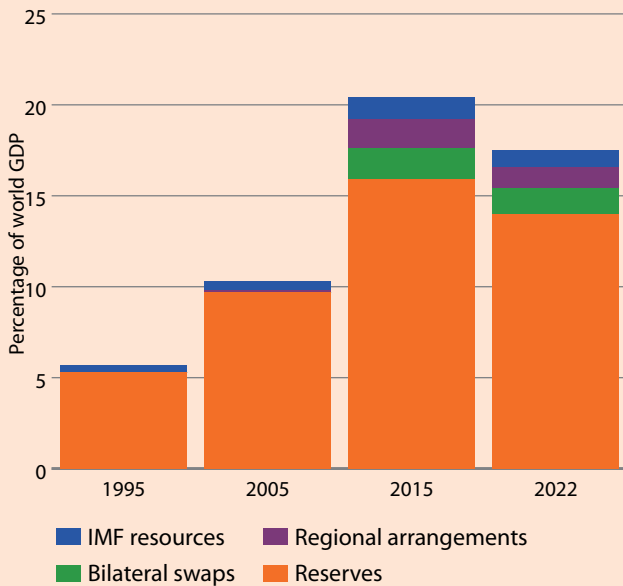


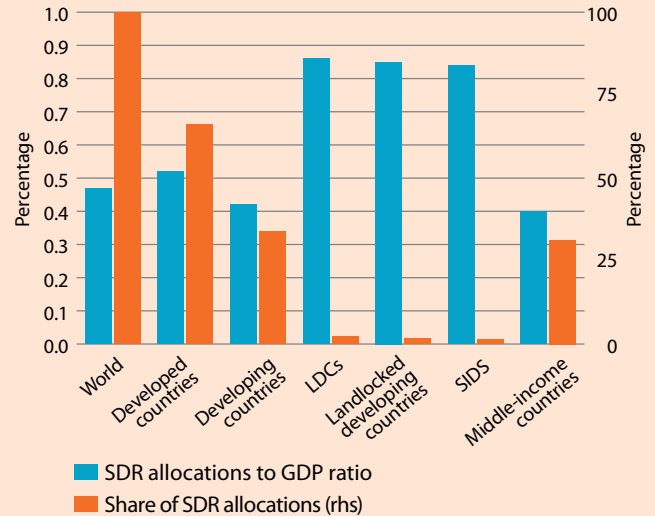


Addressing systemic issues *in numbers*

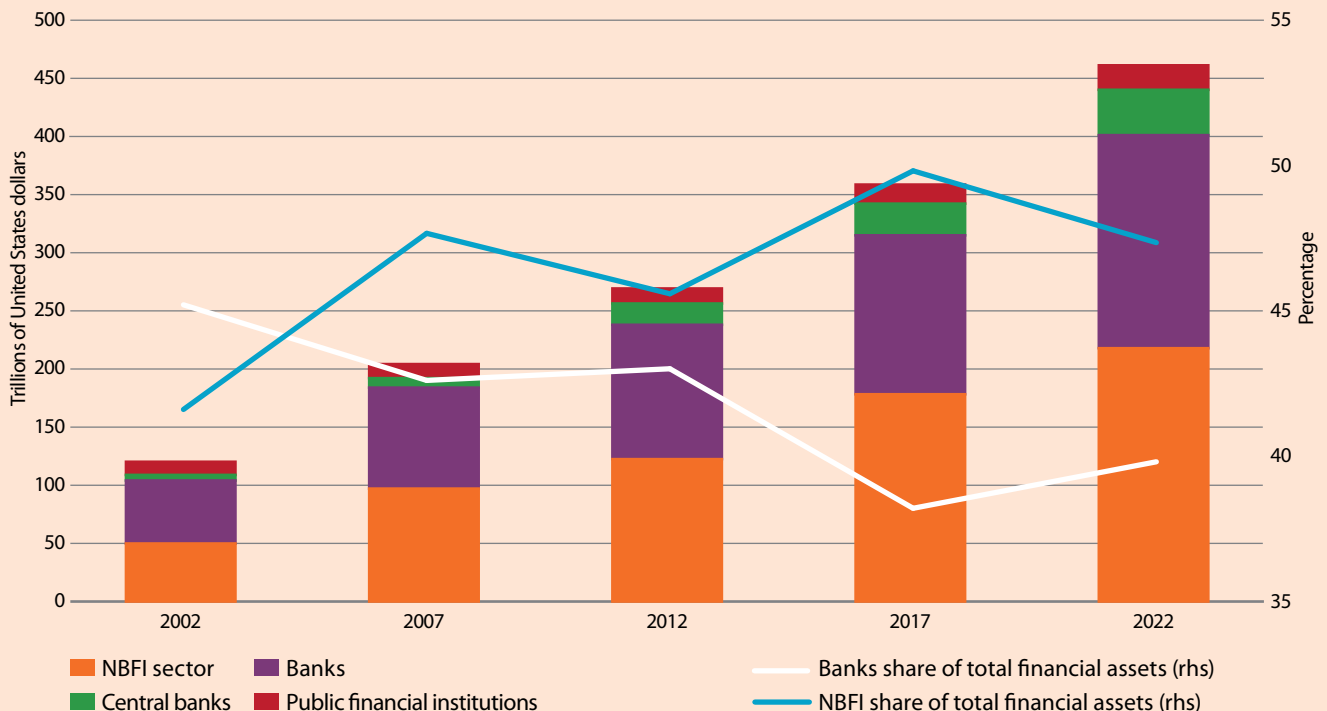
The global financial safety net has grown to over 17.6% of world GDP, but recent crises have revealed gaps in the architecture and uneven coverage



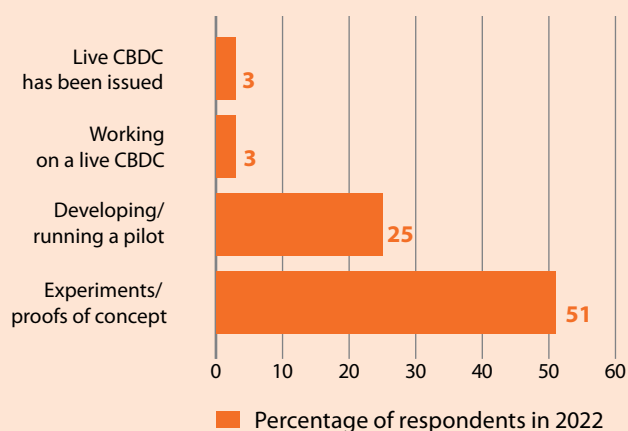
Developing countries received around one-third of the \$650 billion 2021 allocation of special drawing rights, which represented 0.42 per cent of their GDP.



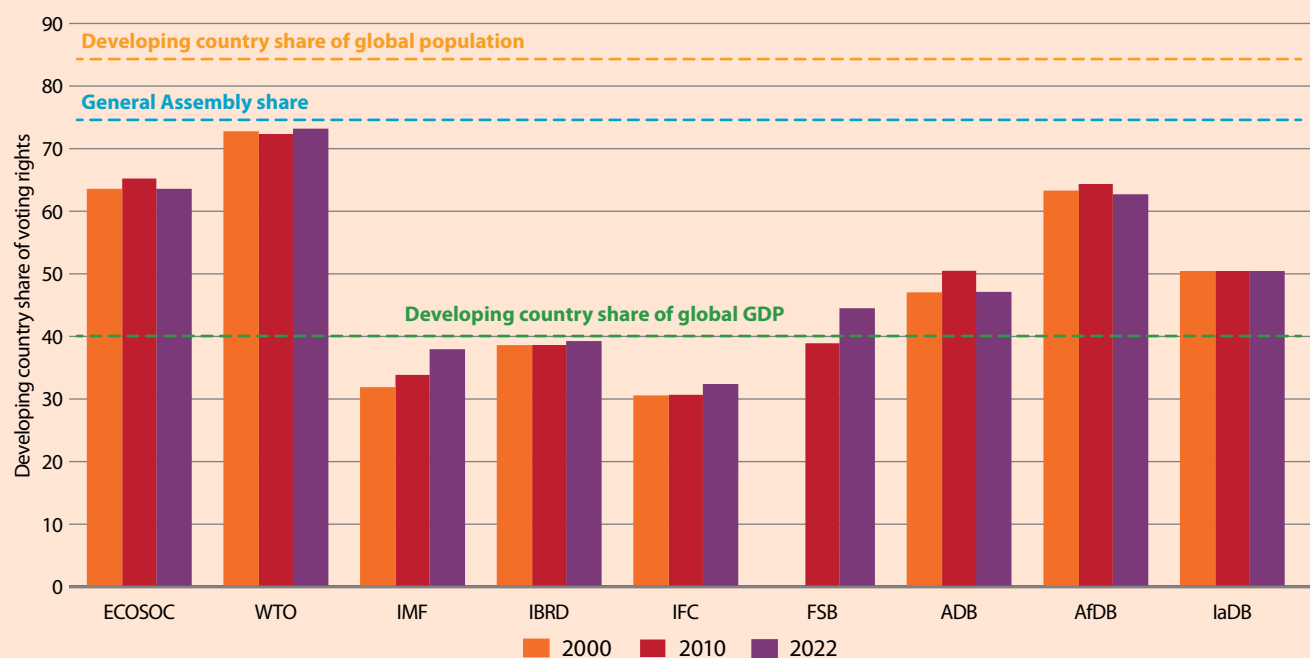
Non-bank financial intermediation, also known as shadow banking, has grown to almost \$218 trillion, almost half of global financial assets.



93 per cent of central banks were engaged in some form of central bank digital currencies work, and almost a quarter of central banks are piloting a retail CBDC.



Developing countries' representation has not significantly changed in many international financial institutions, regional development banks and standard-setting bodies.





Chapter III.F



Addressing systemic issues

1. Key messages and recommendations

There is universal recognition of the need to better align global financial and monetary systems with the Sustainable Development Goals (SDGs). The need for reform of the international financial architecture and strengthening the coherence and consistency of institutions and platforms is now universally recognized, with Member States endorsing such calls for reform in various forums, not least the financing for development outcomes. Some have used the term “non-system” to describe the various international financial and monetary frameworks, rules, institutions and markets that have evolved since 1945, often in an uncoordinated and ad hoc fashion, with different phases of economic globalization. The lack of coherence and coordination has often resulted in disjointed responses to economic, financial and other crises. Such shortcomings have become more acute with the increase in non-economic risks, foremost those of climate change, which is increasingly impacting economic and financial stability. The Addis Ababa Action Agenda is the first financing for development outcome to recognize the need to enhance policy coherence across all three dimensions of sustainable development and to thus take into account challenges such as climate change, pollution and the loss of biodiversity.

The financial volatility that has characterized the current global financial system has undermined efforts to achieve the SDGs; efforts to set up the structures that can deliver the necessary financing and stability have thus far fallen short. Since the end of the Bretton Woods exchange rate system in the 1970s, the global economy has seen growth in the size of the financial sector, progressively deeper integration of global financial markets, rapid technological change that has allowed more interlinkages, increasingly complex financial instruments and intermediaries and with that, growing

systemic risks. The Bretton Woods system included mechanisms that sought to moderate the accumulation of financial and trade imbalances through exchange rate adjustment; since the 1980s, countries have at times developed large surpluses or deficits. The strength of regulatory frameworks for banks has oscillated over the decades, but a growing share of financial activity has moved to unregulated or lightly regulated markets and instruments which are more likely to generate volatility. The world has experienced recurrent financial crises, with increasing cross-border transmission of instability, generating strong impacts on developing countries and the poorest people who tend to be deeply affected by the associated economic disruptions.

