

FINANCING FOR DEVELOPMENT: PROGRESS AND PROSPECTS

Report of the Inter-agency Task Force
on Financing for Development 2017



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Chapter III.F

Addressing systemic issues

1. Key messages and recommendations

The 2008 world finance and economic crisis underscored how systemic risks can undermine progress towards poverty alleviation and development. Today, risks in the global economy highlighted earlier in this report underscore the seriousness of the systemic challenges facing the international community in its efforts to achieve the 2030 Agenda for Sustainable Development. As repeatedly demonstrated by the transmission of financial crises, events in one country can have effects across borders, impacting jobs, employment and growth. There are cross-border spillovers from social and environmental systems as well. For example, instability, crime, poverty and inequality have the potential to provoke extremism or drive irregular migration, both of which have cross-border implications.

International cooperation is essential to addressing these risks. Indeed, such cooperation can boost the economic, social and environmental performance of all countries. For example, the actions of the Group of Twenty (G20) in the wake of the 2008 world financial and economic crisis helped contain the crisis, and global financial regulatory standards have helped improve the financial safety of all countries. Similarly, cooperative efforts towards social development produce results in the near term and prevent costlier problems and instability in the future, while efforts to improve environmental sustainability are often only effective with joint actions across borders.

While important steps have been taken to reduce vulnerabilities in the international system and to increase the voice of developing countries, the Addis Ababa Action Agenda states that more needs to be done. Continuing these efforts, while further aligning international institutions, most of which

were not designed with sustainable development as a goal, to support the agenda are at the heart of this chapter on addressing systemic issues.

The United Nations development system is moving to implement a more coherent approach aligned with sustainable development, as are other regional and global organizations, although efforts are more advanced in some institutions than others. *All regional and global organizations, especially those with norm-setting functions, should continue efforts to align their strategies, policies and practices with the Sustainable Development Goals (SDGs).* While the Inter-agency Task Force will continue to report on the coherence of international systems, *international organizations' self-assessments of coherence with the sustainable development agenda, reported to their own governance mechanisms, could contribute. Additional standard-setting bodies that are not currently part of the follow-up process could be invited to voluntarily join this effort through the Task Force platform.*

The Addis Agenda recognizes the need to further strengthen the global financial safety net (GFSN) to ensure that no one is left behind. *Member States should work to remove gaps in the GFSN's coverage, ensure adequate levels of financing, increase its flexibility and strengthen its countercyclicality.* The world continues to face large and volatile capital flows, which the Addis Agenda acknowledges can be dealt with through necessary macroeconomic policy adjustment, supported by macroprudential policies and, where appropriate, capital flow management measures. *Greater international macroeconomic coordination, including cooperation between capital flow source and destination countries, can help reduce the impact of spillovers and financial flow volatility.*

Financial reforms need to achieve and maintain the right balance among stability, safety and sustainability, while also promoting access to finance. Much technical work has been done on financial reform and adopting macroeconomic policies to protect against future financial crises, though the regulatory reforms are not yet complete and more needs to be done. ***Efforts to implement already agreed financial regulatory reforms should be sped up and strengthened.*** However, the efficacy of these reforms has not yet been tested, with some indicating that they are not sufficient, while others have called them too onerous. The Addis Agenda also underscores the importance of monitoring the impact of financial regulation on incentives for financial inclusion and investment in sustainable development. Work is under way, particularly at the Financial Stability Board (FSB), to develop a framework for the post-implementation evaluation of the effects and any unintended consequences of financial regulatory reforms that will guide analyses of whether the reforms are achieving their intended outcomes. At the same time, efforts to include all dimensions of sustainable development into the financial reform agenda are still in their infancy. ***Member States may wish to endorse FSB efforts to evaluate the effects of agreed post-crisis reforms on the resilience of the global financial system. Member States may also consider a broader examination of the extent to which all incentives in the financial system are aligned with sustainable development, and balance the goals of access to finance, sustainability and stability.***

