



Financing for Sustainable Development Report 2021

Inter-agency Task Force on Financing for Development



United Nations

This report is a joint product of the members of the Inter-agency Task Force on Financing for Development. The Financing for Sustainable Development Office of the United Nations Department of Economic and Social Affairs serves as the coordinator and substantive editor of the Financing for Sustainable Development Report.

The online annex of the Task Force (<http://developmentfinance.un.org>) provides additional data and analysis on progress in implementation of the Financing for Development outcomes, including the Addis Ababa Action Agenda and relevant means of implementation targets of the Sustainable Development Goals.

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Federal Ministry
for Economic Cooperation
and Development

The production of this report and the online annex of the Inter-agency Task Force are generously supported by the Federal Ministry for Economic Cooperation and Development of Germany.

How to cite this report:

United Nations, Inter-agency Task Force on Financing for Development, *Financing for Sustainable Development Report 2021*. (New York: United Nations, 2021), available from: <https://developmentfinance.un.org/fsdr2021>.

United Nations publication

Sales No. E.21.I.6

ISBN: 978-92-1-101442-6

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Addressing systemic issues



Chapter III.F



Addressing systemic issues

1. Key messages and recommendations

The COVID-19 pandemic, and the social and economic crisis it triggered, has amplified underlying risks in the international financial system. After record capital outflows from developing markets in early 2020, international financial markets have stabilized, thanks in large part to fast and aggressive actions by central banks of major economies. Nonetheless, many developing countries continue to face liquidity shortages. While the international community has taken steps to respond to the crisis, the scale of the economic downturn and uncertain prospects for recovery merit additional joint efforts to address urgent needs and ensure a more inclusive, sustainable and risk-informed recovery.

Emergency financing, along with debt service relief for the poorest countries, helped address urgent liquidity and balance-of-payment needs. However, external financing needs are expected to remain elevated throughout 2021, and many developing countries continue to face debt and liquidity pressures. They will need additional funding to mitigate the social and economic impacts of the pandemic, and resulting external imbalances.

- A new allocation of special drawing rights (SDRs) would help meet a global long-term need to supplement countries' official reserves, help restore confidence, and support a resilient and lasting recovery of the global economy;
- Countries in strong external positions can voluntarily use their SDRs to help countries most in need—for example, by lending them to the Poverty Reduction and Growth Trust (PRGT) of the International Monetary Fund (IMF);
- IMF member countries should replenish IMF concessional financing and debt relief instruments;
- The Sixteenth General Review of Quotas should ensure that the IMF remains strong, quota based and adequately resourced in the medium term, while continuing with the process of governance reform. It should ensure that

any adjustment in quota shares results in increases in the quota shares of emerging and developing countries, while protecting the voice and representation of the poorest members;

- The international system should also provide additional concessional finance to countries in need, and make available longer-term financing for sustainable development that takes advantage of the current low interest environment, including by replenishing the capital of multilateral development banks (MDBs) as necessary (see also chapters III.C and III.E).

The COVID-19 crisis once again highlighted the importance of managing the consequences of capital flow volatility. Countries need to consider the full policy toolkit—including monetary, exchange rate, macroprudential, capital flow management, and other policies—to address capital flow volatility.

- Countries should explore coherent, Integrated Policy Frameworks that bring together the full policy toolkit as part of integrated national financing frameworks (INFFs) to manage excess leverage and volatility in domestic and cross-border finance;
- The international community should be mindful of spillovers from domestic policy choices, including on the volatility of private capital flows to developing countries. Efforts to incentivize long-term investment to facilitate achievement of the Sustainable Development Goals (SDGs) can contribute to this objective.

The financial market turmoil at the onset of the pandemic also shone a spotlight on remaining vulnerabilities in different market segments. While the banking sector was more resilient than at the beginning of the 2008 financial crisis (thanks to the financial regulatory reforms agreed by the Group of Twenty (G20) along with extraordinary

policy support), risks in the non-bank financial sector had increased over recent years. Large tech companies could also become systemically important in financial markets, which would create new challenges for policymakers to manage growing risks without impeding innovation.

- Regulators should continue to move towards regulating financial intermediation based on the function it performs rather than the type of institution involved;
- Regulators will also need to ensure that so-called “stablecoins” comply with financial stability and integrity requirements, including by cooperating across jurisdictions and making sure that the voices of all countries are part of discussions on setting new regulatory standards.

The growing threat of non-economic risks to financial and macroeconomic stability has underscored the need for monetary and regulatory authorities to incorporate the impact of climate risks in regulatory and policy frameworks. While there is broad agreement that financial institutions need to better integrate climate risks into their risk management frameworks, there is less consensus around the potential role of monetary authorities in the transition towards a low carbon economy.

- Climate risk considerations need to be further included in global financial regulation in a timely fashion; policymakers should support climate risk management of financial institutions by setting mandatory reporting standards and integrating climate risk scenarios in financial stress tests;
- Central banks should continue to integrate climate risks into policy frameworks, including protective measures to safeguard financial stability and protect central banks’ own balance sheets; they could also explore the impact of “market neutral” bond purchasing strategies on climate risk, as such strategies tend to reflect market bias towards heavy carbon emitters.

To emerge from the COVID-19 crisis and recover better, the international policy response must be inclusive and coherent, taking into account the voices of all countries and addressing interconnected global risks, including non-economic risks such as climate change. The crisis is an opportunity for the international community to build consensus around necessary reforms to the global architecture and align financial, investment, trade, development, environmental and social policies. The United Nations provides a universal platform for high-level political discussions on comprehensive policies for financing for sustainable development.

- States Members of the United Nations should consider whether governance arrangements at various international institutions need further reform, especially those that have not undertaken reforms in many years.

This chapter is organized in five sections: the first reviews the international crisis response and the role of the global financial safety net; the second considers policy options for managing capital flow volatility; the third reviews financial regulatory reforms and the role of climate risks; the fourth section addresses the growing role of digital finance; and the final section discusses how to strengthen global governance and coherence.

2 International monetary system and the global financial safety net

2.1 International crisis response

Policymakers took aggressive actions to avert a full-fledged global financial crisis. Creative and decisive actions by central banks in major economies during the market turmoil in March of 2020 put a floor on falling asset prices and injected much-needed liquidity into the markets, which helped stop a collapse in global financial markets and unprecedented capital outflows from developing countries (see chapter I).

The international community also stepped in, by offering debt service relief to the poorest countries and providing emergency financing to many developing countries in need. To address liquidity pressures caused by the crisis, international support included the Debt Service Suspension Initiative (DSSI) of the G20, which offered the suspension of debt service payments to the poorest countries. More recently, the G20 has agreed on a common framework for debt treatment beyond DSSI to address debt solvency issues (see chapter III.E). The IMF is also providing debt service relief to its poorest members under its Catastrophe Containment and Relief Trust (CCRT), and supporting other member countries through its financing facilities. The World Bank and regional development banks have also mobilized significant resources in support of their member countries (see chapter III.C). Yet, continued debt and liquidity pressures for some countries have also been a stark reminder of limitations of the global financial safety net.

Some developing countries have continued to experience balance-of-payment pressures and face liquidity shortages due to COVID-19. The COVID-19 shock adversely affected developing countries’ access to foreign currency through four channels: (i) non-resident capital flight shutting low-income and least developed countries (LDCs) out of capital markets (see chapter I); (ii) dramatic falls in international trade volumes (see chapter III.D); (iii) stark falls in global remittances (see chapter III.C); and (iv) a sharp contraction in foreign direct investment (see chapter III.B). As a result, external financing needs of LDCs and other low-income countries, in particular, are projected to have more than doubled compared to recent historical averages in 2020 (see chapter III.E). Although the pressure should moderate somewhat in 2021, external financing needs are expected to remain elevated.¹ At the same time, these countries’ foreign exchange reserves are projected to fall by around \$22.5 billion collectively in 2020, leaving half of them with less than 2 years of coverage of external financing needs, and some with less than a full year of coverage. After receiving emergency financing in the first half of 2020 from the IMF and increased lending by MDBs, many LDCs and other low-income countries will continue to rely on additional concessional financing, or else face unsustainable liquidity or debt situations.

2.2 The global financial safety net

Countries have drawn on all layers of the global financial safety net to mitigate the impacts of the COVID-19 crisis, but this support, overall, is unlikely to be sufficient. With the IMF at its centre, the global financial safety net further includes regional financing arrangements,

bilateral swap arrangements and, at the national level, countries' own foreign exchange reserves. While it has expanded substantially since the 2008 global financial crisis, gaps still remain, and many countries don't have access to either one or more of its layers. For most developing countries, the main source of external liquidity support during the COVID-19 crisis came from IMF lending facilities.²

IMF lending

At the end of January 2021, the IMF had approved \$105.5 billion for 85 countries under emergency loans, new financing arrangements, and augmentations of existing arrangements. The IMF made financing available under emergency loans, expanded member countries' access to concessional resources, and streamlined approval processes. This includes around \$30 billion without formal adjustment

programmes (\$7.9 billion through the Rapid Credit Facility for low-income countries and \$22.2 billion through the Rapid Financing Instrument available to all IMF member states) (table III.F.1). In April 2020, the IMF established a new Short-term Liquidity Line for member countries with very strong policies and fundamentals, but by the end of 2020, no qualifying country had officially requested access to this new facility.