Global financial stability is especially sensitive to policies and developments in a few systemically important markets and instruments, with spillovers to developing countries. As noted in chapter II, monetary and financial policies in major developed countries have significant spillover effects on developing countries. This was borne out in the 2008 world financial and economic crisis, ripple effects from market instability at the onset of the COVID-19 pandemic, and strong impacts from monetary policy decisions in developed countries, especially in 2022. In the current environment of relatively high interest rates, stretched asset valuations and greater economic uncertainty, the risks of abrupt movements and higher volatility of asset prices are elevated. Continued geopolitical tensions also raise the risk of further volatility in commodities prices. Overall, over the course of the last two decades systemic risks appear to be growing, partly driven by the increase in climate-related risks such as an increase in the severity and frequency of disasters.

The global financial safety net, with the International Monetary Fund (IMF) at its centre, has come

under enormous strain in recent years, revealing both gaps in the architecture and uneven coverage. As countries have moved to liberalize financial flows, capital flow volatility provides a channel to generate or amplify financial and non-financial shocks. The global financial safety net, a multilayered arrangement for responding to crises, has been repeatedly tested, especially by the 2008 world financial and economic crisis and the 2020 COVID-19 pandemic. Those countries that were able to accumulate sufficient reserves, predominantly in United States dollar assets, have used them to cushion volatility, but this has opportunity costs in terms of foregone consumption and investment, which can be large in countries facing pressing investment needs to deliver on the SDGs. Meanwhile, access to other layers of the safety net has been very uneven. Bilateral swap arrangements (BSAs) among developed countries have become the tool of choice for fighting the spread of financial crises, with only a small volume of resources available to most developing countries through multilateral and regional arrangements. Special Drawing Rights (SDRs) were successfully allocated twice in crisis situations in the last 20 years, but a larger role for the SDR in buffering external adjustment or providing a flexible source of finance capacity would require architecture reforms. Sustainable development cannot be achieved without a conducive international institutional environment built on solidarity and multilateralism, including a strong global financial safety net, with the IMF at its centre. The international community could consider how the Fourth International Conference on Financing for Development, to take place in 2025, can help to address these challenges and support further strengthening of the global financial safety net.

Recent bank failures show that financial sector stability remains a challenge despite the progress achieved after the 2008 crisis; at the same time, the tasks of regulators are becoming more complex as they are increasingly called on to incorporate climate change and establish related incentives for investors in their regulatory work. A range of national financial regulations and international standards was updated in the wake of the 2008 world financial and economic crisis, but implementation is uneven globally, and certain risks remain outside the regulatory perimeter or scope of regulation. There are also industry pressures to roll back the implementation of stricter banking standards. Meanwhile, some types of non-bank financial institutions are not subject to the same level of prudential requirements as banks. New digital financial instruments, including cryptoassets, present new risks. In addition, financial regulatory norms are only gradually—and not yet sufficiently—addressing climate-related risks. Regulators, supervisors and financial institutions alike face challenges quantifying the forward-looking nature of climate-related risks given the long time horizons and high uncertainties of their manifestation. Market actors with short-term horizons can underestimate the systemic risks of climate change in their business-related and risk management decisions. Addressing the externalities of financial sector credit allocation decisions requires public policy instruments to set appropriate incentives for stability and sustainability. A refocusing of financial sector policies on climate impact would facilitate progress in mobilizing private capital for climate and could take account of the specific challenges faced by developing countries. The Fourth International Conference on Financing for Development could bring together relevant stakeholders, including regulators, governments, international organizations, financial institutions and other private sector actors and civil society, to create financial markets that are accessible, stable and sustainable.

While digitalization has reshaped finance and introduced new risks, it also provides opportunities to enhance the efficiency of outmoded financial infrastructure, such as the payments system.

The rise of digital payments and recent experimentation with central bank digital currencies (CBDCs) could further reshape the plumbing of all economic transactions. The Fourth International Conference on Financing for Development could explore how these changes impact sustainable development, support knowledge-sharing and address questions regarding the interoperability of payment systems to increase the speed and reduce the cost of cross-border transactions for developing countries.

Despite repeated commitments to increase the voice and representation of developing countries in global economic governance, and some progress being made in this area, significant reforms to institutional arrangements proved hard to achieve since the Monterrey Consensus. The governance of international financial institutions reflects decisions taken almost 80 years ago at a United Nations conference with only 44 delegations present. Since then, colonialism has ended and newly independent nations emerged. The expansion of the membership of the international financial institutions significantly diluted the voting shares of some of their original members. Nevertheless, global economic governance has not kept pace with ongoing changes, including the rise of the global South and other economic and geopolitical changes, and is not aligned with today's global economy. All international conferences on financing for development have included commitments to governance reform. Some improvements to increase developing country voice and representation were made between 2005 and 2015, but the pace and scale of change have left many countries dissatisfied. The Fourth International Conference on Financing for Development, taking place in a context of widespread recognition of the need to strengthen the legitimacy of global governance arrangements, presents an opportunity to address these shortcomings.

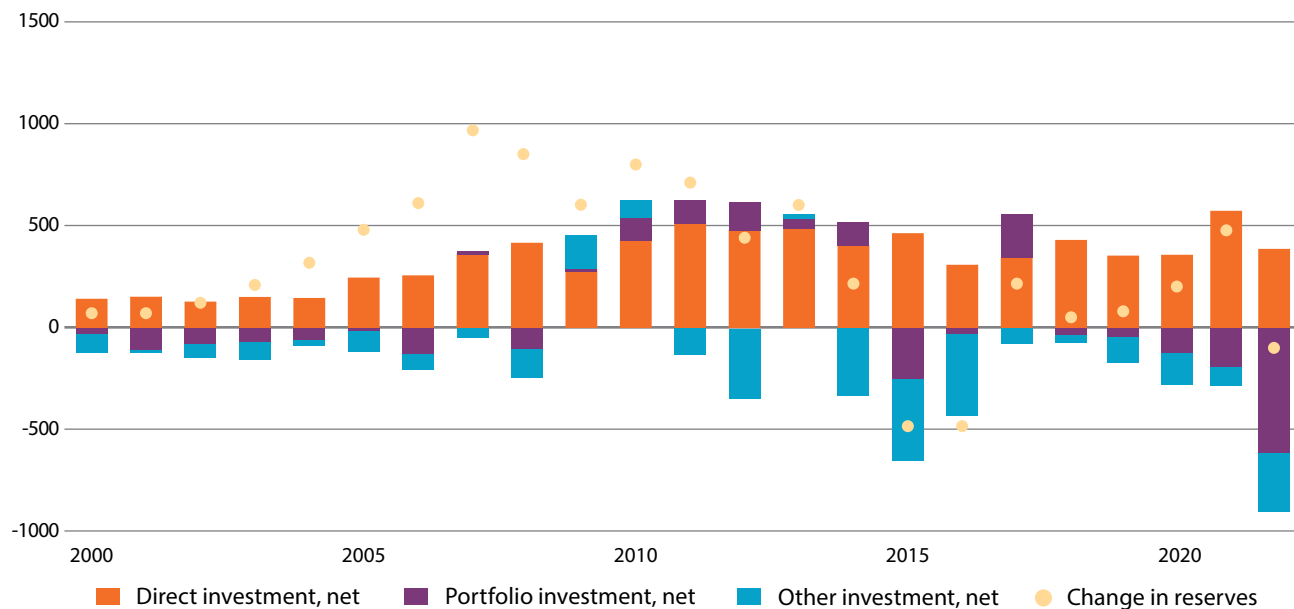
The rest of this chapter first gives an overview of the global financial safety net in the past two decades, followed by a section on financial market regulation and supervision. It then has a discussion on the development of the payments system and market infrastructure. The chapter concludes by discussing reforms to global governance and efforts to enhance policy coherence.

2. The global financial safety net

2.1 Trends in capital flows and capital account management

Push factors beyond the control of recipient countries, such as global risk aversion and global interest rates, are among the main drivers of international capital flows. The increase in the magnitude and volatility of capital flows can have adverse impacts on countries' exchange rate and financial stability, as well as affect access to long-term finance and debt sustainability—for example, when sudden stops impede the refinancing of foreign currency debt. In net terms for all developing countries, portfolio capital flows and other investment flows have seen numerous surges and reversals over the last two decades (figure III.F.1). In general terms, periods of very low interest rates in developed

Figure III.F.1

Net financial flows to developing countries, 2000-2022*(Billions of United States dollars)***Source:** UN DESA calculations based on IMF data.**Notes:** Positive values reflect a financial inflow.

markets from 2008 to 2022 tended to see investors in those markets search for yield in developing countries. In periods of instability or high interest rates, there is a flight to safety, with assets placed in developed markets. The annualized aggregate figures conceal some of the sudden surges, reversals and stops in short-term capital flows, which can manifest over periods of hours or days, and risk instigating financial crises. Capital flows also increased between developing countries, as they developed larger financial sectors.

Policymakers in recipient countries should be able to draw on a full range of policy tools to effectively address how capital flow volatility impacts their domestic economy and financial systems. Tools to counter the volatility of capital flows include monetary and fiscal policies; exchange rate policies, including foreign exchange intervention; macroprudential measures; and capital flow management (CFM) measures. Views on the appropriateness of these macroeconomic tools have varied over time. The IMF articles of agreement include clear recognition of the right to use capital controls, in keeping with the design of the Bretton Woods exchange rate system. In the latter half of the 1990s, the IMF considered, but did not adopt, a proposal to include promotion of capital account liberalization as a mandate of the IMF.¹ In the wake of the 2008 world financial and economic crisis, the risks from large and volatile flows prompted the IMF board to conduct extensive discussions on the policy towards capital flow liberalization and management before establishing an institutional view in 2012 which recognizes that CFM measures can be useful in certain circumstances but should not substitute for warranted macroeconomic adjustment.² In the Addis Agenda, Member States agreed that when dealing with risks from large and volatile capital flows, necessary macroeconomic policy adjustment could be supported

by macroprudential and, as appropriate, CFM measures. In its 2022 review of the institutional view, the IMF recognized a potential role for measures that combine elements of both CFM and macroprudential measures to reduce the volatility of capital inflows and to limit the build-up of financial vulnerabilities. As a result, the new IMF guidance sees a role for pre-emptive measures not only when capital inflows surge but also at other times to reduce systemic risks.³ Given the difficult trade-offs faced by policymakers in dealing with volatile capital flows, which under certain conditions warrant the use of multiple tools, the IMF's Integrated Policy Framework can provide guidance on the policy mix.⁴

2.2 Components of the global financial safety net

The global financial safety net is a set of institutions and mechanisms that aims to provide financial protection against crises and help to mitigate their impact. The safety net seeks to provide countries with insurance against crises, short-term liquidity finance when shocks hit, and incentives for sound macroeconomic policies, thus helping to avoid spillovers and alleviate moral hazard concerns. The stability of the world economy can be considered a global public good as it can help to protect vulnerable countries against shocks. The global financial safety net has four main layers of resources: countries' own international reserves; BSAs among central banks to exchange currencies; regional financing arrangements (RFAs), through which countries pool resources to increase financing in a crisis; and the IMF. Multilateral development banks and official bilateral creditors are usually not considered as part of the safety net as they mainly provide long-term financing for development needs, but their financing can be provided countercyclically to help countries close financing gaps during crises.