Finally, governance of global systems should reflect changes in the global economy and be responsive to the risks faced in all parts of the world. In the Addis Agenda, Member States recommitted to increasing the voice of developing countries in international economic decision-making and norm-setting processes, including at the Basel Committee on Banking Supervision (BCBS) and other main international regulatory standard-setting bodies. The existing regular reviews of governance at

the World Bank and International Monetary Fund (IMF) are meant to address this. Other international organizations are also implementing reforms, although progress is uneven. ***Periodic processes to examine governance structures at global and regional organizations, with the goal of strengthening the voice of developing countries, would help meet commitments.***

2. Institutional and policy coherence

The Financing for Development outcomes recognize that institutional silos should be broken down in order to promote cross-fertilization of ideas and more effective coordination of actions at both the national and international levels. They stress the importance of enhancing coherence, governance and consistency of the international monetary, financial and trading systems, and the need to expand the coherence agenda to take into account economic, social and environmental challenges.

2.1 Policy coherence at international institutions

In response to the development of the Addis Agenda and the 2030 Agenda for Sustainable Development, the international financial institutions have stepped up efforts at joint work. In July 2015, six multilateral development banks (MDBs)¹ and the IMF issued a joint commitment to provide financial support of \$400 billion dollars in the subsequent three years; a subsequent joint statement from them welcomed the adoption of the 2030 Agenda for Sustainable Development. In April 2016, all the MDBs met to promote coherence in infrastructure finance at the first Global Infrastructure Forum. In October 2016, the six MDBs and the IMF were joined by four other development banks² to announce that they were stepping up efforts, within their respective mandates and governance structures, to enhance the effectiveness of their lending, knowledge-sharing and technical assistance.³

1 World Bank, African Development Bank, Asian Development Bank, European Investment Bank, European Bank for Reconstruction and Development and Inter-American Development Bank.

2 Asian Infrastructure Investment Bank, International Finance Corporation, Islamic Development Bank and New Development Bank.

3 See <http://www.worldbank.org/en/news/press-release/2016/10/09/delivering-on-the-2030-agenda-statement>.

The World Bank Group and the IMF outlined plans for adapting to the 2030 Agenda for Sustainable Development at their annual meetings in 2015, which were welcomed by a ministerial communiqué. In 2016, the World Bank Group also prepared a document entitled “Forward Look – A Vision for the World Bank Group in 2030,” which seeks to shape a common view among shareholders on how the World Bank Group can best support the development agenda for 2030 while staying focused on its own corporate goals. Meanwhile, work is under way at the IMF to review its progress in supporting the 2030 Agenda for Sustainable Development.

A number of the regional development banks are also adapting their work to support sustainable development. The Asian Development Bank (ADB) is preparing a new strategy, which will include information on how the ADB aligns with the SDGs and the Paris Agreement on climate change. The African Development Bank has created the High 5s Agenda to respond to the 2030 Agenda for Sustainable Development. The Inter-American Development Bank has updated its Corporate Results Framework to identify the most closely aligned SDGs, as well as its guidelines for preparing country strategies.

The United Nations General Assembly adopted a Quadrennial Comprehensive Policy Review resolution in December 2016, the tool for guiding, assessing and monitoring United Nations system-wide coherence (see chapter III.C for a further discussion).

2.2 Policy coherence in migration

An important emerging area for policy coherence highlighted in the Addis Agenda is migration. Instability, crime, climate change, disasters or drastic poverty and inequality have the potential to drive irregular migration, with strong cross-border implications. In the Addis Agenda, ensuring safe, orderly and regular migration is an agreed goal. This requires effective implementation of policies and systems, access to regular channels for migration, well-administered visa and entry schemes, and effective identity management practices.

On 19 September 2016, the General Assembly-mandated high-level summit on addressing large movements of refugees and migrants was

a watershed moment for strengthening governance of international migration and an opportunity for creating a more responsible, predictable system for responding to large movements of refugees and migrants. All 193 Member States signed up to the plan for addressing large movements of refugees and migrants—the New York Declaration,⁴ which expresses the political will of world leaders to save lives, protect rights and share responsibility on a global scale. In the declaration, Member States stated their commitment to protect the safety, dignity and human rights and fundamental freedoms of all migrants, regardless of their migratory status, at all times. The year 2018 will witness an international conference on migration; the adoption of a global compact for safe, orderly and regular migration; and the adoption of a global compact on refugees. As Member States develop the global compacts on refugees and migrants, they should work to ensure coherence with the Addis Agenda and the 2030 Agenda for Sustainable Development.