Regional financing arrangements

Regional financing arrangements (RFAs) also responded to the COVID-19 crisis, but have made few loan disbursements so far. RFAs can provide support to their member countries through regional reserve pooling arrangements, swap lines, lending facilities and technical support. During the current crisis, the Arab Monetary Fund (AMF), the Chiang Mai Initiative Multilateralization (CMIM), the Eurasian Fund for Stabilization and

Table III.F.1
IMF COVID-19 financial assistance and debt service relief, March 2020–January 2021
(Millions of United States dollars)

Lending facility	Commitment (US\$ millions)	Description	Jurisdiction eligibility	Access type/conditions
Rapid Credit Facility (RCF)	7,947	Rapid concessional financial assistance to low-income countries (LICs) with an urgent balance-of-payments (BOP) need, financed through the Poverty Reduction and Growth Trust (PRGT) ^a	69 PRGT-eligible member states of the IMF	Limited conditionality; 10 years
Extended Credit Facility (ECF)	1,073	Highly concessional financing to LICs facing a <i>protracted</i> BOP problem	69 PRGT-eligible member states of the IMF	Case-by-case basis consistent with strong and durable poverty reduction and growth; 3–5 years
Joint augmentation of Standby Credit Facility (SCF) and Stand-By Arrangement (SBA)	223	Concessional financing to LICs with <i>short-term</i> BOP needs.	69 PRGT-eligible member states of the IMF (SCF)	For BOP need that is expected to be resolved within two years; 12–36 months
Rapid Financing Instrument (RFI)	22,232	Rapid financial assistance for BOP needs	190 member states of the IMF	All member countries facing an urgent BOP need, when a full-fledged economic programme is neither necessary nor feasible; 3.25–5.0 years
Flexible Credit Line (FCL)	51,878	Crisis-prevention/mitigation lending	190 member states of the IMF	Precautionary facility for very strong performers who meet <i>ex ante</i> qualification criteria
Precautionary and Liquidity Line (PLL)	2,700	Financing to flexibly meet liquidity needs of member countries	190 member states of the IMF	Precautionary facility for very strong performers, with sound economic fundamentals but with some vulnerabilities that preclude them from using the FCL; 3.25–5.0 years
Extended Fund Facility (EFF)	9,101	Financing for countries facing serious medium-term BOP problems	190 member states of the IMF	Assistance for countries with structural weaknesses that require time to address; 4.5–10.0 years
Stand-By Arrangement (SBA)	10,375	Main lending instrument for emerging and advanced market countries facing external financing needs	190 member states of the IMF	12–36 months
Total Financial Assistance	105,529			
Debt relief facility	Commitment (US\$ millions)	Description	Jurisdiction eligibility	Access type/conditions
Catastrophe Containment and Relief Trust (CCRT) ^b	489	Grants for debt relief for the poorest and most vulnerable countries hit by catastrophic natural disasters or public health disasters	PRGT-eligible or small States, with per capita income cutoffs	IMF debt repayments relief

Source: IMF. COVID-19 Financial Assistance and Debt Service Relief, as of 29 January 2021. Available at <https://www.imf.org/en/Topics/imf-and-covid19/COVID-Lending-Tracker>.

Notes: ^a The IMF is seeking bilateral loans and donations to augment PRGT resources, with a fundraising target of SDR 12.5 billion (\$17.5 billion); ^b The IMF has issued a call for additional grant funding for the CCRT, with a fundraising target of SDR 1 billion (\$1.4 billion).

Development (EFSD), the European Stability Mechanism (ESM) and the Latin American Reserve Fund (FLAR) have intensified their existing cooperation with the IMF. However, despite having a combined financing capacity of over \$1 trillion, by the end of 2020, only AMF, EFSD and FLAR had disbursed emergency loans to some of their members, amounting to a total of less than \$1.5 billion. Other measures included the development of new financing

Box III.F.1

Financing for Development in the Era of COVID-19 and Beyond: policy options for global liquidity and financial stability

The Discussion Group on global liquidity and financial stability put forward concrete policy options that were submitted for the consideration of the Ministers of Finance at their Meeting on 8 September 2020 and thereafter to the Heads of State and Government at the High-level Meeting on 29 September 2020.

Short-term policy options include

- A new general allocation of special drawing rights (SDRs);
- Encouraging countries with strong external positions to voluntarily use part of their SDR holdings to help countries hit hard by the crisis;
- An expansion of bilateral swap lines or the facilitation of multilateral swap lines through regional financing arrangements/the International Monetary Fund (IMF);
- Enhanced access to concessional loans and grants, through strengthening the IMF Poverty Reduction and Growth Trust, and the recapitalization of multilateral development banks (MDBs) and public development banks to support additional concessional lending.

Middle-income countries in need, but with overall sustainable debt levels, would benefit from additional financing from MDBs and regional development banks at low fixed interest rates and with long maturities. A specific emergency financing mechanism could play a similar role, such as the proposed *Fund to Alleviate COVID-19 Economics (FACE)*, which would channel \$500 billion through MDBs providing loans with 50 years maturity, and allowing them to take advantage of the current low interest rate environment.

A proposed *new liquidity and sustainability facility* for developing countries could provide short-term liquidity and lower borrowing costs to developing countries with strong macroeconomic fundamentals.

For the medium to long term, discussion group members highlighted the importance of enabling developing-country policymakers to deploy the full policy toolkit to address international capital flow volatility, including capital flow management measures, which are often prohibited in international trade and investment agreements (see section 3).

Source: United Nations. 2020. "Financing for the Development in the Era of COVID-19 and Beyond Initiative (FFDI)." Available at <https://www.un.org/en/coronavirus/hle-financing-development>.

instruments (EFSD, FLAR); guidelines for central banks to deal with COVID-19 (AMF); and intensified regional surveillance efforts (CMIM).³ For eurozone members, ESM offered Pandemic Crisis Support up to an amount equivalent to 2 per cent of their GDP, but so far, no country has made use of this facility.⁴

Bilateral swap lines

The extension of bilateral swap lines by central banks in major economies also supported financial markets and helped ease international liquidity pressures. Since the beginning of the COVID-19 crisis, the United States Federal Reserve System (Fed) has expanded the set of countries that are offered swap lines from 5 to 14 (including 4 developing countries). This was complemented by a temporary repurchase agreement facility for other central banks—although this mainly benefits countries with large foreign exchange reserves and US Treasury holdings. Swap line usage peaked in May at \$449 billion, below the \$583 billion at the height of the 2008 financial crisis. The Fed recently extended the swap lines and repo facility until the end of September 2021.⁵ Despite their importance for ensuring international liquidity, most developing countries do not have access to foreign currencies under these arrangements.

2.3 Strengthening the global financial safety net

Resource constraints and coverage gaps have lent new urgency to long-standing calls for strengthening the global financial safety net. Some of these were part of the menu of options for strengthening global liquidity and financial stability, developed by the workstream on Financing for Development in the Era of COVID-19 and Beyond (box III.F.1).

IMF resource envelope and toolkit of instruments

Before the outbreak of the COVID-19 pandemic, IMF members agreed to maintain the Fund's overall lending capacity of around \$1 trillion,⁶ composed by quotas (about 45 per cent), New Arrangements to Borrow (NAB, about 40 per cent) and bilateral borrowing arrangements (about 15 per cent).⁷ Currently, only the quota component is being used to finance new financial commitments. As of 19 February 2021, the Fund's total forward commitment capacity was \$221.6 billion.⁸

Concessional financing and debt relief instruments of the IMF need replenishing to support all eligible countries in need. The IMF concessional emergency lending instrument—the Rapid Credit Facility—is financed through the Poverty Reduction and Growth Trust (PRGT). To meet the increased demands stemming from the COVID-19 pandemic, the IMF is seeking bilateral loans and donations to augment PRGT resources. Total new PRGT loan resources mobilized to date as part of the PRGT fast-track loan mobilization round launched last spring amount to about SDR 17 billion (\$24 billion). Debt service relief for the poorest members of the IMF is financed through the grant-based CCRT. Current funding levels of the CCRT will not be sufficient to cover an envisaged further extension of debt relief until April 2022. The IMF has issued a call for additional grant funding from member states, with a fundraising target of SDR 1 billion (\$1.4 billion). To date, it has received pledges of about SDR 550 million.

Around half of total IMF lending capacity currently relies on borrowed resources from member countries. The Sixteenth General Review of Quotas, to be concluded in 2023, is an opportunity for member states to revisit the adequacy of quotas and continue the process of IMF

governance reform, and ensure the primary role of quotas in IMF resources (see also section 6.1).

Beyond its lending capacity, the IMF has the authority to allocate special drawing rights to supplement member countries' official reserve assets when there is a long-term global need. A new allocation of SDRs in a crisis context is not without precedent: in 2009, during the global financial crisis, the IMF issued 183 billion in SDRs to support developing countries, bringing the total cumulative allocations to about SDR 204 billion (equivalent to around \$294 billion in 2020). A new allocation of SDRs could bring important benefits to the membership (box III.F.2).