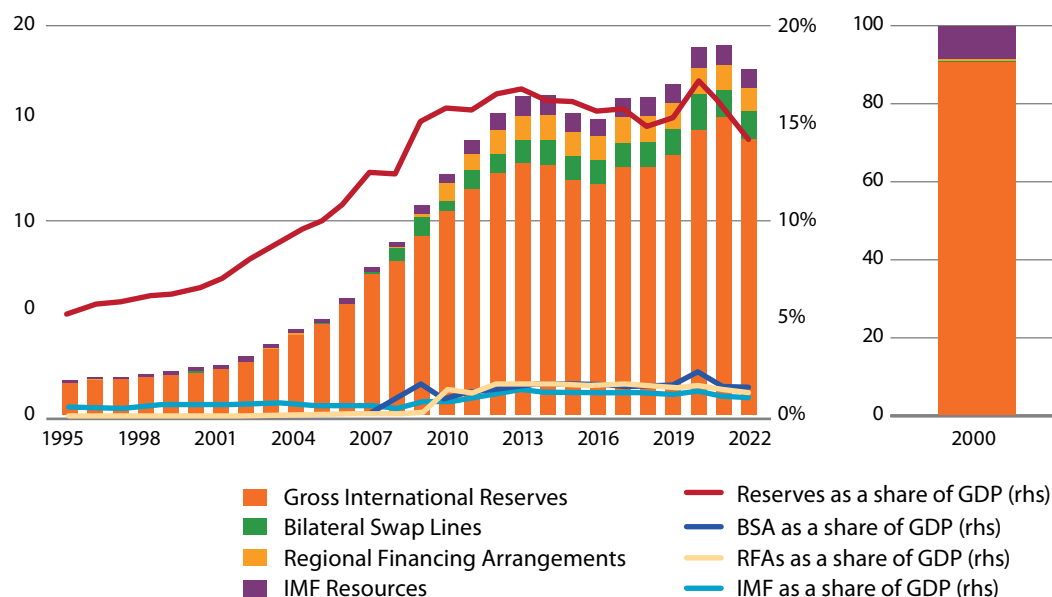
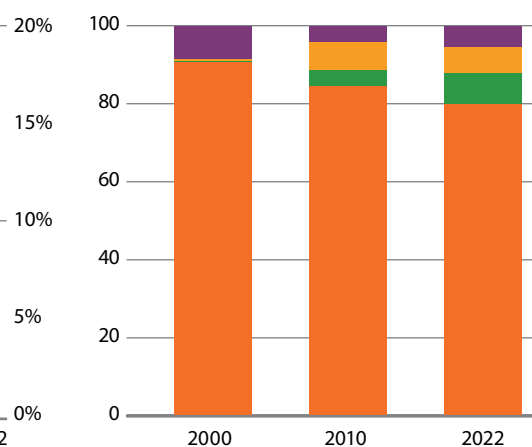
The global financial safety net has become more multilayered over the past two decades. Since 2000, the total stock of international reserve holdings has increased more than six times, reaching US\$14 trillion at end-2022, while the size of external resources available through other safety net layers grew nearly 16 times, to around \$3.5 trillion (figure III.F.2). Already in the Monterrey Consensus, Member States had underlined the need to enhance the stabilizing role of regional and subregional reserve funds, swap arrangements and similar mechanisms. This was accomplished with the introduction of BSAs among reserve currency-issuer countries at the onset of the 2008 world financial and economic crisis, the activation of limited BSAs with other countries during global crisis episodes, and the large scaling-up of the lending capacity of the IMF and RFAs during the world financial and the European debt crises (e.g. Bank of England, 2016). The expansion of Chinese BSAs since 2009 was another notable development.

Global financial safety net coverage has remained uneven, however, with only the IMF providing near universal access to external financing. Bilateral swaps are mainly extended by major central banks to selected countries, while regional arrangements provide liquidity only to their members. Developed countries are best served by the safety net as they can rely on the unlimited BSA network among the reserve currency-issuer countries. Other systemic countries with strong global financial links also have access to BSAs during global crises, although with relatively low limits in some cases. Countries from strongly integrated

regions are covered by RFAs, with the European Union providing the highest coverage, followed by the Eurasian Economic Union and the Chiang Mai Initiative Multilateralization, although the latter has never been activated. Most developing countries, however, rely only on their own reserves and IMF resources (figure III.F.2).

Countries' gross reserves are by far the largest component of the global financial safety net. The predictability of many safety net resources (in particular RFAs) remains inadequate, while other elements, for example some BSAs, provide only geographically limited and time-bound support, which may not cover all countries nor the full duration of shocks. Many countries would therefore need to use several elements of the safety net to fully cover their financing needs, which could raise coordination issues. These considerations incentivize countries to self-insure by accumulating foreign reserves, although reserve accumulation can be attributed to multiple motives.⁵ The benefits of reserve accumulation in terms of avoided crises should be weighed against the costs.⁶ Regardless of the motives, accumulation of reserves carries quasi-fiscal costs and opportunity costs, which could be in the order of magnitude of 1 per cent of GDP if countries are using their reserves as self-insurance, or lower if they are using them to actively manage capital flow volatility.⁷ However, large reserve accumulations also entail potential systemic costs and can create coordination problems that can generate financial fragility and cross-border transmission channels for instability, undermining the resilience of the international monetary system.⁸ These include potential

Figure III.F.2

Global financial safety net size and composition, 1995–2022**(a) Size of the GFSN and share of global GDP***(Trillions of United States dollars, percent of world gross product)***(b) Shares of the GFSN***(Percentage)***Source:** IMF.

Note: Bilateral swap lines includes permanent-unlimited swap lines (major advanced economy central banks) and limited-amount swap lines. The estimated amount of unlimited swaps is based on known past usage or, if undrawn, on average past maximum drawings of the remaining central bank members in the network. Regional financial arrangements based on explicit lending capacity/limit where available, committed resources, or estimated lending capacity based on country access limits and paid-in capital. IMF resources based on lending capacity, which includes quota and borrowing resources for countries in the Financial Transaction Plan (FTP) after deducting prudential balances.

deflationary impacts if the major reserve issuing country no longer runs deficits, the risk of sudden loss of confidence in the sustainability of the debt of the major reserve issuing country, and possible excessive risk accumulation by financial intermediaries as large reserve accumulations push down yields on the sovereign bonds of the major reserve issuer.⁹

The volume of foreign exchange reserves has risen enormously in the last two decades. Central banks around the world continued to accumulate reserves throughout the period, with an acceleration around the 2008 world financial and economic crisis and the COVID-19 pandemic (figure III.F.1). In total, global reserves increased from around \$2 trillion in 2000 to \$14 trillion in 2022. Over the same period, emerging markets added \$5 trillion to their reserves and low-income economies accumulated more than \$4 trillion.

Reserve coverage varies widely across countries. Advanced economies and large emerging markets hold most international reserves, with a high reserve coverage (figure III.F.3). Low-income countries, mostly in Africa, however, have limited reserve coverage, leaving them vulnerable to external shocks.

Bilateral and regional arrangements

The global network of swap lines expanded dramatically, but unevenly with the 2008 world financial and economic crisis and the COVID-19 pandemic—from six swap lines opened among advanced economy central banks in the early 2000s to more than 180 lines by 2021. It appears that scaled-up and reactivated swap arrangements helped to cushion the pandemic shock.¹⁰ In particular, the increased number of BSAs, primarily United States Federal Reserve swaps, provided prompt liquidity support, helping to stabilize the global financial markets and capital flows to emerging and developing economies. With some temporary pandemic-related lines expired, there are currently 160 swap lines in existence, totalling \$1.6 trillion.¹¹ The Inter-agency Task Force mapped out the swap lines in its *2023 Financing for Sustainable Development Report*, showing that very few developing countries have access to these facilities.¹²

RFAs have so far played a more limited role in the global financial safety net. Emerging and developing economies have access to five RFAs¹³ with a combined lending power of \$360 billion in 2022, only a fraction of the bilateral currency swaps. Some of these facilities have explicit requirements for the existence of an IMF programme in order to access larger volumes of liquidity. The use of these arrangements has been marginal, in part because during the COVID-19 pandemic, demand for RFA financing was contained thanks to supportive macroeconomic policies in advanced economies and timely financing from other safety net layers. European Union RFAs were untapped as European Union countries benefited from European Central Bank (ECB) swap/repo lines and United States Federal Reserve swaps, the ECB quantitative easing and ample European Union support through other channels. Some of the larger RFAs, notably the Chiang Mai Initiative Multilateralization and the Contingent Reserve Arrangement of the New Development Bank, remain untested and untapped.¹⁴

Multilateral mechanisms

The IMF is designed to be at the centre of the global financial safety net, and its lending volumes have grown significantly.