3. Macroeconomic stability and financial regulation

A stable global macroeconomic environment is needed to support countries’ ability to equitably and sustainably grow and implement other policies that contribute to sustainable development. Past financial crises have highlighted the cost of major failures in the financial sector as well as failures of financial regulation and supervision. As noted in the Addis Agenda, national financial stability faces risks from spillovers from financial systems in other countries. The Addis Agenda emphasizes the importance of strengthening regulatory frameworks at all levels, and addressing gaps and misaligned incentives in the international financial system to foster stability, safety and sustainability, while also promoting access to finance and sustainable development across its three dimensions.

3.1. International monetary system and global financial safety net

The design and functioning of the international monetary system is a critical factor in global macroeconomic stability. While national policy choices

⁴ A/RES/71/1.

related to exchange rate regimes and foreign reserve accumulation have responded to the evolution of global financial markets, there has not been a fundamental change in the structure of the international monetary system since the 1970s. Nonetheless, there have been important reforms to the global financial system since the 2008 world financial and economic crisis aimed at improving its functioning, stability and resilience, including by strengthening the global financial safety net (GFSN) and introducing new coordination mechanisms. A number of international organizations that are members of the Task Force undertake global economic monitoring in order to sound early warnings about potential risks in the economic and financial system.

There are various ongoing work streams that address the call in the Addis Agenda for the “need to pursue further reforms of the international financial and monetary system”.⁵ The IMF is continuing work on the role of the special drawing right (SDR), which saw the inclusion of the Chinese renminbi in its basket of currencies, which was approved in 2015 and operationalized in 2016. In July 2016, IMF staff prepared a note for the G20 outlining initial considerations on whether a greater role for the SDR could contribute to the smooth functioning of the international monetary system.⁶ In October 2016, a high-level external advisory group, consisting of prominent academics, former policymakers and market practitioners, was convened to advise on this issue.⁷ The IMF will continue exploring whether a broader role for the SDR could contribute to the smooth functioning of the international monetary system. This work will seek to identify gaps and market failures that the SDR could help to address in the light of the structural shifts in the international monetary system.

The GFSN has expanded since the global financial crisis, including through a large increase in IMF lending capacity, development of bilateral swap lines and creation or strengthening of regional

financial arrangements. Nonetheless, as noted in a recent IMF paper, the GFSN has become more fragmented, has uneven coverage with sizeable gaps (especially with regard to access to financing for systemic emerging markets and those markets that can act as transmitters of shocks) and remains too costly, unreliable and conducive to moral hazard. In essence, there is insufficient liquidity for many countries when they face crises or shocks. While bilateral swap lines across central banks have helped some, they reach only a small number of countries. The IMF is currently working on reviewing and modifying its lending facilities and improving its cooperation with regional financial arrangements.

3.2. Financial regulatory reform

A strong financial system should effectively intermediate private financial flows in line with sustainable development objectives. Ongoing work on financial regulatory reform can be broken down into four main components: resilience of financial institutions, solving the too-big-to-fail problem, making derivatives safer, and transforming shadow banking. This work is coordinated through the FSB, which promotes international financial stability through information exchange, cooperation of national financial authorities and international standard-setting bodies, such as the BCBS, the International Association of Insurance Supervisors (IAIS) and the International Organization of Securities Commissions (IOSCO).

The 2016 report of the FSB to the G20 Summit on the implementation and effects of financial regulatory reforms concluded that implementation progress remains steady but uneven, and that strengthened resilience due to the reforms has assisted in the smoother operation of the global financial system. Banks continue to build capital and liquidity buffers to meet the new Basel III capital adequacy standards, with the estimated capital shortfall nearly zero and capital ratios at new highs (figures 1.a and 1.b).

5 Addis Ababa Action Agenda of the Third International Conference on Financing for Development (Addis Ababa Action Agenda) (United Nations publication, Sales. E.16.I.7), para. 105. Available from http://www.un.org/esa/ffd/wp-content/uploads/2015/08/AAAA_Outcome.pdf.

