced economies to establish bilateral swap lines among their central banks. EMDEs have limited access to comparable arrangements to help alleviate their foreign exchange liquidity shortages.[2] Instead, EMDE central banks have tended to rely on accumulation of foreign exchange reserves as a form of self-insurance. Self-insurance is neither individually nor collectively optimal, which has prompted discussions about a more robust, multi-layered global financial safety net.

The global financial safety net for EMDEs consists of countries' own international reserves; bilateral swap lines whereby central banks exchange currencies to provide liquidity to financial markets; regional financial arrangements by which countries pool resources to leverage financing in a crisis; multilateral

[1] Eswar Prasad is the lead author of this chapter. The lead author and editors thank without implicating June Park for helpful comments on an earlier draft.

[2] Only a handful of EMDEs have access to swap lines with advanced economy central banks. A number of EMDE central banks have swap lines with the People's Bank of China although the nonconvertibility of the renminbi limits the value of these swap lines.

institutions such as the International Monetary Fund (IMF); and market-based instruments (see IMF 2021). The IMF argues that the objectives of the safety net are to: (i) provide insurance for countries against a crisis; (ii) supply financing when crises hit; and (iii) incentivize sound macroeconomic policies (IMF 2016).

UN policy brief recommendations to strengthen the global financial safety net

The U.N. Our Common Agenda policy brief on the international financial architecture presents two overarching recommendations to strengthen the global financial safety net: (1) strengthen liquidity provision and widen the financial safety net and (2) address capital market volatility.

To **strengthen liquidity provision and widen the financial safety net**, the U.N. policy brief proposes four reforms. The first reform is to revitalize the function and purpose of Special Drawing Rights (SDRs). This includes establishing triggers that automate the issuance of SDRs at the beginning of financial crises or other shocks. The U.N. policy brief argues that SDRs allocations should be targeted to countries based on need, rather than on quota multiples. The second reform is to make IMF lending more flexible, with fewer conditionalities and access limits and the removal of surcharges. The U.N. policy brief reiterates its previous recommendation to expand the IMF and separate voting rights from contributions, which could also strengthen global economic governance as discussed in the first chapter in this report. The U.N. policy brief urges members to move away from bilateral borrowing arrangements towards full multilateral funding of the IMF, suggesting that IMF could sell its gold valued at historical cost to generate over $175 billion to provide an initial boost to IMF's resources. The third reform is to establish a multilateral currency swap facility, providing urgent liquidity at little cost. The fourth reform calls for strengthening regional financial arrangements. The U.N. policy brief suggests delinking access to regional safety nets from IMF program requirements, which the U.N. policy brief argues negates having a multi-layered safety net.

To **address capital market volatility**, the U.N. policy brief identifies three reforms. The first reform is to strengthen macroeconomic coordination. The U.N. policy brief argues that the G20 Framework Working Group has not been effective at strengthening macroeconomic coordination among G20 countries and suggests that enhanced coordination could be elevated to the meeting of finance ministers and central bank governors. The second reform is to ensure developing countries have access to the full capital account management toolbox. To prevent international spillovers, the U.N. policy brief calls for countries to coordinate policy interventions via an inclusive institutional body (i.e., a reformed IMF board or a biennial summit hosted at the U.N.) with destination countries and relevant international standard-setting bodies. Lastly, source countries of capital flows should play an active role in reducing volatility through sound capital management policies.

The U.N. policy brief has an additional three overarching recommendations to promote financial system stability with sustainability. First, the U.N. policy brief recommends strengthening regulation and supervision of bank and non-bank financial institutions to better manage risks and rein in excessive leverage. Second, the U.N. policy brief requests that corporations and financial institutions make their business more sustainable and reduce greenwashing. Third, the U.N. policy brief recommends strengthening global financial integrity standards.

Reflections on the UN policy brief recommendations

The U.N. policy brief calls for a revamped global financial safety net, including additional resources for the IMF as well as reforms. The recent vote by the Board of Governors to increase IMF's member quotas by 50%, raising total quotas to $960 billion, is indeed most welcome.[3] However, the governance structure of the institution does not reflect economic realities, reducing its legitimacy and its effectiveness.[4] The U.N. policy brief also sidesteps the issue of reforming the quota formula.