Strengthening regional financial safety nets

RFAs could strengthen their role at the centre of regional safety nets by expanding their member base and increasing their resource envelope. Expanding the member base would depend on the political will of existing and potential new member countries. While

Box III.F.2

A role for special drawing rights?

An allocation of special drawing rights (SDRs) is a unique instrument that would help meet a long-term global need for reserves.^a An SDR allocation is a way of supplementing IMF member countries' foreign exchange reserves. In the ongoing COVID-19 crisis, an SDR allocation could help restore confidence and send a powerful signal of a cooperative multilateral response. It would help many countries that are liquidity constrained to smooth the needed adjustment and avoid distortionary policies, while providing scope for responding to the crisis.

SDRs are also a means of providing timely support to countries in need. SDR allocations are distributed across the membership in proportion to IMF quota shares. Therefore, about 42.2 per cent would be allocated to emerging markets and developing countries (EMDCs), of which 3.2 per cent corresponds to low-income countries. By helping stabilize EMDCs, an SDR allocation can help mitigate risks of economic and social fragility, minimize spillovers, support a sustainable and resilient global recovery, and contribute to the stability of the international monetary system.

The formal decision on a new SDR allocation is taken by the IMF Board of Governors and requires support by an 85 per cent majority.

Countries with strong external positions could also use their allocated SDRs on a voluntary basis to help countries hit hard by the crisis and secure a strong and resilient recovery. Already several countries have contributed part of their SDR holdings to expand IMF concessional financing by scaling up the Poverty Reduction and Growth Trust (PRGT). Indeed, the fast-track PRGT loan mobilization round launched in April 2020 has secured about \$24.3 billion so far, with existing SDRs accounting for about two thirds of that amount.

Source: IMF.

^a The IMF has the authority to allocate SDRs "to meet the long-term global need, as and when it arises, to supplement existing reserves assets" (International Monetary Fund Articles of Agreement, Article XVIII). An allocation requires Board of Governors approval by an 85 percent majority of the total voting power in the IMF.

additional quotas would also enhance financing capacity, new financing instruments, including through blended finance, could also help mobilize additional resources. In this context, RFAs could benefit from enhanced exchange of experience and peer learning, including through their annual high-level dialogues and joint research seminars. Continuing cooperation with the IMF will also be important, to exchange information and coordinate assistance to member countries on the ground.

3. Managing capital flow volatility

Policymakers need to be able to deploy the full policy toolkit to address international capital flow volatility. Cross-border capital flows can provide significant benefits, such as improving access to funding for sustainable development. However, as highlighted again by the COVID-19 crisis, volatile short-term capital flows pose significant challenges for developing economies, with potential impact on asset prices, exchange rates, debt sustainability and financial stability. In the Addis Ababa Action Agenda, Member States recognized that necessary macroeconomic policy adjustments could be supported by macroprudential and, as appropriate, capital flow management measures. They also acknowledged the far-ranging effects that national policy decisions in source countries can have on international capital flows.

Source countries can consider policy combinations that would meet their macroeconomic objectives and strengthen the resilience of their financial sectors, while also reducing large international spillovers. Indeed, efforts to align capital markets with sustainable development can support longer-term-oriented and risk-informed productive investment and help avoid excessive leverage in source countries' financial sectors, which could decrease domestic financial stability risks (see also chapter III.B). This could have the additional benefit of reducing international spillovers in the form of short-term capital flow volatility.

3.1 Monetary and exchange-rate policy

The traditional approach to capital flow swings—letting foreign exchange rates adjust freely to allow monetary policy to focus on domestic cyclical conditions—has been shown to work better in developed market contexts than in many developing economies.

In particular, large swings in foreign exchange rates can threaten financial stability in countries with shallower financial markets and larger currency mismatches in the financial positions of domestic actors.

During the COVID-19 crisis, more developing countries than in the past have been able to implement countercyclical monetary policies. The limitations of the traditional policy approach have, in the past, caused many developing countries to tighten monetary policy in response to capital outflows, to lure back investors and defend their domestic currencies. However, such tightening in times of economic distress can trigger recessions by putting additional pressure on domestic investment and growth.⁹ During the current crisis, a number of developing countries were able to loosen their monetary policies to support their domestic economies, and about 20 emerging market economy central banks launched asset purchase programmes for the first time (see chapter I).¹⁰ Many developing countries also employed active foreign exchange rate interventions, and several eased macroprudential regulations. A few have also used capital flow management measures.

3.2 Macroprudential regulations

Macroprudential measures can strengthen the resilience of domestic financial systems and shield economic activity from domestic and external shocks. Since the 2008 financial crisis, the use of macroprudential regulation has expanded significantly in both developing and developed countries. Policies range from measures targeted at bank capital and liquidity buffers, credit demand (e.g., loan-to-value ratios or debt service-to-income ratios), credit supply (such as limits on credit growth), and foreign currency exposure. The latter tend to be among the most widely employed measures in developing countries, reflecting their importance for managing exchange rate risks.¹¹ During the COVID-19 pandemic, many countries, including developing countries, were able to support domestic liquidity provision and business continuity by temporarily loosening regulations on capital and liquidity buffers (see section 4.1).

However, macroprudential regulation may have unintended consequences that still need to be better understood. There is evidence that macroprudential regulations can create leakages—shifts in lending or credit to less regulated institutions—and may lead to spillovers to other countries. Further research is needed to better understand under what circumstances such leakages and spillovers occur, and what they mean for domestic and international financial stability.¹²

3.3 Capital flow management measures

Capital flow management measures can limit speculative inflows and currency mismatches during economic booms, and reduce outflows during crises. There is substantial empirical evidence that capital flow management measures can shift the composition of capital inflows towards longer maturities or away from portfolio debt, and thereby mitigate financial stability risks, although it is less clear whether they impact the overall size of flows.¹³

During the COVID-19 crisis, some developing countries have used capital flow management measures to incentivize inflows and mitigate large outflows. Several larger emerging economies relaxed existing limits on capital inflows, while others reduced foreign-currency reserve requirements or suspended taxes on financial institutions' foreign-currency liabilities.¹⁴ Some smaller countries put in place restrictions on capital outflows and tightened restrictions on international payments and transactions and on the purchase of foreign currency for transfers abroad.¹⁵ While capital flows to many countries recovered strongly towards the end of 2020, aided by very loose global financial conditions, lingering downside risks mean that a broader use of the policy toolkit may still be warranted in the near future.

Capital flow management measures should be a part of the policy toolkit, within a broader macroeconomic and financial management framework. The optimal combination of policy measures depends on a country's characteristics and the nature of the shock. The Integrated Policy Framework (IPF), put forward by the IMF, can help determine the best policy mix by taking into account the country situation and possible interactions between different policies.¹⁶ This should include monitoring and recalibrating policies as needed, to avoid a loss of effectiveness if market conditions change. This approach will inform the upcoming review of the IMF "Institutional View on the Liberalization and Management of Capital Flows". There is also a need to strengthen policy coherence; for example, trade

and investment agreements may include restrictions on the use of capital flow management measures, which can impede effective macroeconomic management for sustainable development (see also box III.F.1). Embedding IPFs in a broader INFF can strengthen the coherence between policies for financial and macroeconomic stability, debt sustainability, trade, and public and private financing strategies for sustainable development.

4. Financial and monetary policy and the SDGs

The COVID-19 crisis has demonstrated again the interconnectedness of the global financial system, as well as interrelationships between economic, social and environmental risks. There has been significant progress in the implementation of the financial market reform agenda initiated in the wake of the 2008 global financial crisis, which made the banking system more resilient to the current crisis. Nonetheless, the pandemic has underscored how growing non-financial economic and social risks can threaten financial stability. Financial regulation must aim to address systemic risks to financial stability from all sources, including disasters and the impacts of climate change. At the same time, all regulation affects incentives; as noted in the Addis Agenda, unintended consequences of regulation on inclusive finance and implementation of the SDGs should continue to be monitored. The strong crisis response of financial and monetary policies also turned new attention to their interrelation with sustainable development.