6 See <http://www.imf.org/external/np/pp/eng/2016/072416.pdf>.

7 See <https://www.imf.org/en/News/Articles/2016/10/31/PR16474-IMF-Launches-Consultations-on-Role-of-Special-Drawing-Right-with-External-Advisory-Group>.

However, substantial work remains in implementing the policies designed to address the too-big-to-fail problem—for example, achieving effective resolution regimes and operationalizing plans for systemically important banks and non-bank financial institutions. Given the gaps in implementation of financial regulatory reforms, efforts to implement the already agreed reforms must be speed up and strengthened. Effective implementation will require further cross-border cooperation and the addressing of legal, data and capacity constraints.

There are some concerns, however, that existing reforms do not fully address the systemic risks in the financial system or the too-big-to-fail problem. Additionally, the efficacy of these reforms has not yet been tested. Some members of the Task Force feel that the stronger capital adequacy requirements still allow banks to maintain high leverage ratios that pose systemic risks. At the same

time, there is pressure in some countries to ease or repeal the rules.

The Addis Agenda emphasizes the importance of ensuring that incentives underlying financial market regulations are aligned with sustainable development. All regulatory frameworks create incentives. Regulations could have unintended consequences and spillovers by reducing incentives to lend to sectors, enterprise types, or countries where financing is critical to achieving the SDGs. To date, emerging market and developing economies have not reported major unintended consequences from implementing the reforms.

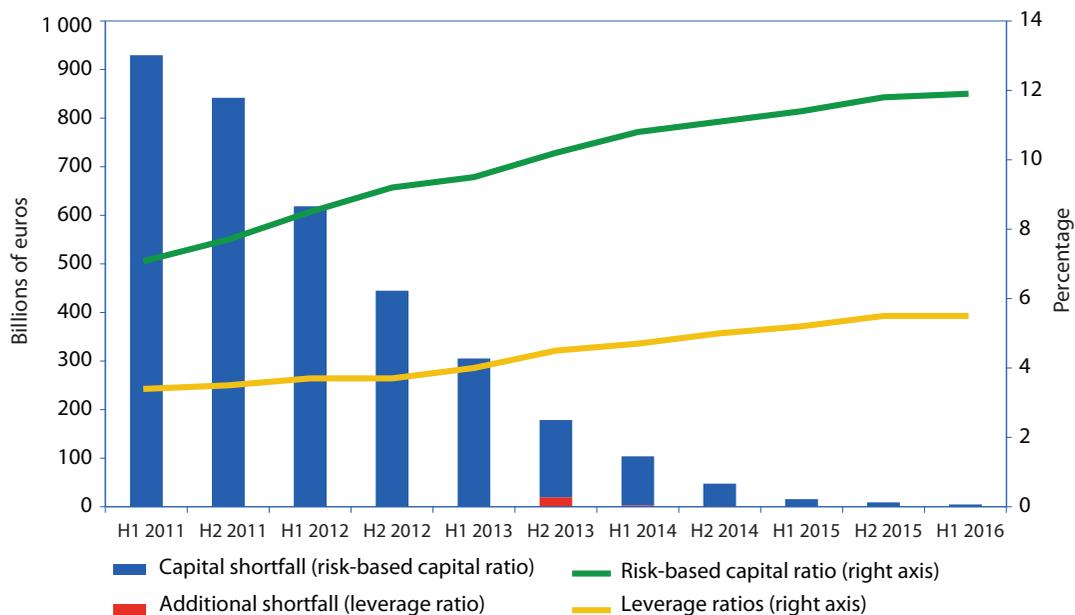
There is anecdotal evidence on how countries are addressing these impacts. Some measures to boost long-term investment were discussed in the thematic chapter, and better design of regulations can address unintended consequences and spillovers. European Union countries have included carve-outs