The U.N. policy brief does not fully address the relative merits and potential costs of each pillar of the global financial safety net. For instance, EMDEs view self-insurance through reserve accumulation as the first, and in some ways most robust, line of defense as it is under their control, and its very existence reduces the risk of speculative attacks on their financial markets and currencies. However, this strategy is sub-optimal from the perspective of individual countries, partly because it diverts resources that could be used to promote domestic investment. Also from a global perspective, it can spawn global current account imbalances that turn into an additional source of financial volatility. Similarly, regional financing arrangements help pool risks across a region but are of little value in the face of common shocks that beset a majority of countries in a region as is often the case.[5]

There is broad support for the idea that the IMF should be in a position to issue SDRs when there is a pressing need for infusions of global liquidity, and that this should be done in a systematic manner that cannot be a blocked by one or two major shareholders. The IMF's present governance structure makes this an uncertain proposition, particularly if domestic political dynamics in the major advanced economies impede rapid action. Moreover, it is necessary to develop mechanisms for SDRs to be available to countries most in need rather than continuing to be distributed according to the existing quota formula.

The U.N. policy brief highlights an interesting point that the IMF's lending and surveillance activities might limit its effectiveness in providing liquidity insurance. The IMF has developed programs such as the Flexible Credit Line that aim to substitute ex ante conditionality for ex post conditionality, but government authorities' concerns about the negative signaling effects of signing on to such programs has limited their take-up. The IMF should be encouraged to refine existing programs and develop new ones along these lines, but ultimately the international community might have to consider alternative proposals for global liquidity insurance, such as the one presented by Coulibaly and Prasad (2021).

The U.N. policy brief also suggests creating a multilateral currency swap arrangement. This is consistent with the proposals offered by Levy-Yeyati and Cordella (2010) that envision the IMF as a "clearing house" for swap lines, reducing the risks for countries offering the swaps and enabling countries that need the swap lines to be able to count on them at times of financial distress. However, it is not clear whether all of the risks of providing what are in effect hard currency lines of credit will be assumed by the IMF or will be shared between the IMF and the central banks providing hard currencies. As a consequence, it remains an open question whether the IMF can truly delink its provision of such swap

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[3] For more details, see the official announcement by the IMF (2023). The next step is for IMF members to consent to their respective increases which in many cases requires legislative approval.
[4] Reforming the governance structure of the IMF is discussed further in the first chapter on global economic governance in this report.
[5] There is work underway to strengthen some of the regional financing arrangements, such as the Chiang Mai Initiative Multilateralization Initiative. See the Joint Statement of the 26th ASEAN+3 Finance Ministers' and Central Bank Governors' Meeting (2023) and Yu and Lim (2024).

lines from any element of conditionality, which could leave EMDEs uncertain about whether they will have access to such swap lines at times of dire need. This suggests the need for a mechanism where there might be some degree of ex ante conditionality, but that raises the concern about moral hazard. Coulibaly and Prasad's (2021) proposal for a global liquidity insurance arrangement fits in with this logic and also addresses the need for a more market-based mechanism that avoids ex post conditionality while also mitigating moral hazard.[6]

One important issue is whether the proposals in the U.N. policy brief and the broader discussion reflects the needs and interests of middle-income emerging market economies, while having less relevance for lower income developing economies, such as those in sub-Saharan Africa. These countries are especially vulnerable to spillovers from the policies of advanced economies, have less room for policy maneuver, and lack the ability to generate adequate self-insurance through reserve accumulation. Unlike in Asia and Latin America, the availability of regional financing arrangements is also limited. While each of the recommendations in the report has relevance for this group of countries, further consideration of their specific circumstances is called for.

A path forward

Coulibaly and Prasad (2023) have suggested the following reforms, which add specificity to the points made in the U.N. policy brief:

1. **Improve quota formula**: In light of their importance in multiple respects, getting the distribution of quotas to be properly aligned with the realities of the world economy is essential. It is laudable that the IMF has created a simple and transparent formula, but we believe that the current formula can be improved in some respects. We have the following suggestions:

    - Increase the weight of PPP-based GDP in the blended GDP measure to 50%; this change will also go part way to capturing differences in population.
    - Drop the variability variable and replace the openness variable with a set of vulnerability indicators that capture financial and trade integration into the global economy as well as vulnerability to climate shocks.
    - Redistribute the 15% weight of the variability variable to GDP and the new vulnerability variable.[7]
    - Maintain the compression factor and cap the contribution of the vulnerability variable to a country's overall quota (to limit the increase in quotas simply on account of a country's greater vulnerability to external and climate shocks).
    - We suggest the following alternative formula: (0.60*GDP + 0.35*Vulnerability + 0.05*Reserves)^Compression factor. This formula would assign 0.30 weights each to PPP and market-based GDP, 0.30 to a composite measure of trade and financial integration, and 0.05 to a measure of climate vulnerability.