Table III.F.2
Adjustments of global regulatory reform timetables

Standard-setting body	Area	Change
BCBS	Basel III	Extended the implementation date of the final Basel III framework by one year, to 1 January 2023
BCBS	Basel III	Clarified the treatment of payment moratoria and public guarantees in the context of risk-based capital requirements, and agreed to amend its transitional arrangements for the regulatory capital treatment of expected credit loss accounting
BCBS	Basel III	Postponed implementation of revised G-SIB framework by one year, to 2022
BCBS-IOSCO	OTC derivatives	Deferred by one year the two final implementation phases of the framework for margin requirements for non-centrally cleared derivatives
FSB	NBFI	Extended the implementation timelines for minimum haircut standards for non-centrally cleared securities financing transactions
IAIS	Ending TBTF	Deferred by one year the 2020 Global Monitoring Exercise (GME) of the Holistic Framework for systemic risk in the insurance sector

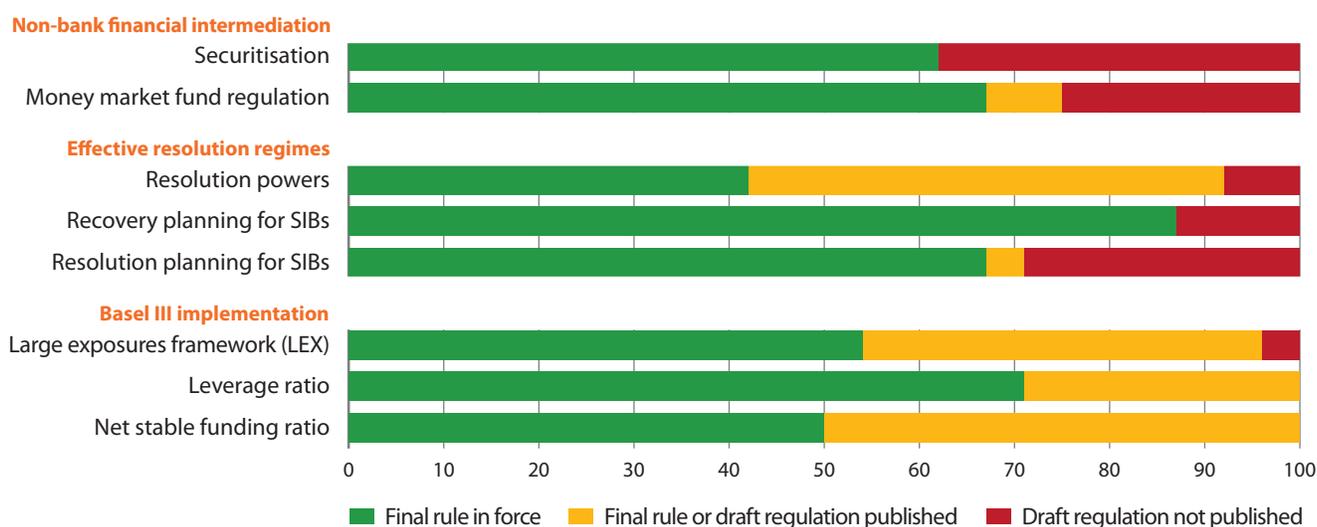
Source: FSB.

Notes: Basel Committee on Banking Supervision (BCBS), International Organization of Securities Commissions (IOSCO), Financial Stability Board (FSB), International Association of Insurance Supervisors (IAIS), over-the-counter (OTC), non-bank financial intermediation (NBFI), too-big-to-fail (TBTF), global systemically important bank (G-SIB).

Figure III.F.1

Progress of regulatory reform implementation, 2020

(Percentage of FSB member jurisdictions)



Source: FSB.

Note: For systemically important banks (SIBs), the five European Union members of the FSB are presented as separate jurisdictions.

4.1 Implementation and effects of agreed regulatory reforms

Strengthened resilience to macroeconomic shocks

The banking system was more resilient at the outset of the COVID-19 crisis than it was before the 2008 financial crisis. Put to the test by the pandemic, regulatory reforms agreed by the G20 in the wake of the 2008 crisis served the financial system well. The increased resilience of major banks allowed the financial system in many countries to broadly absorb the macroeconomic shock, rather than amplify it.¹⁷ Nonetheless, implementation of reforms is still somewhat uneven. Financial system resilience was also supported by fiscal and monetary policies that reduced stress on the financial sector, for example, through government support for loan forbearance and other assistance to struggling companies, along with the injection of much needed market liquidity.

Continuing implementation progress

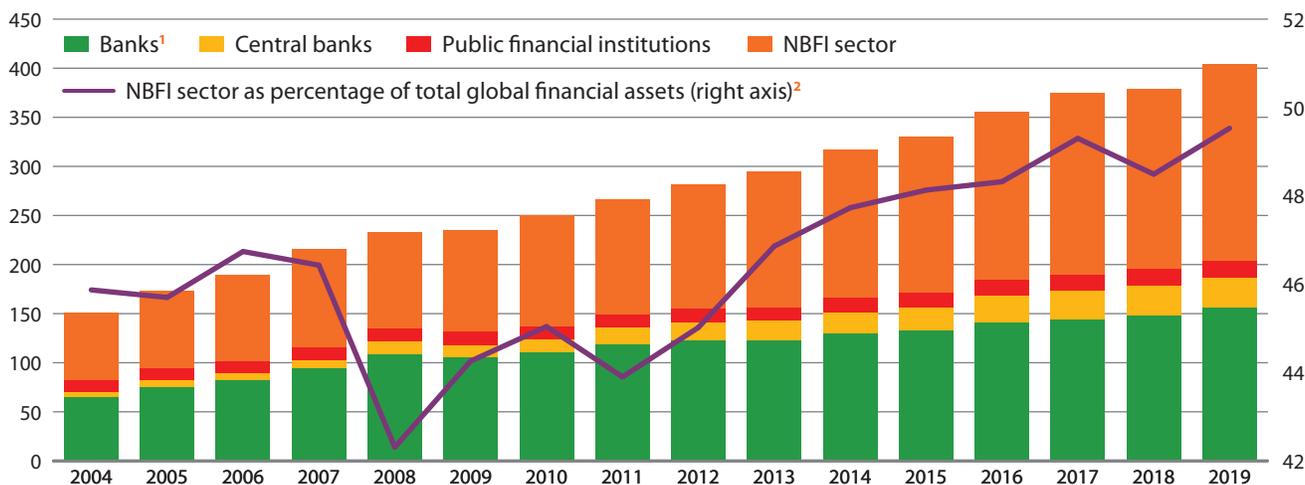
Supervisors used flexibilities within global standards to address the crisis. Further implementation of agreed reforms slowed down, as standard-setting bodies extended deadlines. As part of the policy response to the COVID-19 crisis, financial supervisory authorities in many countries took a range of measures to support liquidity provision and maintain business continuity of banks and payment systems, including by using flexibility within global standards (e.g., through the use of firm-specific and system-wide capital and liquidity buffers).¹⁸ The Financial Stability Board (FSB) and standard-setting bodies have been monitoring and advising national authorities on the consistency of their policy responses with international standards. They also provided additional breathing space by extending deadlines for the implementation of financial regulatory reforms agreed by the G20—where possible, without undermining underlying objectives (table III.F.2).¹⁹

Nonetheless, there has been some implementation progress in 2020, mainly in the banking sector. Among the Basel III standards that are still lagging behind in implementation, the supervisory framework for measuring and controlling large exposures moved ahead in four jurisdictions, bringing the number of countries with full adoption to 13 (with an additional 10 countries having published draft or final rules). Two countries finalized the implementation of the agreed leverage ratio and the net stable funding ratio, respectively (figure III.F.1). Overall implementation of reforms in the over-the-counter derivatives market is well advanced, although there has been limited progress since 2019.²⁰

Progress was also made in addressing financial institutions that are considered too big to fail. A June 2020 FSB consultative evaluation report found that prior to the outbreak of the pandemic, systemically important banks (SIBs) were better capitalized than prior to the 2008 global financial crisis (all relevant global SIBs had already met the final minimal requirements for 2022 for external total loss-absorbing capacity). Progress in the implementation of resolution regimes has given authorities more options for dealing with banks in stress. Evidence from market prices and credit ratings suggest that these reforms are seen as credible by market participants, and that they bring net benefits to society. Credit rating agencies have also removed the assumption of sovereign support in several FSB member countries. However, more work is needed to (i) address obstacles to resolvability for SIBs; (ii) limit instances of state support for failing banks, which is still occurring; and (iii) improve reporting and disclosure. In addition, the application of the reforms to domestic SIBs, and risks arising from the shift of credit intermediation to non-bank financial intermediaries (NBFIs) warrant closer monitoring.²¹

The COVID-19 crisis revealed continued vulnerabilities in non-bank financial intermediation. Implementation of NBFi reforms is lagging behind other financial sector reforms.²² As highlighted in the *Financing*

Figure III.F.2

Total global financial assets, 2004–2019*(Trillions of United States dollars)*

Source: FSB. 2020. Global Monitoring Report on Non-Bank Financial Intermediation.