Figure 1

Evolution of banks' regulatory capital and liquidity ratios, 2011–2016

Figure 1.a

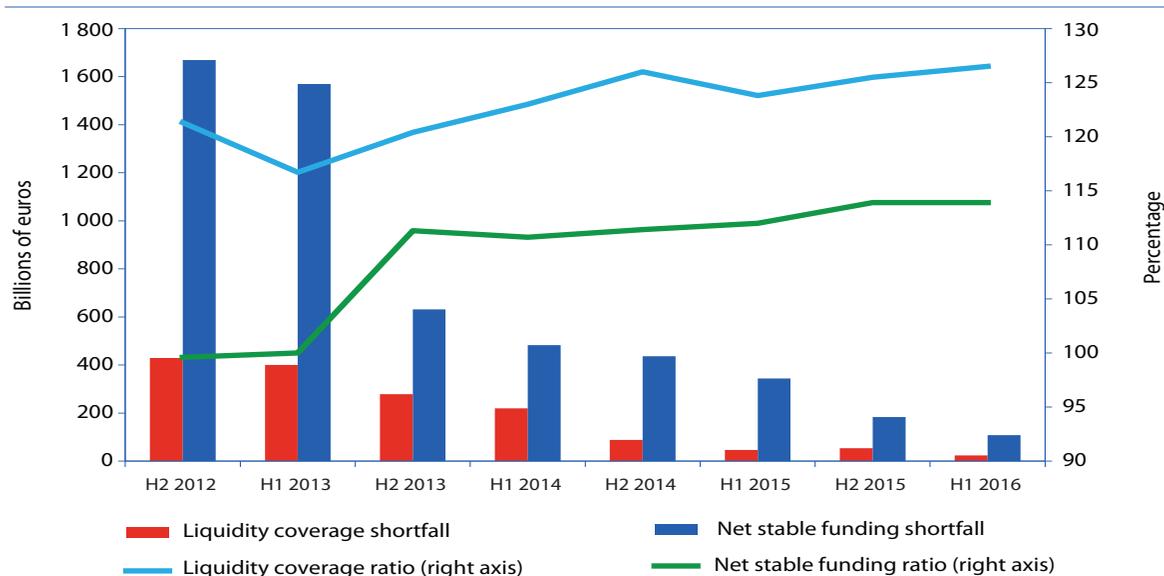
Risk-based capital and leverage ratios, 2011–2016



Source: BCBS Basel III Monitoring Report, March 2017.

Note: The graph shows data for banks that have Tier 1 capital of more than €3 billion and are internationally active (Group 1 banks). The ratios are weighted by risk-weighted assets. Total capital shortfall for banks to reach the fully phased-in 2019 Common Equity Tier 1 (CET1) target ratio of 7 per cent plus bank-specific G-SIB surcharges if applicable, and the respective target levels (and G-SIB surcharges) for Tier 1 and total capital ratios. Additional total capital shortfall to meet the fully phased-in leverage ratio (on top of the target risk-based capital ratios), assuming a 3 per cent calibration as per BCBS (2014).

Figure 1.b

Aggregate liquidity shortfalls, 2012–2016

Source: BCBS Basel III Monitoring Report, March 2017.

Note: The graph shows data for banks that have Tier 1 capital of more than €3 billion and are internationally active (“Group 1 banks”). The liquidity ratios are weighted by CET1 capital.

to the implementation of the Basel III capital adequacy framework that allow lower risk weights for exposure to sovereign debt and loans to small and medium-sized enterprises. These carve-outs attempt to ensure sufficient access to credit in these areas, although this has led to them being judged materially non-compliant with the Basel III standard in peer reviews.

3.3. Financial spillover prevention and capital flow management

As discussed in chapter I, net capital flows continue to exhibit volatility. The Addis Agenda notes that “when dealing with risks from large and volatile capital flows, necessary macroeconomic policy adjustment could be supported by macroprudential and, as appropriate, capital flow management measures”.⁸ In 2016, to help countries better understand and address the impact of cross-border capital flows, the IMF reviewed countries’ experiences with capital

flows from 2013 to 2016 and their policy responses through the lens of the IMF institutional view on capital flows.⁹ In the sample, most countries facing challenges of capital flow reversals relied on macroeconomic policies, although eight countries also used capital flow management measures on outflows. The measures were used mainly in crisis circumstances or when a crisis was considered imminent and as part of a broad policy package, at the same time, some countries used them in circumstances that posed particular challenges. The IMF Executive Board considered that the IMF institutional view on capital flows, adopted in 2012, “remains relevant in the current environment and does not need substantive adjustment at this point”, but “would need to remain flexible and evolve over time to incorporate new experience and insights”.¹⁰ They also agreed that further clarification or elaboration was warranted in a few areas, including how the institutional view can serve as a framework for greater multilateral con-

8 Addis Ababa Action Agenda of the Third International Conference on Financing for Development (Addis Ababa Action Agenda) (United Nations publication, Sales. E.16.I.7), para. 105. Available from http://www.un.org/esa/ffd/wp-content/uploads/2015/08/AAAA_Outcome.pdf.