2. **Realign actual and calculated quotas**: At present, there are significant ad hoc adjustments to calculated quotas and voting power. These should be minimized or eliminated to reflect the formula more accurately, although we recognize that there is a case for some adjustments to maintain the

[6] For more details on the proposal, see Prasad (2011, 2014).

[7] The United Nations has developed a Multidimensional Vulnerability Index, some elements of which could be incorporated into the construction of this variable. See final report of the high-level panel on the development of a Multidimensional Vulnerability Index (2024).

relevance of low-income economies in the voting structure. Eliminate veto power which exposes the IMF to the domestic politics of major shareholders but leave some important decisions to a supermajority approval or double majority approval as suggested in the first chapter of this report. It is possible that the actual and calculated quota realignment will achieve that.

3. **New resources**: We suggest that the IMF charter be enhanced through a provision allowing the institution to systematically create SDRs at a time of severe global financial stress. Some of these allocations could be of a temporary nature in the case of large, systemic liquidity shortages. The IMF could enhance such liquidity creation by providing swap lines to countries that meet certain criteria for access to temporary liquidity.[8] Lending programs are subject to Board approval anyway so oversight on use of SDRs could occur at that stage.

4. **Delink quotas and resources contributions from lending**: Linking quotas and lending is inherently contradictory to the mission of the IMF. The logic behind this link is weak as it substantially reduces the IMF's ability to meet the balance of payments needs of its members at their times of need. We also suggest delinking the allocation of new SDRs from quotas. New SDR allocations should ideally go into an IMF account, with their distribution across countries determined by agreed-upon criteria and subject to the nature of shocks (global versus country-specific).

It would be useful to classify these and other reform proposals into those that are relatively straightforward to implement, those that identify and propose solutions to deep-seated problems but deserve more thought and analysis, and those that are even broader in scope and could have unintended consequences and therefore bear careful consideration. Thus, rather than focusing on first-best outcomes, a prioritization of outcomes might be helpful in guiding debate and creating momentum for reform in a way that recognizes the difficult realities of domestic politics and geopolitics, while highlighting areas of shared interests among different stakeholder groups.

Of the four specific recommendations mentioned above, the first (improve quote formula) will require some background work to analyse the implications of different formulas, and the second recommendation (quota realignment) will follow from that. These can be taken up in preparation for the 17th General Review of Quotas. The next two (new resources and delink quotas from lending) come down to the political will of the major shareholders and a collective desire to improve the efficacy of the global financial safety net into actionable items.

Conclusion

The U.N. policy brief highlights two areas that are of considerable importance for the economic well-being of EMDEs but where they are subject to external forces and factors beyond their control. The U.N. policy brief does a good job of identifying areas where progress can be made through collective action. It sets the stage for developing specific policy proposals in each of these areas, some of which have been put forth in this chapter.

[8] These swap lines might be relevant only for countries with good creditworthiness that are facing temporary liquidity problems. Traditional lending facilities with conditionality will of course be more relevant for countries facing solvency problems or with low creditworthiness by conventional measures.

The expert group consulted during the Brookings Institution roundtable on strengthening the global financial safety net is in broad agreement with the focus areas and recommendations in the U.N. policy brief. The expert group's discussions, building on the U.N. policy brief and other groups' analyses, highlighted some key aspects of necessary reforms: changes to the formula for assigning IMF quotas (and voting shares), and within a reasonable period, realignments of the quota shares based on the formulas; changes to the method for distributing new SDR allocations, particularly when those allocations are in response to periods of global liquidity shortages; the continued development of bilateral swap lines and regional financing arrangements; and global liquidity insurance mechanisms that eliminate ex post conditionality while mitigating moral hazard.

The main challenge for the international community, though, is to summon the collective will to make progress that will benefit the EMDEs as well as the world economy at large.

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