Notes: ¹ All deposit-taking corporations; ² the NBF sector includes insurance corporations, pension funds, other financial intermediaries (particularly investment funds) and financial auxiliaries.

for Sustainable Development Report (FSDR) 2020, the “lower for longer” interest rate environment prior to the pandemic had contributed to increased leverage in financial markets in “a search of yield”.²³ The share of global financial assets held by NBFs had risen to almost 50 per cent in 2019, compared to 42 per cent in 2008 (figure III.F.2). NBFs have also become important providers of market liquidity, partially in response to financial market reforms that may have constrained the market-making capacity of large banks. Together with the growing interconnectedness among NBFs and between NBFs and banks, this increased liquidity stress across market segments during the March market sell-off, as investors tried to rapidly unwind their positions.²⁴ The FSB identified margin calls, significant outflows from non-government money market funds and certain types of open-ended funds, as well as substantial sales of US Treasury bills by some leveraged investors, as sources of liquidity imbalances and propagation mechanisms. Additional work is needed to strengthen the resilience of NBF, including by (i) examining and, where appropriate, addressing specific risk factors and markets that contributed to the market turmoil; (ii) enhancing the understanding of systemic risks in NBF and in the financial sector as a whole; and (iii) assessing policies to address such systemic risks. To this end, the FSB has developed a comprehensive work programme to enhance the resilience of the NBF sector while preserving its benefits.²⁵

4.2 Climate risks for financial institutions and sustainable finance

The COVID-19 crisis has highlighted the impact of social and environmental risks on the financial sector. There are two main types of financial risks related to climate change: (i) physical risks, as climate-related hazards may erode the value of financial assets and/or increase liabilities; and (ii) transition risks, as policy shifts to mitigate and adapt to climate change, as well as market sentiment and technology shifts, affect the value of financial assets and liabilities. Climate change

can also create liability risks, when actors are held accountable for losses related to environmental damage they may have caused (see chapter III.B).

However, the number of financial institutions that are incorporating climate-related risks in their decision-making and risk management, while growing, remains small. Only a minority of financial institutions are directly integrating specific climate variables into credit risk models, or into institution-wide risk management frameworks. Even fewer regularly incorporate the full range of climate and non-climate related disaster risks. The UK Prudential Regulation Authority and the European Central Bank find that most institutions in their jurisdictions are not yet taking a sufficiently comprehensive, strategic and/or long-term approach to addressing climate risks. The efficacy of such actions may also be hampered by a lack of data with which to assess clients’ exposures to climate-related risks, or the magnitude of the effects (see also section 4.3).²⁶

Financial standard-setting bodies and authorities can give guidance to financial institutions on how to include climate and other SDG factors into risk assessments. Authorities can also incorporate climate-related stress tests to assess the exposure of financial institutions.²⁷ Climate risk assessments require new forward-looking models, based on scenario analyses, rather than traditional models based on extrapolating historical trends.²⁸ Some countries have started moving ahead with such models, and the IMF is also working on incorporating climate risk in macrofinancial stress testing.²⁹ Climate change-related standards could also be incorporated into the Basel capital adequacy framework.

Reporting on climate and other SDG risks is necessary to generate reliable and comparable data as a basis for implementing measures to safeguard financial stability. The recommendations of the private-sector led FSB Task Force on Climate-related Financial Disclosures (TCFD) go in this direction, but their voluntary nature so far has meant that, on average, only 23 per cent of banks align with their recommended set of disclosures.³⁰ In addition, it is also important to measure banks’

contributions to climate goals and the SDGs (rather than only measuring the impact of climate and SDG risks on banks' balance sheets), as more banks make pledges to net-zero emissions (see chapter III.B).

4.3 Central bank policies for sustainable development

The large and unconventional policy responses to the COVID-19 pandemic have turned new attention to the question of how financial and monetary policies interact with sustainable development. While policymakers are still responding to the current crisis, they (and other stakeholders) are looking ahead at how central bank policies can help societies to rebuild better. This includes considerations of when and how to return to a more neutral policy stance, but also what a new normal should be. Among the lessons of the COVID-19 crisis is the increased recognition of the importance of non-economic risks, and the need to address rising inequalities within many countries (see chapter I).

Despite a general awareness of climate-related risks on macroeconomic stability, the response of central banks has been uneven. All respondents of a recent survey by the Central Banks and Supervisors Network for Greening the Financial System—an association of 83 central banks and supervisors, including those from almost all G20 countries—considered climate change a challenge to the economy and to the functioning of central banks' operational frameworks. *Protective measures* (to safeguard financial stability and protect central banks' own balance sheets) would help reduce threats to monetary policy transmission from climate-related shocks to asset prices, supply and demand, and market expectation, in line with central bank mandates of price stability. However, a majority of central banks indicated that they had not yet considered implementing specific protective measures, although several respondents say that they may do so in the future. The main arguments cited against such measures were a lack of reliable and comparable data and appropriate analytical techniques, indicating a need for additional research and enhanced cooperation on data standards.³¹

Several central banks have started moving ahead with protective measures. For instance, some central banks have started using climate change considerations to assess collateral, and ensuring that collateral meets certain climate-related reporting obligations.³² In early 2021, the Bank for International Settlements (BIS) launched a euro-denominated green bond fund for investments by central banks and official institutions. This follows the introduction of a first BIS green bond fund denominated in US dollars in 2019. Together, the two funds manage \$2 billion worth of high-quality bonds that comply with international green standards and finance environmentally friendly projects, providing an option for central banks to include environmental sustainability objectives in their own reserve management.³³

Some central banks are taking or considering more proactive measures to support climate change mitigation. For example, the European Central Bank is considering how best to account for climate-related risks.³⁴ The People's Bank of China also announced plans to incorporate ways to promote low carbon emissions and other sustainable development measures into its financial plans over the next five years.³⁵ Most recently, the Government of the United Kingdom of Great Britain and Northern Ireland announced a change in the mandate of the Bank of England, to explicitly consider environmental and climate

goals, including as part of its quantitative easing programme.³⁶ Current discussions around “green” monetary policy options are mainly focused on whether central banks' bond purchases, as part of their quantitative easing strategies, should be directed away from sectors and companies with high carbon emissions. Opponents argue that this (i) oversteps central banks' mandates (which generally focus either solely on price stability or on price stability and other socioeconomic factors, such as employment); (ii) may conflict with conventional monetary policy targets; and (iii) risks creating financial distortions.³⁷ Others claim that current purchasing strategies are not truly neutral, since they reflect market bias towards heavy carbon emitters, given that sectors like oil and gas companies, utilities and airlines issue more bonds than others.³⁸ Other proposed options for greening monetary policy include collateral frameworks and credit allocation policies that take climate change into account.³⁹

However, better data, harmonized reporting standards, and new, forward-looking risk assessment models are needed to support climate-risk informed financial policy. All policy options discussed above rely on better (consistent, reliable and meaningful) climate risk data, and harmonized reporting standards to ensure a level playing field. Data availability is often limited in developing countries, in particular. There is also a need for longer-term impact assessments following disasters, to strengthen the understanding of cascading risks. International cooperation can help forge consensus around reporting standards, including by building on existing frameworks such as the TCFD recommendations and sustainable finance taxonomies (see chapter III.B).

5. Digital finance

Another important shift in financial markets with systemic implications has been the growth of digital financial services. The rapid growth of these services during the COVID-19 pandemic—including innovative fintech solutions—supported the functioning of the financial system, but also raised equity and regulatory concerns. These include the need to ensure that basic building blocks are in place (such as science, technology and innovation (STI) and complementary infrastructure), as well as appropriate regulatory frameworks for dynamic and inclusive digital finance (see chapter III.G) that still leave room for innovation, while tackling increased threats to cybersecurity, financial integrity and stability. To date, national regulators and standard-setting bodies have made progress in this area, through active engagement with service providers, innovation hubs and regulatory sandboxes. The growing role of global big tech platforms in the provision of financial services will require a review of these policies, as their potential for market domination poses additional risks.⁴⁰ Another longer-term trend that has come to the fore in 2020 is the development of digital currencies, including both privately issued so-called “stablecoins” and central bank digital currencies.

5.1 Regulation of digital financial services

The quick and nimble regulatory adjustments that supported the expansion of digital financial services during the COVID-19 crisis can inform future regulatory innovation. While most measures were focused on payments and remittances (see chapter III.G), this experience could be used to inform flexible measures for other services, such as digital lending and capital

raising. Examples include the reduction of fees and facilitation of onboarding processes. The effects of such crisis measures should be closely monitored and evaluated, to avoid unintended side effects and build-up of risks—such as threats to cybersecurity, digital fraud, and potential credit bubbles—and to use them as natural experiments that could inform more long-term measures.⁴¹

Financial stability risks

The expansion of big tech’s role in financial services is changing financial markets. As discussed in chapter III.G, big tech companies have continued to expand their digital financial services offerings, especially in some developing countries. At the same time, some smaller providers had difficulty raising funding in 2020 and consolidation trends in the fintech sector are creating larger and more systemically important actors. The growing role of large fintech companies that compete with incumbent financial institutions may affect the latter’s resilience, either by affecting their profitability or by reducing the stability of their funding. This is particularly problematic when the tech firms are outside of the regulatory umbrella, so that traditional firms are unable to compete. Interlinkages with the rest of the financial system may also prove disruptive, an issue that would be augmented by an increase in scale and concentration. As such firms become “too big to fail”, they may pose financial stability risks similar to those of systemically important banks (see section 4.1).⁴²

Policy responses should follow the principle of “same business, same risk, same rules” and will need to cut across regulatory realms. To mitigate the financial stability risks posed by tech companies, authorities will need to carefully monitor their financial services activities and close regulatory gaps between those companies and regulated financial institutions (e.g., around know-your-customer and anti-money-laundering and combating the financing of terrorism (AML/CFT) measures), following the principle of “same business, same risk, same rules,” as highlighted in previous issues of this report.⁴³ For instance, the regulatory obligations in some jurisdictions for banks to share data with new entrants (as in open banking regulations) may create an uneven playing field if big tech companies are not also required to share relevant data. This implies focusing regulations on the functions that actors are performing (e.g., payments, deposit taking, intermediation, etc.) rather than the type of institution. As fintech markets and the role of big tech continue to evolve—creating new linkages between sectors and different market participants—this may require a mixed or hybrid regulatory framework that combines elements of both activity- and entity-based approaches. Regulators will need to collaborate with other regulatory authorities, including ICT and competition authorities. In the case of data governance—which is key for consumer protection and fair competition—this may also require international cooperation to regulate cross-border data flows.⁴⁴

Regarding competition policies, there has been recent movement in several large jurisdictions. In December 2020, the European Union presented two new proposals to reign in the market dominance of big tech companies: the Digital Markets Act and the Digital Services Act. The former aims at anti-competitive behaviour by so-called internet gatekeepers, while the latter would oblige them to remove illegal content and be more transparent about their algorithms (see also chapter III.G). Once passed, these regulations are expected to have a wider impact, as they will serve as legislative benchmarks and are likely to be adopted by large companies for their global operations. At the same time, Chinese authorities have

increased scrutiny of big tech companies’ financial sector activities and released new draft rules against anti-competitive behaviour.