9 See <http://www.imf.org/external/np/pp/eng/2016/110416a.pdf>.

10 See <http://www.imf.org/en/News/Articles/2016/12/20/PR16573-Review-of-Experience-with-the-Institutional-View-on-Capital-Flows>.

sistency in the design of policies for dealing with capital flows. The review of experiences showed that countries have relied on a combination of policies in response to capital flows, including the use of macroprudential policies to contain risks from financial cycles. Further IMF staff analysis of how macroprudential policies can contribute to increasing resilience to large and volatile capital flows is expected to be discussed by the IMF Executive Board in June 2017.

4. Global economic governance

The Addis Agenda welcomes recent reforms to the international financial architecture, and calls for additional measures to ensure that international mechanisms and institutions keep pace with the increased complexity of the world, and respond to the imperatives of sustainable development. Governance reforms to ensure a more inclusive and representative international architecture are being implemented gradually but unevenly across international organizations.

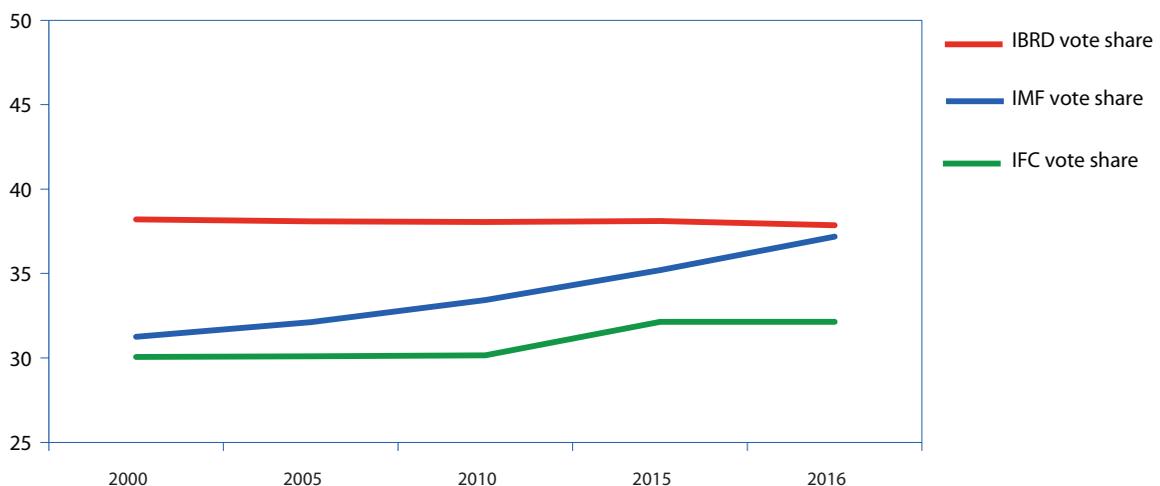
4.1. International financial institutions

As reported in the 2016 Task Force report, the IMF quota and governance reforms agreed to in 2010 became effective in January 2016, doubling the

quota resources, increasing the aggregate voting rights of developing countries, as well as improving their representation on the IMF board. The World Bank Group and IMF are currently discussing further reforms to their governance and voting rights. In October 2015, the governors of the World Bank Group agreed to consider realignment of International Bank for Reconstruction and Development and International Finance Corporation shareholding alongside consideration of a capital increase in 2017. An IMF general review of quotas—its fifteenth—had also been due for conclusion in the autumn of 2017; but, in October 2016, the governors of the IMF agreed to reset the timetable for completing the review to the Spring Meetings of 2019 and no later than the Annual Meetings of 2019, subject to adoption by the Board of Governors, in order to provide adequate time to build the necessary broad consensus. For both institutions, the last agreed reforms occurred in 2010. At the IMF, final implementation of the 2010 reform is largely complete, while at the World Bank implementation is still underway, as Member States subscribe to the additional shares agreed to be created. As shown in figure 2, the uneven speed of take up of new shares at the World Bank has resulted in countries in developed regions actually gaining voting rights. The IMF