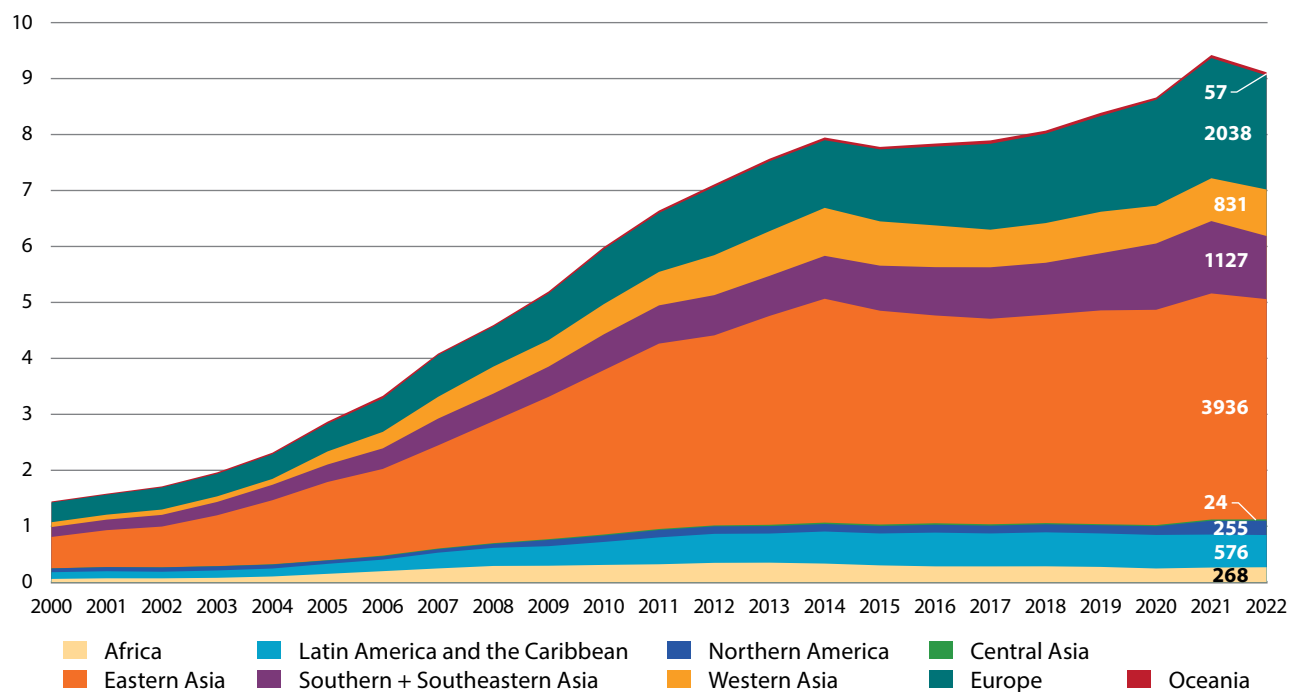
Unlike other layers of the safety net with uneven coverage, the IMF has a near-universal membership. The IMF works to prevent and address country-specific, regional and global crises through surveillance, lending and capacity development. Its unique quota-based financing model allows it to pool a portion of its members' reserves efficiently and at very low cost, with transparent burden sharing. It has also played a catalytic role in unlocking additional resources and better financing conditions for countries seeking financial assistance. While IMF lending was low in the early years of the new millennium, demand for IMF loans significantly increased in the wake of the 2008 world financial and economic crisis, both in terms of the volume and number of loans (figure III.F.4). Since then, it has approved an annual average of 17 new IMF-supported programmes, half of which focus on providing concessional financing to developing economies. In addition, through the Rapid Financing Instrument and Rapid Credit Facility disbursed emergency assistance, the IMF has lent to 97 countries (including 70 low-income countries) since the pandemic, bringing total disbursements since 2020 alone to around \$270 billion. The increase in lending and the large size of some programmes has led to an increase in the number of countries paying IMF surcharges, which apply only to high and prolonged borrowing of non-concessional resources and which are designed to discourage large and prolonged use of IMF resources.

The IMF has several lending windows that have evolved over the years to strengthen the global financial safety net in the face of more prevalent, protracted and diverse external shocks. The IMF provides crisis response, emergency, concessional and precautionary lending instruments, with lending facility design repeatedly evolving in the last two decades as the institution sought to learn lessons from shocks and quickly provide liquidity to all countries. Following the 2008 world financial and economic crisis, the IMF strengthened its lending toolkit by reforming its non-concessional lending to enhance crisis-prevention tools. The Flexible Credit Line, Precautionary and Liquidity Line and Rapid Financing Instrument were added as new lending instruments to the traditional Standby Arrangement and Extended Fund Facility, aiming to bolster confidence and reduce balance-of-payments pressures during periods of heightened systemic risk. In April 2020, the IMF further expanded its non-concessional lending toolkit by establishing a new Short-Term Liquidity Line for countries with very strong policies and fundamentals. These precautionary instruments have been effective in providing insurance against external risks.¹⁵ In September 2022, the IMF established a temporary Food Shock Window in its emergency financing instruments to support countries facing urgent balance-of-payment needs related to the global food crisis.¹⁶

The recently concluded 16th General Review of Quotas will boost IMF permanent resources without changing its overall resource base. In December 2023, the IMF Board of Governors approved the 16th General Review of Quotas which will boost IMF members' quotas by 50 per cent. Once implemented, this will bring the IMF's total quotas, which are permanent resources, to 715.7 billion SDRs (\$960 billion). It will maintain the current lending capacity of the IMF through a combination of the approved quota increase and a reduction in resources borrowed bilaterally from member countries. To be implemented, member countries holding 85 per cent of IMF voting rights must now consent to their respective quota increases, which in many cases involves legislative approval.

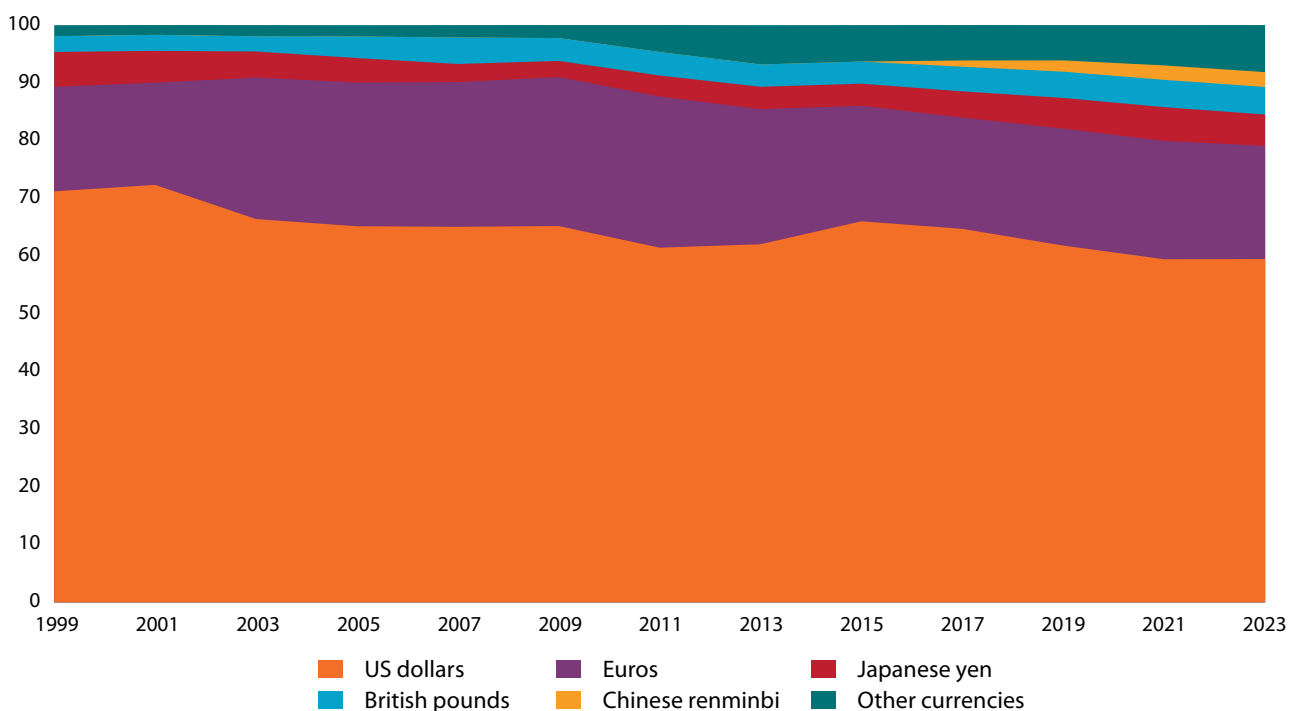
Figure III.F.3
International reserves, 2000-2022

(a) Value of reserves
(Billions of SDRs)



Source: UN DESA calculations based on IMF data.

(b) Currency composition of reserves
(Percentage)



Source: IMF.

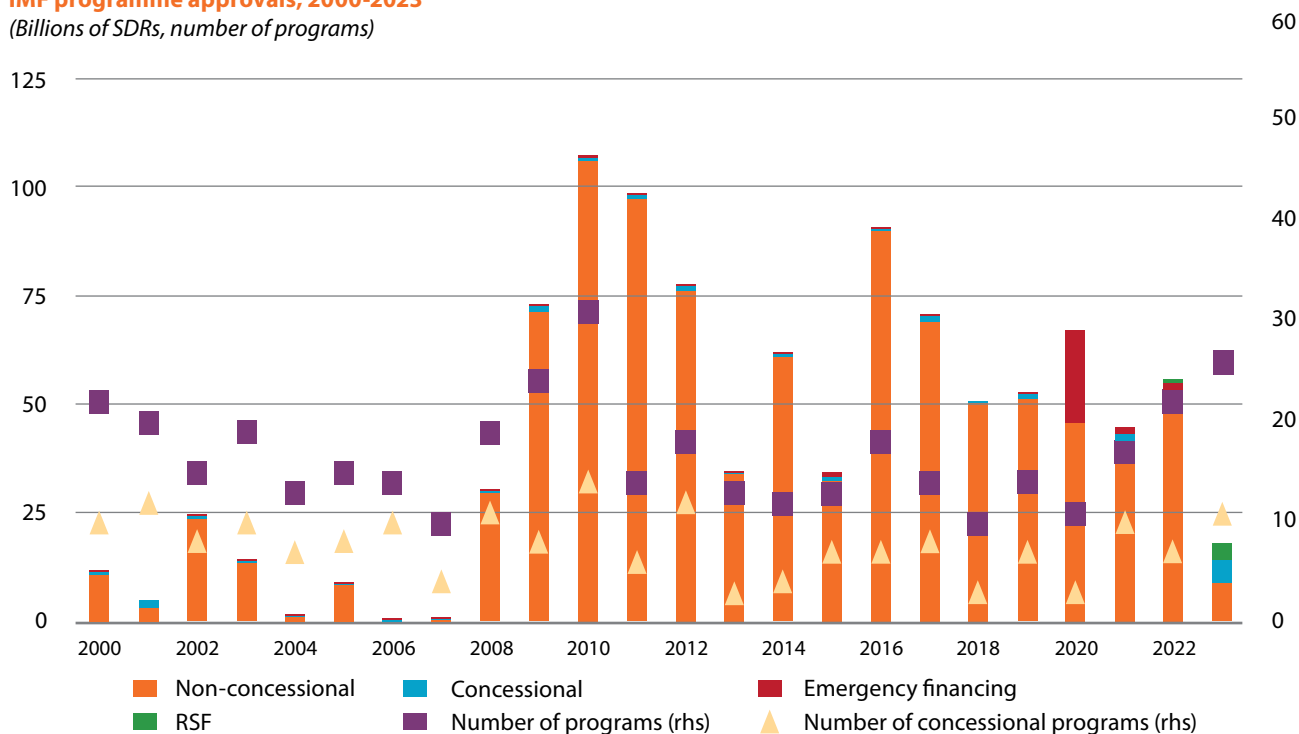
IMF concessional and development-oriented lending has been reformed and expanded. The IMF Poverty Reduction and Growth Trust (PRGT) provides concessional lending to lower-income countries, many of which are affected by fragility and conflict. More recently, the new Catastrophe Containment and Relief Trust (CCRT) was established to help the poorest and most vulnerable countries hit by catastrophic natural disasters or by epidemics with potential international spillovers. Two new concessional facilities have been established—the Standby Credit Facility for short-term balance-of-payments needs, and the Rapid Credit Facility to provide low-access financing for urgent balance-of-payments needs—while protracted balance-of-payments needs continued to be addressed through the Extended Credit Facility. In the period from the pandemic until January 2024, the IMF approved around \$44.2 billion for 57 PRGT-eligible countries in PRGT and General Resources Account financing. Overall, the IMF has quintupled its interest-free lending to low-income countries through the PRGT, compared to pre-pandemic annual levels. Around \$50 billion has been disbursed through emergency financing (Rapid Credit Facility/Rapid Financing Instrument and augmentations under existing arrangements) to 81 countries. The Resilience and Sustainability Trust (RST), created in 2022 and funded in part by the SDRs of G20 countries, provides longer-term lending through an associated facility for low-income and vulnerable middle-income countries. This instrument focuses on helping countries to build resilience to external shocks and promote sustainable growth. It supports policy reforms that aim to reduce macroeconomic risks arising from longer-term structural challenges, including climate change

and pandemic preparedness. Around three quarters of IMF member countries are eligible for RST support, including all small island developing States (SIDS).¹⁷