Cybersecurity

Another growing risk to financial stability is the increase in cybersecurity breaches targeting financial institutions. In a recent survey, financial regulators have identified cybersecurity threats as one of the fastest growing risks, with a potential to severely disrupt the financial sector.⁴⁵ This is in line with longer-term trends of increasing cyberattacks over the last decade, with the financial services sector being the most targeted. According to a recent report, banks and other financial services providers are the target of over 25 per cent of all malware attacks. For instance, the number of compromised credit cards increased by over 200 per cent in 2019 compared to 2018.⁴⁶ As hacking tools have evolved and become more widely accessible, threats range from small breaches carried out by individual hackers to cyberattacks spanning multiple jurisdictions perpetrated by sophisticated organizations and cyber warfare units. Cyberattacks on financial institutions or third-party technology and service providers can threaten the broader stability of the financial system by disrupting the underlying trading, clearing and settlement infrastructures and/or causing a loss of confidence by investors and depositors, leading them to withdraw funds and cancel accounts and services.⁴⁷

Strengthening the financial system’s cyber resilience requires collaboration of national and international actors. While individual institutions have an incentive to manage their own exposure to cyber risks, national supervisory and regulatory authorities need to protect the broader financial system from spillovers and cascading effects. International organizations and standard-setting bodies can support national authorities by promoting a better understanding of effective practices, facilitating information exchange on common threats and coordinating responses. In addition, many developing countries will require support to develop cybersecurity capacity.⁴⁸ In 2016, the Committee on Payments and Market Infrastructures and the International Organization of Securities Commissions published detailed guidance on cyber resilience for financial market infrastructures,⁴⁹ and in 2020, the FSB released a toolkit of effective practices to help both individual institutions and national authorities better prepare, respond and recover from cyber incidents.⁵⁰ Collaboration at the regional level is also increasing. For example, the European Union is building a three-pronged approach by (i) testing cyber resilience through a voluntary test programme that mimics sophisticated cyberattacks (TIBER-EU); (ii) sharing intelligence through the market-driven Cyber Information and Intelligence Sharing Initiative (CISI-EU); and (iii) strengthening regulation and oversight through the proposed Digital Operational Resilience Act (DORA).⁵¹

Digital technology for regulation and supervision

Authorities and financial institutions are also leveraging digital technology to support supervision and compliance. To mitigate increasing risks from the rapid growth of digital finance and meet the challenge of remote supervision during the COVID-19 pandemic, many regulatory and supervisory authorities have increased efforts to harness technology for their regulatory, supervisory and oversight tasks (SupTech).⁵² The use of such strategies has been growing steadily over the past five years. According to a recent survey of regulatory and supervisory authorities, only 4 out of 25 respondents had a SupTech strategy in 2016, while in 2020, 24 out of 25 had a SupTech strategy in place or were in the process of developing one. The main

perceived benefits of SupTech include “efficiency and effectiveness” gains in regulatory processes, and “improved insights” into risk and compliance developments, which strengthen oversight, surveillance and analytical capacities. In turn, regulated institutions can harness digital technologies to improve compliance outcomes and risk management capacities to meet their regulatory requirements (RegTech).⁵³ In addition to market surveillance and the digitalization of regulatory processes, SupTech/RegTech can also strengthen consumer protection, for example, through the electronic handling of complaints and dispute resolutions.⁵⁴

While SupTech and RegTech applications can strengthen oversight and increase efficiency, they also create new challenges and risks.

As discussed above, increased digitalization of financial services, including through the reliance on third party providers, can cause or exacerbate cyber risks. In the case of SupTech and RegTech, this can heighten the cyber vulnerability of authorities and regulated institutions, possibly increasing financial stability risks. The use of historical data and digital technology (such as artificial intelligence) also risks codifying historical biases and creating “black boxes,” as laid out in the *FSDR 2020*.⁵⁵ An over reliance on SupTech tools could thus hamper the timely identification of new and emerging financial sector risks and lead to incorrect projections and policies. A lack of transparency in the tools’ designs can make it difficult to interpret their outcomes and alerts, and may decrease accountability. SupTech and RegTech applications can also lead to competition barriers, as smaller financial institutions find it harder to implement more complex systems. In addition, these applications may create opportunities for market arbitrage, if regulated institutions learn to game the system by adapting their reporting to the functioning of SupTech systems.⁵⁶

International collaboration can help address these issues and overcome implementation challenges. Most regulatory and supervisory authorities identified resource constraints as their greatest challenge for implementing SupTech strategies, including the need for training of specialized staff. Peer learning and increased collaboration between authorities can help overcome these constraints, while additional support and capacity-building will be needed in many developing countries. International standard-setting bodies can play a role for strengthening data quality and standardization, especially for cross-border reporting purposes, or with regard to data security and localization requirements (e.g., the requirement to store data within the borders of a jurisdiction).⁵⁷

5.2 Digital assets and currencies

Cryptoassets and digital currencies—including so-called “stablecoins” and central bank digital currencies—continued to develop in 2020. Existing cryptoassets, such as bitcoin, continue to see large swings in their valuations, making them unsuited to fulfil the basic functions of a currency (as a store of value, unit of account, and medium of exchange). Their anonymous and decentralized nature has also led to concerns about their use for illicit finance and other fraudulent activities. In June 2019, the Financial Action Task Force (FATF) revised its standards and recommendations regarding cryptoassets, explicitly placing AML/CFT requirements on virtual assets and virtual asset service providers.

Stablecoins have more currency-like features than cryptoassets. While stablecoins are typically based on the same distributed ledger technology that underlies most cryptoassets, they aim to maintain a stable

value relative to a specified asset (e.g., a fiat currency like the US dollar) or a pool or basket of assets (e.g., multiple currencies).⁵⁸ Currently, existing stablecoins present only limited systemic risk, since they are small in scale and their use cases are mainly limited to facilitating trade in cryptoassets.

Global stablecoins have been touted for their potential to facilitate and reduce the cost of cross-border payments, but their wide-spread adoption could pose risks.

The expansion of new and emerging stablecoin projects proposed by big tech companies and platforms has the potential to create systemically important private currencies adopted globally by users across jurisdictions.⁵⁹ Such global stablecoins (GSCs) risk reducing the effectiveness of national monetary policy if economic actors choose to substitute them for domestic currencies (similar to the cases of dollarization that can sometimes be observed in developing countries). In the extreme, the large-scale adoption of a GSC would mean that countries would be subjected to monetary policy decisions made by a private currency provider—decisions based on business interests of a multinational company rather than the national policy mandates of a monetary authority. It could also increase volatility of capital flows, owing to lower transaction costs, and the possibility of using GSCs to circumvent exchange restrictions and capital flow management measures, among others.⁶⁰ Operational failure of the GSC infrastructure could disrupt the global payments market and affect the wider financial system through close linkages and spillovers. Such disruptions could be aggravated by confidence effects that might trigger large-scale redemptions and fire sales of underlying assets.⁶¹