Figure 2

Share of voting rights at IFIs of countries in developing regions, 2000–2016 (Percentage)



Source: United Nations Statistics Division database.

reforms have increased the share of votes held by countries in developing regions.¹¹

4.2. International regulatory standard-setting bodies

A number of public and private bodies set international standards for financial regulation and supervision that countries may adopt into national frameworks. Members of international regulatory standard-setting boards (SSBs) are usually national regulators. The main international SSBs include the following:

- the Financial Stability Board (FSB), an international body founded in 2009 to coordinate national financial authorities and other SSBs, including the BCBS, IAIS, IOSCO, IASB, CPMI, and the BIS Committee on the Global Financial System
- the Basel Committee on Banking Supervision (BCBS) for standards on banking regulation
- the Basel Committee on Payments and Market Infrastructure (CPMI) for standards

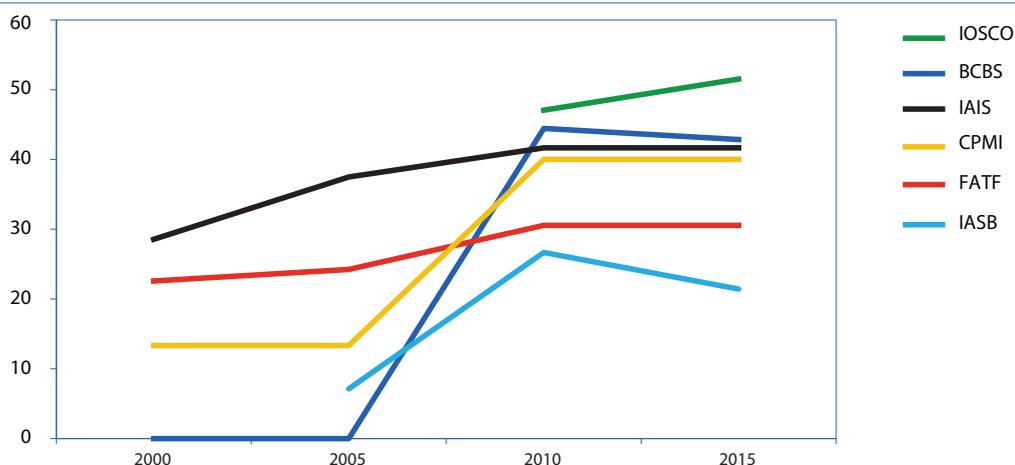
on payment, clearing, settlement systems and related arrangements

- the International Organization of Securities Commissions (IOSCO) for standards on securities regulation
- the Financial Action Task Force (FATF) for standards on combating money laundering and terrorist financing
- the International Accounting Standards Board (IASB) for accounting standards
- the International Association of Insurance Supervisors (IAIS) for standards on insurance industry regulation and supervision

These institutions were generally set up by developed countries. As shown in figure 3, following the 2008 world financial and economic crisis, a number of SSBs implemented governance reforms to give developing countries greater voice, although they lack a process for regular governance reviews. Other standard-setting bodies are developing ways for developing countries to have more input into, but not necessarily a vote on, norm setting and/or implementation discussions. This is often accomplished through regional consultative committees.

Figure 3

Share of countries in developing regions in the governance of international regulatory standard-setting bodies, 2000–2015 (Percentage)



Source: UN/DESA.

¹¹ There is no established convention for the designation of “developed” and “developing” countries or areas in the United Nations system. In common practice, Japan in Asia, Canada and the United States in northern America, Australia and New Zealand in Oceania, and Europe are considered “developed” regions or areas. Until a definition of developing countries is agreed, data under this SDG indicator provisionally aggregates all countries located in “developing regions” according to the M49 statistical standard for the purposes of monitoring the voting share of “developing countries”.