Implications for the international monetary system

The end of the Bretton Woods exchange rate system in the 1970s heralded a more uncoordinated international monetary system, although the United States dollar remains at its centre. Before the 1970s, all IMF members managed their exchange rates, but now countries are free to choose their exchange rate regimes—fixed exchange rates, a free-floating currency or a managed float.¹⁸ As noted above, larger and more volatile cross-border capital flows have led countries to accumulate significant foreign exchange reserves to protect themselves from external shocks. Most of these reserves are kept in dollar-denominated assets (figure III.F.3 panel b). There are multiple motivations for this, such as that international trade, including important commodities, is frequently priced and settled in dollars, and United States financial markets are the biggest and most liquid in the world. However, there have been slow shifts away from the dollar for a mixture of practical, idiosyncratic and geopolitical reasons. SDRs, an international reserve asset created by the IMF in 1969 to supplement its member countries’ official reserves, have not taken on this role even though they were created with “the objective of making the special drawing right the principal reserve asset in the international monetary system”.¹⁹

Figure III.F.4
IMF programme approvals, 2000-2023
(Billions of SDRs, number of programs)



Source: IMF.
Notes: Based on total approved amounts per arrangements. Concessional programs also include blended arrangements. The numbers of programs approved do not include emerging financing. Resilience and Sustainability Facility (RSF) is funded by resources in the RST.

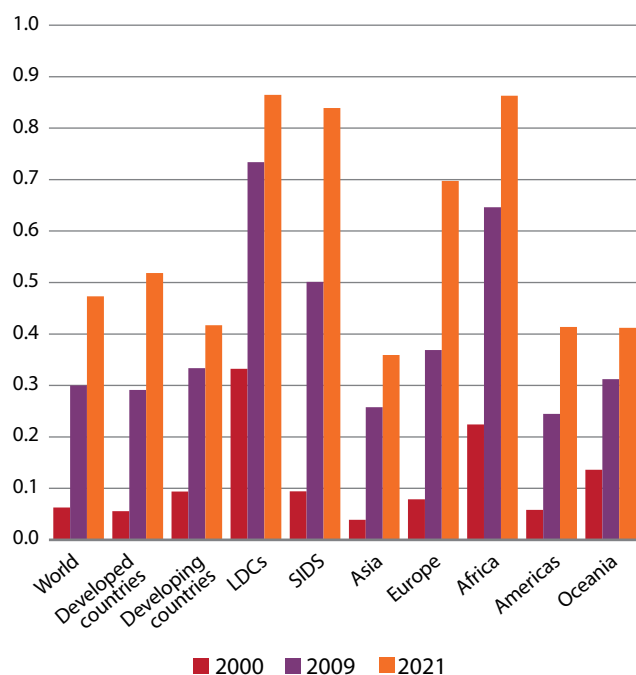
SDR allocations have boosted the supply of global reserves at times of financial and economic system stress. SDR allocations make new SDRs available to countries without creating additional debt, allowing them to increase their international reserves or cover spending needs. Two allocations have been implemented since 2000, the first during the 2008 world financial and economic crisis (around \$250 billion) and the second during the COVID-19 pandemic in August 2021 (around \$650 billion). These allocations provided IMF members with a critical financing source, injecting much-needed reserves and liquidity during a period of exceptionally high uncertainty, helping to bridge some of the gaps in the global financial safety net. To date, a total of 660.7 billion SDRs (equivalent to around \$943 billion) have been allocated. The quota-based allocation of SDRs, in proportion to countries' quota shares at the IMF, means that developing countries received around one third of the allocations, which represented a large share of their international reserves (figure III.F.5). Countries in special situations and, to a lesser extent, middle-income countries, are the main users of SDRs, for whom they alleviate external and fiscal financing constraints at times of urgent financing needs, while developed countries tend to hold them as part of central bank reserves (figure III.F.6). A review found that the 2021 allocation of SDRs was beneficial for the global

economy as it helped to meet the long-term global need for reserves and supported confidence by reducing sovereign risk premia.²⁰

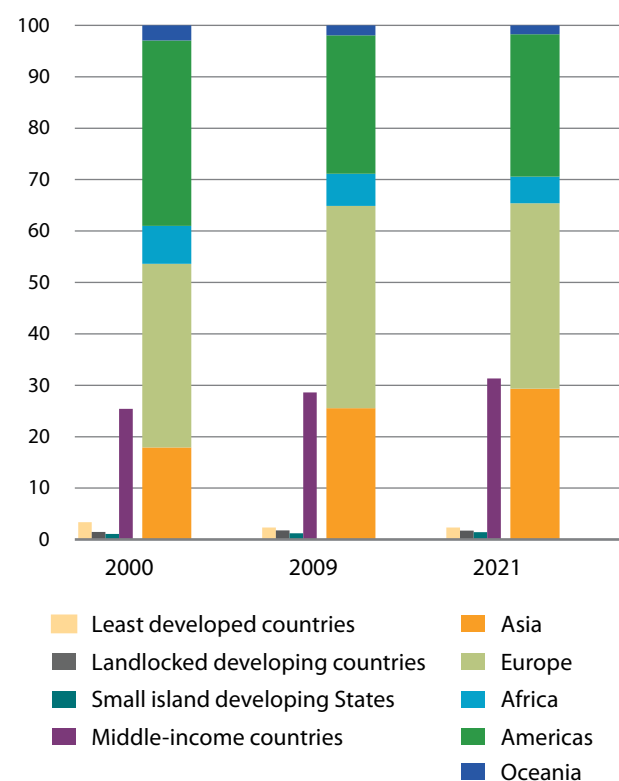
There are many ideas on how to better use SDRs as a development tool, but some of them would require changes to the structure of the international monetary and financial architecture. While SDRs have not yet become the principal reserve asset, there have been periodic efforts over the last two decades to consider how to strengthen their role. The most recent comprehensive discussion on this topic at the IMF executive board was held in 2016.²¹ In the wake of the 2021 allocation of SDRs, some IMF members with sufficient reserves and strong external positions agreed to the voluntary rechanneling of SDRs to countries that need them. Over \$100 billion has been pledged mainly to the IMF's PRGT and RST. Given that many of the SDRs on central bank balance sheets in developed countries are unused, there have been calls for more rechanneling, including to multilateral development banks (see chapter III.C). A larger role for the SDR in buffering external adjustment or providing a flexible source of finance to bolster IMF lending capacity would require revisions to the IMF Articles of Agreement, although the IMF executive board could on its own agree to triggers that automatically generate a recommendation for SDR issuance, or to standing arrangements to rechannel SDRs on issuance.²²

Figure III.F.5
SDR allocation, by country group and region, 2000–2023

(a) SDR allocations as a share of GDP
(Percentage of GDP)



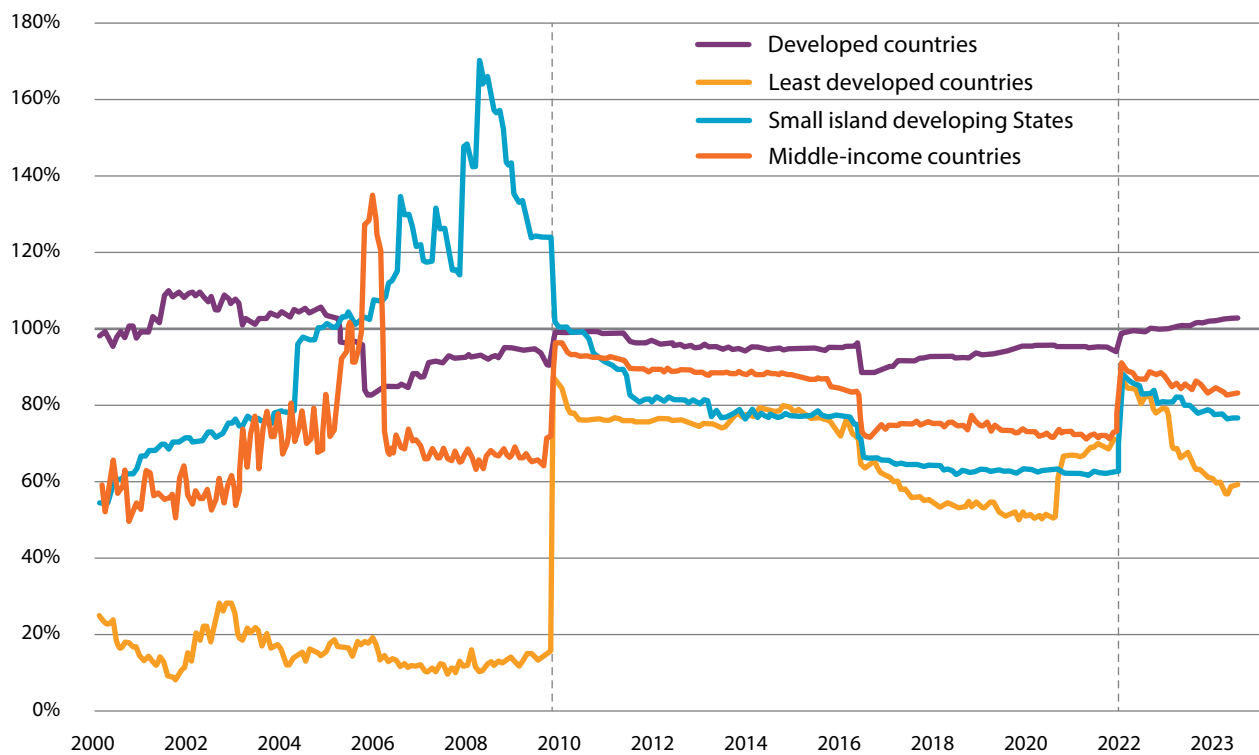
(b) SDR allocations as a share of total
(Percentage of SDRs allocated)



Source: UN DESA calculations based on IMF data.

Note: Regional groupings based on M49. 2000 reflects existing SDR allocations at the end of the year, 2009 and 2021 reflect the shares of new SDRs allocated that year.

Figure III.F.6
Holdings of SDRs as a share of total SDR allocation, 2000-2023
 (Percentage)



Source: UN DESA calculations based on IMF data.

Note: SDR holdings by country groups as a percentage of their group's SDR allocation. Below 100 per cent indicates net use of SDR allocation, i.e., SDR holdings were exchanged for other currencies. Dashed vertical lines indicate 2009 and 2021 general SDR allocations.