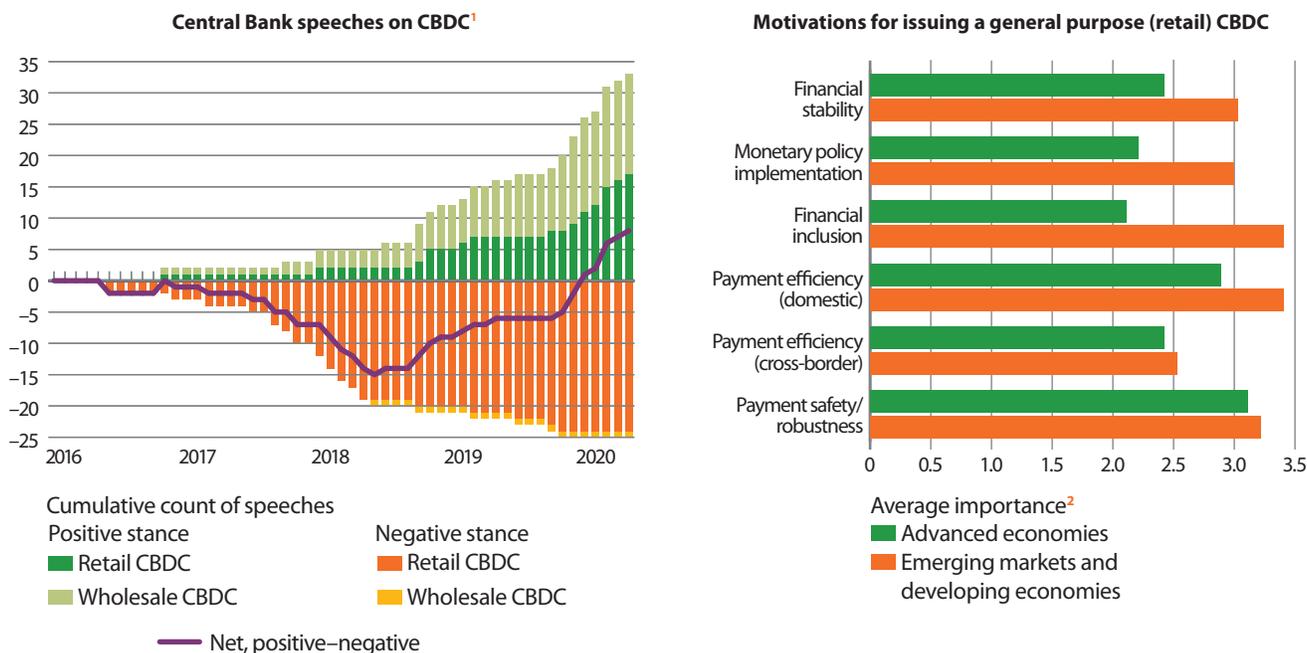
To address these risks, national authorities need to closely monitor the further development of global stablecoins and ensure comprehensive regulation, supervision and oversight, including by revisiting legal and regulatory frameworks where necessary, and cooperating across jurisdictions and with international organizations and standard-setting bodies.

The FSB has developed a set of high-level recommendations for national regulators, supervisors and overseers, urging them to apply comprehensive regulatory requirements and relevant international standards following the principle of “same business, same risk, same rules,” and to ensure that GSC arrangements meet all applicable requirements before commencing operations in any particular jurisdiction. They should also communicate and consult with each other in order to facilitate regulation, supervision and oversight of GSC arrangements across borders and sectors.⁶² Existing coordination mechanisms may need to be enhanced to strengthen cross-sectoral coordination and develop more detailed international standards to avoid regulatory arbitrage. To protect financial integrity, authorities also need to ensure compliance with the AML/CFT standards developed by the FATF, including its new standards for virtual assets.⁶³ Operating under an appropriate and effective regulatory, supervisory and oversight framework, GSCs can potentially contribute to enhancing cross-border payments, as one of the building blocks laid out by the FSB roadmap developed for the G20.⁶⁴

Central bank digital currencies

Interest in central bank digital currencies has increased, amidst a decline in the demand for cash in a number of countries—a decline which accelerated due to COVID-19—and rendered more urgent by proposed stablecoin projects by the private sector. At the end of 2020, 86 per cent of surveyed central banks were engaging in research, experimentation or development of central bank digital

Figure III.F.3
Central bank digital currencies, perceptions and motivations, 2016–2020
 (Number of speeches; average importance)



Source: Auer, R., G Cornelli and J Frost. 2020. “The rise of central bank digital currencies: drivers, approaches and technologies”, BIS Working Papers no 880; Boar, C., A Wehrli. 2021. “Ready, steady, go – 1 Results of the third BIS survey on central bank digital currency”, BIS Papers no 114.
Notes: 1 Search on keywords “CBDC”, “digital currency” and “digital money”. The classification is based on authors’ judgment. The score takes a value of –1 if the speech stance was clearly negative or in case it was explicitly stated that there was no specific plan at present to issue digital currencies. It takes a value of +1 if the speech stance was clearly positive or a project/pilot was launched or was in the pipeline. Other speeches (not displayed) have been classified as neutral; 2 1 = not so important; 2 = somewhat important; 3 = important; and 4 = very important.

currencies (CBDCs)—up from 80 per cent in 2019—and around 40 per cent considered it likely or possible that they would issue a retail CBDC (providing general users with direct access to central bank money) within one to six years.⁶⁵ Central bank interest in CBDCs has increased steadily since the mid-2010s, although a negative perception, particularly of the systemic risks involved in retail CBDCs, dominated the discourse for several years. While most public speeches of central bank governors and board members still had a negative or dismissive stance towards CBDCs in 2017 and 2018, overall perceptions have turned positive since late 2019. The most frequently cited benefits of retail CBDCs are payment safety and efficiency, and financial inclusion in the case of developing countries (figure III.F.3).⁶⁶ The first “live” retail CBDC was launched in October 2020 in the Bahamas, with the explicit goal of facilitating financial inclusion.⁶⁷

Potential benefits of retail CBDCs for national and cross-border payment systems will have to be weighed carefully against risks. Risks to a CBDC depend in part on its design.⁶⁸ With CBDCs as an alternative to bank deposits, there is a risk of disintermediation, which could lead to higher funding costs for private banks and affect the availability of capital for productive investment. If depositors were to perceive an increase in bank solvency risk, the option of a safe retail CBDC could increase the risk of bank runs, effectively weakening the stability of the banking system. Disintermediation would also affect traditional transmission mechanisms of monetary policy (although it has also been argued that interest-bearing CBDCs could be a more immediate and effective

way to implement monetary policy).⁶⁹ Interoperable CBDCs that would be accepted in different jurisdictions could help enhance cross-border payments, but could create similar risks as GSCs in terms of currency substitution and increased capital flow volatility. Competition between CBDCs from different jurisdictions could also impact the currency composition of international foreign exchange reserves. Another important challenge would be the protection of data privacy and security, as well as operational resilience.

The technical design of CBDCs will determine the balance of benefits and risks, depending on the characteristics of each economy and their financial sectors, and should be informed by further research and international peer learning. Careful technical design of CBDCs is needed to mitigate risks and make them a safe, stable and universally accessible alternative alongside the growing offering of private digital payment services, while ensuring competition and avoiding market fragmentation. Based on their respective research and experimental studies, a group of central banks and the Bank for International Settlements (BIS) developed a set of common principles and core features that would allow a CBDC to become a trusted means of payment that supports central banks’ public policy objectives. The three common principles call for (i) the safeguarding of monetary and financial stability; (ii) the coexistence of CBDCs with other existing forms of money; and (iii) the promotion of innovation and efficiency. While the specific technical design would continue to differ between jurisdictions, it should be sufficiently interoperable to allow for cross-border transfers.⁷⁰ Additional research and experimentation

will be needed before moving to a full implementation, and central banks can benefit greatly from sharing experiences. International institutions like the BIS can support this research and provide platforms for peer learning.

6. Global governance and policy coherence

6.1 Governance at international institutions and standard-setting bodies

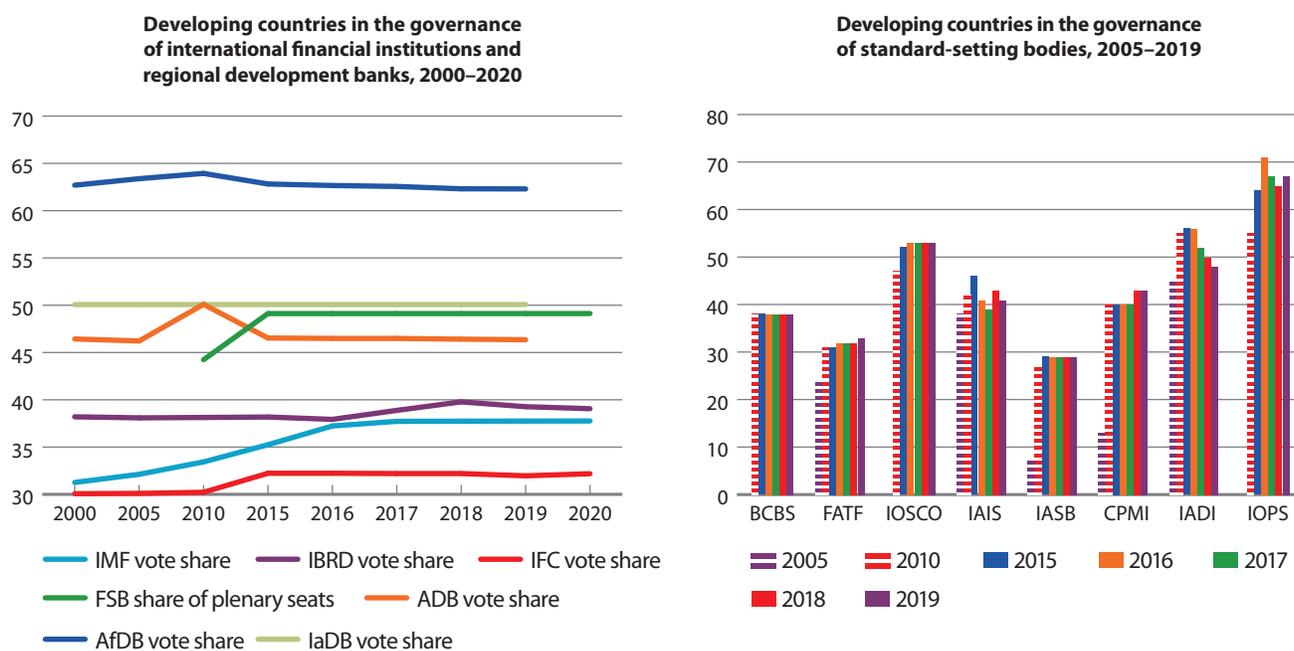
Despite existing commitments, global economic governance reform remains as urgent as ever. In the Addis Agenda, Member States committed to strengthening the voice and participation of developing countries in international economic decision-making and global economic governance. Despite some progress since 2010, the voting shares of developing countries in major international institutions have hardly changed in recent years (figure III.F.4., left-hand panel).