3. Financial market regulation and supervision for sustainable development

3.1 Banking regulation and supervision since 2000

Banking regulation has been evolving in response to repeated instances of financial instability and the increasing complexity of the financial system. The first international standards for banking regulation were agreed in 1988 in the Basel Accord through the Basel Committee on Banking Supervision (BCBS) and have since become known as Basel I.²³ The Monterrey Consensus did not explicitly reference the Basel Accord but did call for developing country participation in the formulation of financial standards and codes and their implementation on a voluntary basis. Reforms to the international framework were agreed first in 1996 with the market risk amendment, and then in 2004 with the Basel II agreement that introduced risk-sensitive approaches, including allowing banks to use complex proprietary risk-weighting systems. While members of the BCBS were obligated to implement the reforms, other countries used them on a voluntary basis, with only selective implementation in developing countries as a result of the complexity and lack of applicability

to many developing country contexts.²⁴ In the Doha Declaration, which was agreed in the midst of the 2008 world financial and economic crisis, Member States agreed to implement reforms to strengthen the regulatory and supervisory frameworks of financial markets, as needed. In the wake of the financial crisis, a set of reforms that covered banks' capital, leverage and liquidity, named Basel III, were issued between 2010 and 2019. All G20 countries became BCBS members and were thus obligated to implement these rules. The Addis Agenda in 2015 included agreement to hasten completion of the reform agenda on financial market regulation, and further amendments to Basel III were completed in 2018.

The Basel reforms have focused on international standards for banking supervision and the capital adequacy of banks, but have less coverage of other types of risks. A number of high-profile bank failures in the 1970s and 1980s related to fraud, illiquidity and currency risk demonstrated the importance of banking supervision.²⁵ International principles for supervision were first agreed in the early 1980s and consolidated into the Basel Core Principles of Effective Banking Supervision in 1997.²⁶ The original Basel I agreement standardized the capital adequacy rules for banks internationally for the first time, setting a baseline for how banks should address credit risk. However, the framework did not directly address operational risk, interest rate risk, securities investment risk, or liquidity risk. Basel II addressed criticisms of lack of risk sensitivity on credit risk, enabling both more and less complex approaches, and included

operational risk for the first time. Focusing on common equity, Basel III sought to enhance the permanence and loss absorbency of banks' capital, while also introducing additional ratios (such as the leverage ratio, liquidity coverage ratio, and net stable funding ratio) and extra capital buffers for systemically important banks. Globally, banks have been growing with regard to total asset size, but they have grown less than total financial assets, meaning that banks have played a progressively smaller role in global credit allocations (figure III.F.7).

While member jurisdictions continue to make progress in implementing the finalized Basel III reforms, risks are still present in the banking system. The BCBS evaluation of the impact and efficacy of Basel III reforms found that the overall resilience of the banking sector has increased following implementation.²⁷ Notably, this greater resilience did not come at the expense of banks' cost of capital. The report also found no robust evidence that banks with lower initial capital and liquidity ratios had lower loan growth than peers. The Financial Stability Board (FSB) was created in the wake of the 2008 world financial and economic crisis to coordinate implementation of regulatory reforms across banking and other non-bank financial intermediaries (NBFIs). The FSB is responsible for policy measures to address systemically important financial institutions, including the Key Attributes of Effective Resolution Regimes for Financial Institutions. Work is still ongoing to close gaps in the operationalization of resolution plans for banks, which is particularly important to prevent States from stepping in to bail out the largest banks.²⁸ Overall, efforts to tackle the too-big-to-fail problem through increased regulation and supervision of the largest globally systemically important banks have

made progress, but domestic systemically important banks are not evenly covered and information gaps persist.

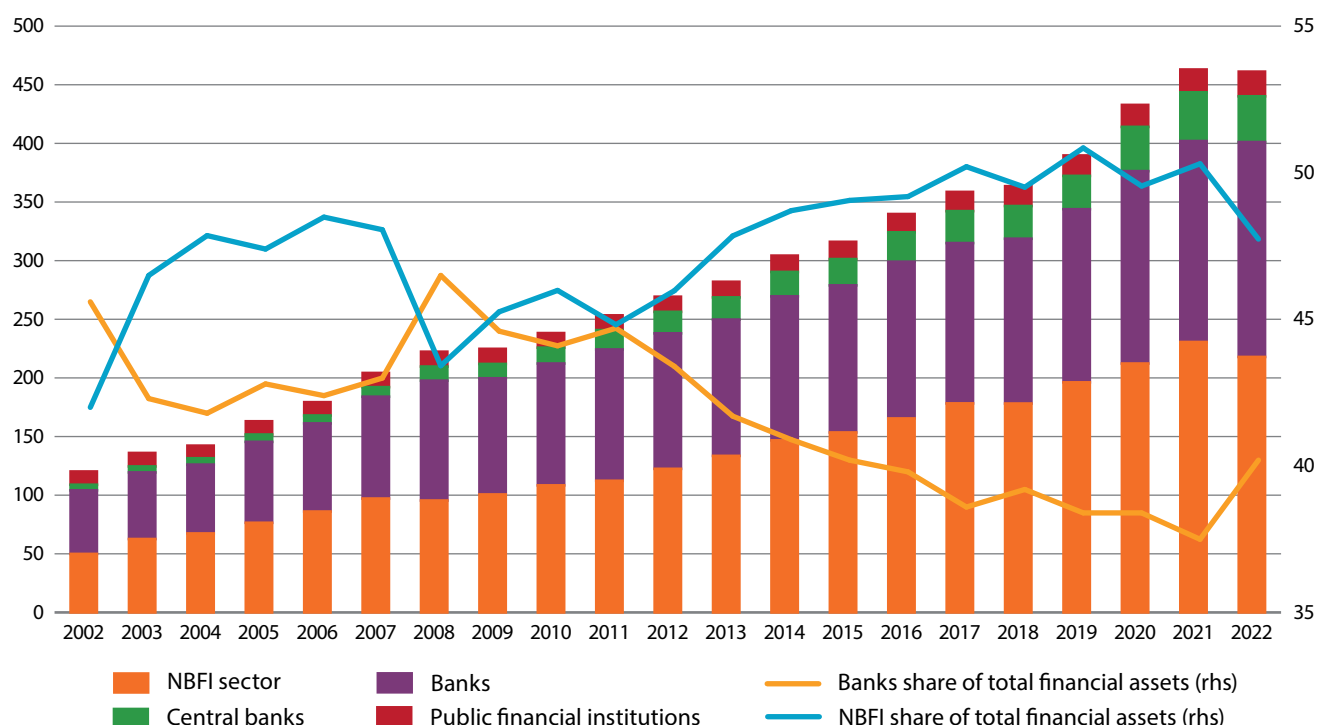
Regulatory fatigue is another challenge, despite recent banking turmoil. In annual monitoring exercises, countries reiterate their expectations of implementing all aspects of the Basel framework in full, consistently and as soon as possible, although implementation in many cases is being pushed to 2024 or later.²⁹ Nonetheless, banks and other industry actors in some jurisdictions are also lobbying against the final implementation of the Basel III reforms, citing potential impacts on credit to households and businesses and potential loss of competitiveness. A string of bank failures and runs in March 2023, including one bank labelled as globally systemically important, resulted in the authorities in two developed jurisdictions using public money to underwrite the banking system. The earlier iteration of the Basel III reforms, which were implemented before the 2023 bank failures, are thought to have helped shield the global banking sector and the real economy from a wider spread of financial instability; at the same time, these crises underlined the importance of effective regulatory implementation and supervision.³⁰ Effective supervision of banks requires political will to give supervisors the ability and resources to act.³¹

3.2 Non-bank financial intermediation

Over the past decade, the global financial system has become increasingly reliant on market-based intermediation. As bank lending declined in the wake of the 2008 world financial and economic crisis, non-bank financial intermediation, also known as shadow banking,

Figure III.F.7

Total global financial assets broken down by type of financial institution, 2002-2022
(Trillions of United States dollars, percentage of assets)



Source: FSB.

has grown to comprise almost half of global financial assets (figure III.F.7), and has become more diverse. As a result, the importance of NBFIs for the financing of the real economy has increased.³² The 2022 decline in the size of the NBF sector (a 5.5 per cent decrease compared to 2021) was the first notable decrease since 2009. It is largely attributed to the impact of higher interest rates leading to valuation losses in mark-to-market asset portfolios, particularly in investment funds;³³ total financial assets held by banks, largely composed of loans less sensitive to interest rate changes, increased by 6.9 per cent over the same period. The recent changes are not expected to alter the long-term shift away from banks and towards NBFIs.

The 2008 world financial and economic crisis, although involving banks, also implicated many types of NBFIs, particularly securitization and derivatives markets, yet implementation of NBF reforms continues at a slow pace and is at an earlier stage than other reforms. In relation to securitization, there has been incremental progress in implementing recommendations on incentive alignment approaches and the BCBS securitization framework. Progress continues at a slow pace on global securities financing data collection and aggregations with limited coverage. Overall, implementation of over-the-counter derivatives reforms is well advanced (particularly in the largest markets) but progress has slowed in recent years. Implementation of reforms to mitigate spillovers between banks and NBFIs is still ongoing. The adoption of recommendations to reduce the run risk of money market funds (MMFs) is most advanced in 19 jurisdictions—unchanged since 2021—with at least 95 per cent of MMF assets covered by regulations in line with global rules.³⁴ However, the main risk to financial stability from certain parts of the NBF sector is illiquidity, and that challenge awaits resolution. Intermediaries such as MMFs and open-ended funds can experience instability in moments of market stress due to liquidity and currency mismatches.³⁵ Reducing excessive spikes in the demand for liquidity and better preparation for margin calls can enhance resilience.

Non-bank financial institutions have also increasingly taken on the provision of credit to developing countries, accentuating procyclicality. NBFIs have played an increasing role in funding developing country external debt (see chapter III.E). Part of this financing has come from investment funds, whose assets more than tripled in the decade after the 2008 world financial and economic crisis. While this development has added to the diversity of funding sources, it has created new challenges for developing countries. Empirical evidence suggests that investment funds—especially those that are either passively managed or follow benchmark indices—may be more susceptible to global financial conditions, accentuating the procyclicality in capital flows.³⁶ Cross-border capital flows from different market actors respond differently to push and pull factors,³⁷ and portfolio debt flows seem to be more volatile.³⁸ Investment funds face investor protection regulations related to fraud and operational risks, but do not face prudential regulations in their home jurisdictions aimed at reducing the volatility of capital flows. Developing countries themselves may want to take macroprudential and other regulatory measures to reduce corporate foreign currency risks and mismatches and deepen the local currency markets and the domestic investor base (see chapter III.B).

Regulatory frameworks need to adapt to new technologies and instruments by ensuring a “same activity, same risk, same rules” approach. In the last two decades there has been enormous financial innovation, with new types of instruments, new markets and new actors

that were often created outside the scope and perimeter of existing regulatory and supervisory frameworks. These are often enabled by new technological developments, and digitalization has opened a new frontier in financial technology (see chapter III.G). While creating new opportunities for efficiency gains and financial inclusion, the large-scale adoption of these technologies also creates new risks, including for financial stability and integrity. One of the key proposals is that authorities should apply effective regulation, supervision and oversight in line with the principle of “same activity, same risk, same regulation”, with financial standards applied based on economic function and risks, rather than on legal form.

3.3 Addressing climate change and the environment in regulation

The escalating climate crisis has led to growing interest in how financial market regulation and supervision can incorporate questions of environmental sustainability. Before the 2015 Paris Agreement on climate change, financial regulators and supervisors paid little attention to environmental issues. Yet accelerating climate change increasingly impacts financial systems, and stakeholders have accepted the need to assess, manage and mitigate the financial vulnerabilities, which are commonly referred to as “climate-related financial risks”.³⁹ These are often characterized as including physical risk (due to both acute and chronic climate-related disasters), transition risk (related to changes in government policies and regulations adopted to combat climate change, technological developments, and changes in consumer preferences and market sentiment), as well as liability risks associated with potential compensation claims from those negatively impacted by climate change. So far the focus of regulators’ work on transitioning to a more sustainable financial system has been on transparency/disclosures, data, vulnerability analysis and developing regulatory approaches and supervisory practices.⁴⁰ The BCBS issued an international standard defining 18 high-level principles for how regulators and supervisors should improve risk management and supervisory practices to address climate-related financial risks.⁴¹ Many businesses are developing transition plans to set out their strategy for addressing climate-related financial risks, which can be an important source of information for financial regulators and supervisors.⁴² Some jurisdictions are planning to mandate the development of transition plans and their use by supervisory authorities. In addition, climate change-related scenario development is a practical tool to help authorities and private sector players assess both the macro-financial risks posed by climate change and the opportunities of timely climate change mitigation.⁴³

Regulatory responses to climate change will not be effective in a vacuum but can contribute to overall climate-related policies and action plans. Fostering financial stability while enabling finance flows aligned with the objectives of the Paris Agreement and the Global Biodiversity Framework are key for a successful transition. The mandate of regulators and prudential supervisors is to promote the safety and soundness of financial institutions and the financial system. The actions of central banks, supervisors and financial institutions can complement and facilitate the implementation of climate policies. However, they are not a substitute for gaps in governments’ climate policies.⁴⁴ For example, the application of different capital risk weightings to banks’ exposure to green and brown assets could create price incentives for banks to shift their exposures, yet it cannot trigger reallocations at the required scale and could

lead to unintended consequences for financial stability. Financial sector policies should be complementary to other tools such as carbon pricing, directed subsidies, or other types of public policy (see chapter III.A).⁴⁵

Regulatory efforts to improve sustainability disclosure can contribute to more effective pricing of climate risks and provide the information needed for regulators and other market actors that have a mandate to ensure climate change mitigation. Efforts since 2015 to improve climate-related disclosures were coordinated out of the voluntary Task Force on Climate-related Financial Disclosures (TCFD), which has now been disbanded, as follow-up efforts are being led by the International Sustainability Standards Board alongside other efforts on sustainability disclosure (see chapter III.B).⁴⁶ Other market actors, including public institutions such as central banks, may want or need reliable and consistent information on both the financial impacts of climate change on financial institutions as well as the impact of the financial sector on the ability of countries to transition to sustainable economies. The BCBS is analysing how a mandatory disclosure framework for climate-related financial risks could enhance financial stability and has issued a consultation document.⁴⁷ However, international standards on environmental disclosures on their own are unlikely to result in real impacts on how the financial sector contributes to climate change, as evidence shows a disconnect between environmental disclosures and lending activities.⁴⁸

4. Payments and market infrastructure

Smoothly functioning payments systems have many positive externalities that can support financing for development, while digitalization may fundamentally alter the international monetary and financial systems. While the previous financing for development outcomes did not directly address payments and market infrastructure, recent developments have shown the importance of these systems to financial stability. Payment and settlement systems were largely left to private banks until the 1980s when an expert committee was formed on payment systems under the auspices of the Bank for International Settlements. More formal coordination was launched in the 1990s, roughly concurrent with the development of international banking standards. However, in recent years, the slow speed and high cost of cross-border payments has become a major issue of concern to developing countries, affecting remittances, trade and other transfers. New digital technologies have opened up the prospect of mediums of exchange and payment systems operating outside of the regulated financial sector, introducing new risks. Digital technologies also provide opportunities to improve the payments system which underpins global financial activity, but design considerations should be cognizant of the needs of developing countries and their place within the international monetary architecture.

4.1 Correspondent banking and cross-border payments

The decline of correspondent banking relationships has been a major concern of developing countries, particularly SIDS. A “correspondent bank” provides local account and payment services for banks based abroad—collectively forming the correspondent banking network

that facilitates cross-border payments. Correspondent banks make their payments by sending SWIFT messages to one another that include instructions to debit or credit their accounts. While none of the financing for development outcomes reference correspondent banking relationships, Member States addressed the issue several times in the intergovernmental follow-up process, as the steep decline in relationships could leave some jurisdictions without any means to receive cross-border payments. Correspondents fell by almost 30 per cent over the last decade, with the decline very unevenly distributed: SIDS, Latin America and the Caribbean and Southern Africa experienced the steepest declines.⁴⁹ The perceived costs of implementing know-your-customer rules mandated by regulators, the development of alternative remittance channels, and the high costs of maintaining channels with low transaction volume all contributed to the decline.

As a result, the costs of sending cross-border payments remain above targets set by the G20. Partially as a response to the concern about correspondent banking relationships, Member States have sought to address inefficiencies in cross-border payments, including through improving the use of technological tools. The G20 target for retail payments, which are defined as payments of less than \$100,000 sent by people or businesses, but which are not remittances (see chapter III.B), is that they cost less than 3 per cent of the payment amount. Globally, approximately one quarter of corridors have average costs greater than 3 per cent, largely because of the cost of payments initiated by individuals. For business-initiated payments, only 3 per cent (51 of 1,564) of payment corridors to other businesses and 6 per cent (108 of 1,715) of corridors to individuals have average costs greater than 3 per cent (see table III.F.1).⁵⁰

Table III.F.1
Global average cost of cross-border payment transactions, 2023
(Percentage of payment amount)

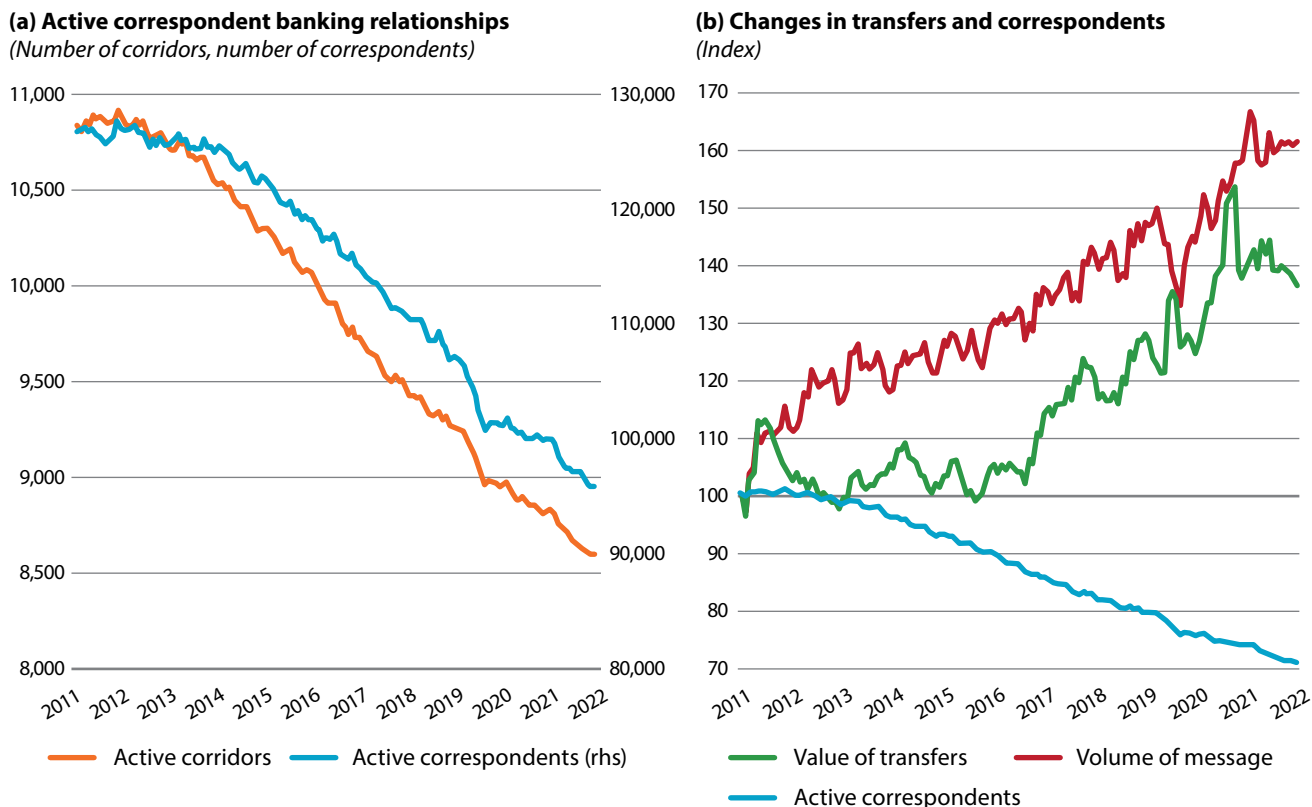
		Recipient	
		Business	Individual
Sender	Business	1.5%	1.7%
	Individual	2.0%	2.5%

Source: FSB.

4.2 Central bank digital currencies

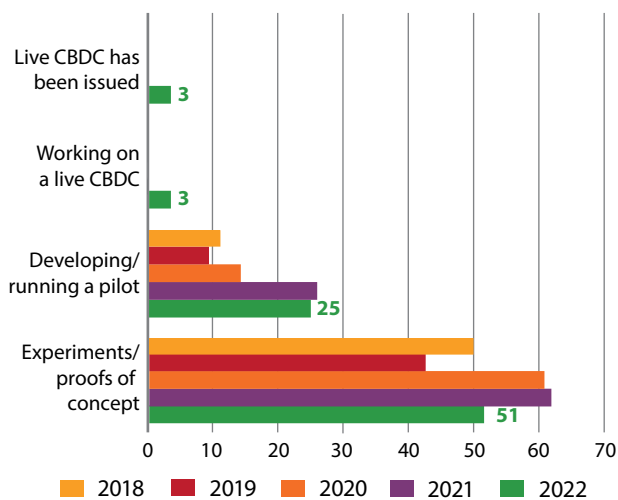
Central banks are experimenting with digital currencies with a view to improving payment systems. CBDC is digital money issued by central banks. A retail CBDC is intended for use by the general public and would operate alongside or in place of cash; a wholesale CBDC is used for transactions between financial institutions and would be used alongside or in place of reserves held in central bank accounts. As of 2022, the overwhelming majority of central banks (93 per cent) were engaged in some form of CBDC work. Progress on retail CBDC is more advanced than on wholesale CBDC: almost a quarter of central banks are piloting a retail CBDC. More than 80 per cent of central banks see potential value in having both a retail CBDC and a fast payment system.⁵¹ A few CBDCs have already been launched. Reasons given by central banks for working on CBDCs include the safety and efficiency of payments, improving financial inclusion, better implementation of monetary policy, and enhancing financial stability.