Quota reviews remain critical to the reallocation of voting shares for a fairer representation of developing countries in international

financial institutions and regional development banks. The IMF Fifteenth General Review of Quotas concluded in February 2020, with no increases in quotas. For the Sixteenth Review, to be concluded no later than 15 December 2023, Member States should revisit the adequacy of quotas and continue the process of IMF governance reform, including a new quota formula as a guide, and ensure the primary role of quotas in IMF resources. Any adjustment in quota shares would be expected to result in increases in the quota shares of dynamic economies in line with their relative positions in the world economy and hence likely in the share of emerging market and developing countries as a whole, while protecting the voice and representation of the poorest members.⁷¹ In October 2020, the joint World Bank-IMF Development Committee endorsed a progress report on the voting rights review of the World Bank Group’s International Development Association, which aims to protect and, if possible, enhance the voting power of the Association’s recipient countries. The Committee requested a completion of the review by October 2021.⁷² No other international financial institutions or regional development banks have announced new plans for shareholder reforms in 2020.

International standard-setting bodies have made little progress in strengthening the voice of developing countries. The public and private bodies that set global standards and norms for financial regulation

Figure III.F.4
Representation of developing countries in international institutions and standard-setting bodies, 2000–2020
(Percentages of voting rights or members)



Source: UN DESA.

Notes: International Monetary Fund (IMF), International Bank for Reconstruction and Development (IBRD), International Finance Corporation (IFC), Asian Development Bank (ADB), African Development Bank (AfDB), Inter-American Development Bank (IADB) show percent of voting rights. Financial Stability Board (FSB) does not have voting rights, and thus data shows number of seats at the plenary. All data categorised according to the M49 classification of developed and developing regions.

The main international SSBs include the Basel Committee on Banking Supervision (BCBS) for standards on banking regulation; the Financial Action Task Force (FATF) for standards on combating money laundering, terrorist financing and other related threats to the integrity of the international financial system; the International Organization of Securities Commissions (IOSCO) for standards on securities regulation; the International Association of Insurance Supervisors (IAIS) for standards on insurance industry regulation and supervision; the International Accounting Standards Board (IASB) for accounting standards; the Basel Committee on Payments and Market Infrastructure (CPMI) for standards on payment, clearing, settlement systems and related arrangements; the International Association for Deposit Insurers (IADI) for deposit insurance standards; and the International Organisation of Pensions Supervisors (IOPS) for pension regulation. Basel Committee on Banking Supervision (BCBS) had no developing country members in 2005; and IOSCO and IOPS do not have data before 2010.

and supervision have generally been set up by developed-country regulatory and supervisory authorities. There have been repeated calls, including in the Addis Agenda, to strengthen the voice and participation of developing countries in international norm-setting processes. However, while there has been some improvement in developing countries' board representation in these bodies since 2005, little additional progress has been made since 2015 (figure III.F.4, right-hand panel).

6.2 Improving coordination and policy coherence

Increasing the coherence and consistency of the international monetary, financial and trading systems has long been a central concern in the financing for development process. Building on the Monterrey Consensus, the Addis Agenda calls for coherence across a broader range of policy areas, including investment, development policy, and environment institutions and platforms. The deeper coordination that is now needed covers additional areas, such as tax, competition, and non-economic issues such as climate change, disaster risk, human rights, gender and migration.

The United Nations General Assembly and the United Nations Economic and Social Council serve as the main forums for forging a global consensus around key economic and social policy norms and targets, including the 2030 Agenda for Sustainable Development and the Addis Agenda. The Economic and Social Council Forum on Financing for Development follow-up (FfD Forum) serves as a platform to discuss the full range of policies that could advance the financing of sustainable development. Two virtual sessions of the FfD Forum were held in 2020 to address priority issues, such as liquidity and debt challenges and the mobilization of resources, and work towards a global and coordinated response to tackle the immediate crisis and rebuild better.⁷³ More recently, the 2020 resolution on the Quadrennial Comprehensive Policy Review of United Nations system operational activities called upon the United Nations development system to develop a joint framework of collaboration with multilateral development banks to foster achievement of the 2030 Agenda, by improving synergies at regional and country levels.⁷⁴

High-level political leadership is key for advancing international policy coherence. The series of high-level events on Financing for Development in the Era of COVID-19 and Beyond brought together all Member States, including those that are not represented in other multilateral forums, such as the G20. Six Member State-led working groups developed a comprehensive menu of policy options on (i) external financial flows and remittances; (ii) recovering better for sustainability; (iii) global liquidity and financial stability; (iv) debt vulnerabilities and the role of private sector creditors; and (v) illicit financial flows (see also box III.F.1).⁷⁵ During 2021, the proposed policy options will be further advanced through collaboration within the United Nations system, to develop action-oriented policy proposals.

The seventy-fifth anniversary of the United Nations has galvanized discussions on multilateralism and the role of the United Nations in addressing global challenges. In commemoration of the anniversary, Member States adopted a declaration that recognizes multilateralism as a necessity for a more equal, more resilient, and more sustainable world, and that implementation of the 2030 Agenda is necessary for survival.⁷⁶

The upcoming twenty-sixth session of the Conference of Parties to the United Nations Framework Convention on Climate Change (COP26) is a key milestone for the implementation of the Paris Climate Agreement. Building on a series of preparatory events and initiatives that have been taking place since 2019, all countries will need to come forward with more ambitious nationally determined contributions, and targets that are consistent with a net-zero pathway. While major developed economies and members of the G20 should lead the way, developing countries, particularly LDCs and small island developing States, will need additional support to enhance their climate ambition. Financial, investment, trade and development policies at the global, regional and national levels must also be aligned to avoid a global climate catastrophe, achieve the SDGs, and leave no one behind.

6.3 Strengthening policy coherence and governance at the national level

National policymakers also need to ensure a coherent policy mix to achieve the SDGs. International organizations have proposed frameworks to support these efforts. For instance, the Organization for Economic Cooperation and Development reviewed and amended its recommendations on good institutional practices in 2019, and put forward the Recommendation on Policy Coherence for Sustainable Development.⁷⁷ Integrated national financing frameworks, first called for by the Addis Agenda, can help countries strengthen their planning processes and overcome existing impediments to financing sustainable development and the SDGs. They lay out the full range of financing sources (i.e., domestic and international sources of both public and private finance) and allow countries to develop a coherent strategy to increase investment, manage risks and achieve sustainable development priorities, as identified in a country's national sustainable development strategy.⁷⁸

Good governance and inclusive and accountable institutions are key for designing and implementing coherent policies for achieving the SDGs. In the Addis Agenda, Member States recognize the importance of good governance and commit to strengthening national institutions to combat corruption. As part of its support for developing countries' pandemic response, the World Bank created a database of country actions and is providing policy advice on a broad range of issues, including emergency measures for state continuity, measures to safeguard integrity in government response, and institutional mechanisms to ensure whole-of-government coordination.⁷⁹ This is based on the ongoing work of the World Bank to combat corruption. A recent report lays out World Bank anticorruption initiatives that broaden its focus to include financial centres; the harnessing of new technologies to understand, address, and prevent corruption; and the integration of behavioural social science insights.⁸⁰

Endnotes

- 1 External financing needs are calculated as current account balance + capital account balance + external debt amortization – net FDI inflows. These are calculated for 53 out of 73 LICs for which data is available from the WEO. The overall EFN estimate is derived by extrapolating to cover the countries for which data is not available.
- 2 A breakdown of IMF Covid-19 Financial assistance and Debt Service Relief is available at <https://www.imf.org/en/Topics/imf-and-covid19/COVID-Lending-Tracker>.
- 3 Stubbs, Thomas, William Kring, Christina Laskaridis, Alexander Kentikelenis, and Kevin Gallagher. 2021. “Whatever it Takes? The Global Financial Safety Net, COVID-19 and Developing Countries.” *World Development* 137 (2021): 1–8.
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