Figure III.F.8
Correspondent banking relationships, 2011-2022



Source: BIS.
Notes: Three-month moving averages, based on SWIFT BI Watch and National Bank of Belgium. An active corridor is defined as a country pair that processed at least one transaction. The count of active correspondents measures, corridor by corridor, the number of banks that have sent or received messages. Volume refers to the number of messages. For index Jan 2011 = 100.

Figure III.F.9
Status of CBDC work by central banks, 2018-2022
(Percentage of respondents)



Source: BIS, Paper No. 136.
Notes: Chart shows type of work in addition to research work. Based on responses from central banks in 86 jurisdictions.

CBDC issuance has the potential to enhance payments efficiency, but it could introduce new risks, including macro risks such as currency substitution. There are many design decisions that need to be made in regard to CBDCs, including the role of private banks, the openness of the architecture, limits on transactions and balances, the payment of interest on balances, and the costs of transactions. Payment service markets are often marked by oligopoly, and CBDCs with certain designs can reduce the rents earned.⁵² If cross-border interoperability is implemented, then CBDCs can help speed up and reduce the costs of cross-border payments. The decision to explore and potentially even launch CBDCs should remain jurisdiction-specific, depending on policy objectives and domestic circumstances, such as the degree of digitalization, the structure of the financial system, legal and regulatory frameworks, and the central bank’s own capacity.⁵³ There will be new operational risks for central banks to manage: For example, the digital infrastructure for processing CBDC transactions will require significant upfront investment and ongoing maintenance. There are also financial stability risks related to potential bank disintermediation if the CBDC competes with bank deposits. The technical design of CBDCs will determine the balance of benefits and risks. Developing countries should also consider the implications of the potential increased ease of their residents holding CBDC issued by a reserve currency-issuing central bank and transacting in foreign currencies, as this

can reduce seigniorage, worsen the transmission of monetary policy and help users to evade financial regulations.⁵⁴

5. Global governance and policy coherence

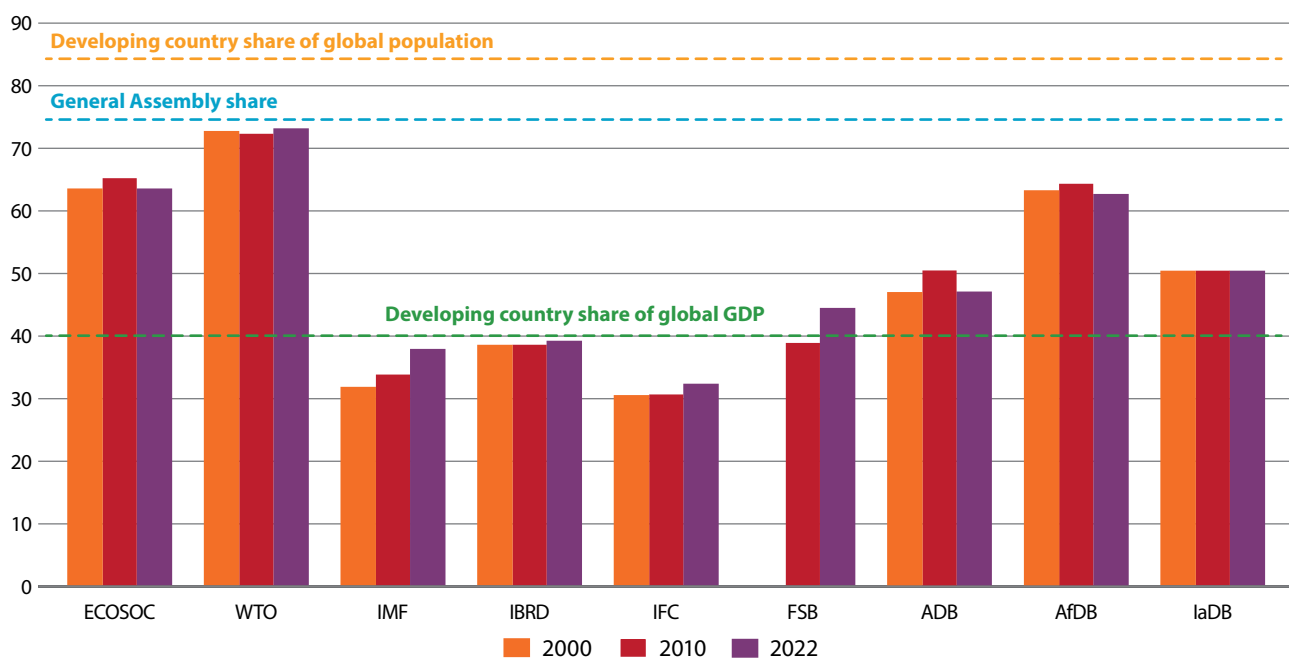
Global economic governance reform has been one of the central topics of international financial architecture reform since the beginning of the financing for development process. The current arrangements for global economic governance have been in place—and remained largely unchanged—for almost 80 years. Such arrangements have not entirely kept pace with changes in the global economy, including the rise of the global South and other geopolitical shifts. Member States have repeatedly sought to address this issue in the United Nations precisely because the organization operates on the principle of universal inclusion and sovereign equality. In the Monterrey Consensus, Member States adopted a commitment to broaden and strengthen the participation of developing countries and countries with economies in transition in international economic decision-making and norm setting. This commitment has been repeated in many intergovernmental agreements over the past two decades, including in the Addis Agenda. Reforms to the governance arrangements, depending on their size, may change the power balance at

international institutions, allowing different policies to be adopted on the issues addressed in this chapter and elsewhere in this report.

Despite repeated commitments and some improvement between 2005 and 2015, developing countries' representation has not significantly changed in many international financial institutions, regional development banks and standard-setting bodies. Member States intensified the discussion of increased participation of developing countries in international economic decision-making after the Monterrey Consensus, and some progress was achieved across several institutions (figure III.F.10). The realignment of voting rights at the IMF was achieved based on agreements adopted in 2005 and 2010. Change at the World Bank Group was accomplished through a selective capital increase agreement in 2017. There was a major revision of voting rights at the World Bank's concessional arm, the International Development Association (IDA), in 2021, its first in over 50 years. For its part, the FSB increased the number of plenary seats allocated to developing countries. Yet, the largest developed countries continue to hold de facto veto powers in the decision-making bodies of international financial institutions. After gains in the period following the 2008 world financial and economic crisis, several international standard-setting bodies have experienced stagnant or declining representation of developing countries on their principal decision-making organs in recent years (figure III.F.11). The recently concluded IMF Sixteenth General Review of Quotas was closed without any agreement to realign voting rights.

Figure III.F.10

Developing country share of voting rights, select institutions, 2000-2022 (Percentage)



Source: UN DESA.

Notes: The 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 the percentage of voting rights. The Financial Stability Board (FSB) does not have voting rights, and thus data shows the number of seats at the plenary. All data is categorized according to the M49 classification of developed and developing regions.

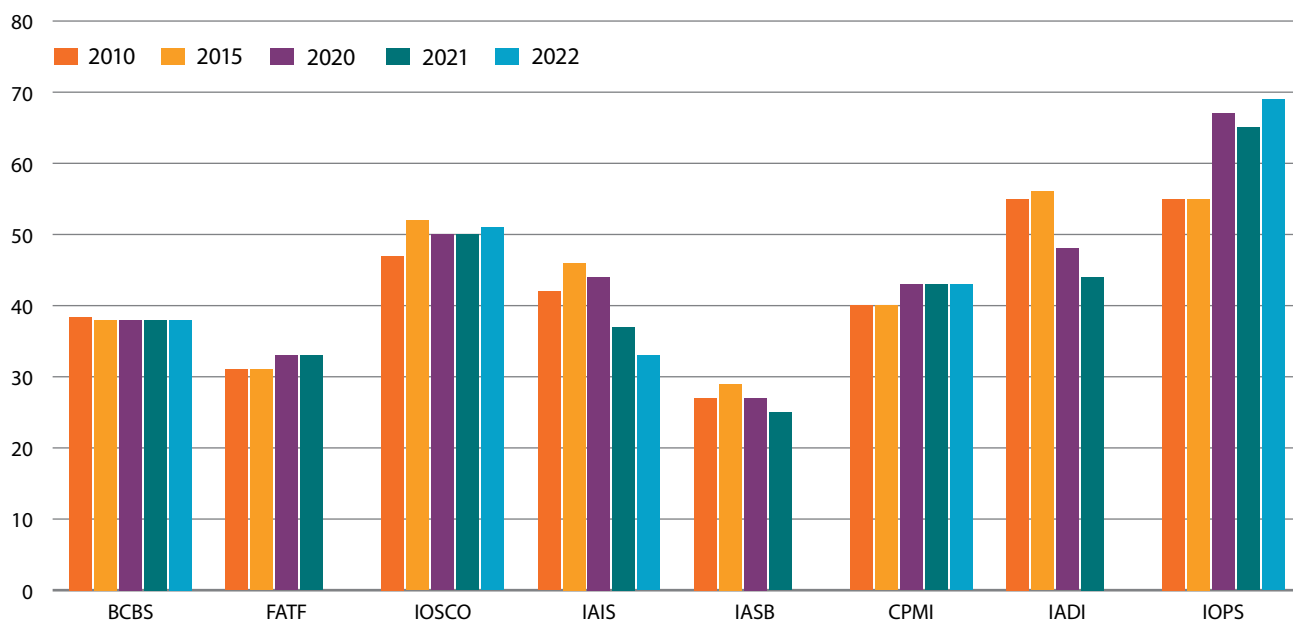
Complementary reforms to increase the voice and improve the participation of developing countries have been adopted, but tangible change on other aspects of governance remain out of reach.

Since 2000, both the World Bank and the IMF⁵⁵ have expanded the size of their boards of executive directors to create space for more developing country representatives. The follow-up process to the financing for development outcomes has also increased the economic and financial dialogues among the major United Nations bodies, the World Trade Organization, the World Bank and the IMF. The specialized standard-setting bodies and the FSB have also improved and institutionalized their consultative structures to receive input from regional bodies.⁵⁶ As suggested in the Monterrey Consensus, the ad hoc groupings of countries, for example the G20, are conducting outreach to non-member countries and finding new ways to incorporate developing country views, such as making the African Union a new permanent member of the G20. The Addis Agenda also contained a commitment to open and transparent, gender-balanced and merit-based selection of international financial institution heads and to the enhanced diversity of staff; while there have now been two women leaders of the IMF, the IMF managing director has always hailed from Europe and the World Bank president has always been a citizen of a single country.

System-wide coordination and policy coherence remain a challenge in a complex geopolitical landscape, with increasing risks of fragmentation.

All the financing for development outcomes have referenced the importance of enhancing the coherence and consistency of the international monetary, financial and trading systems in support of development. The Addis Agenda advanced this understanding to include “all three dimensions of sustainable development”. The follow-up process has enhanced coordination among international institutions, including in the joint work undertaken by the Inter-agency Task Force on Financing for Development and participation in the annual United Nations Economic and Social Council on Financing for Development Follow-up. However, other geopolitical pressures, including war and conflict, have complicated the work of international and intergovernmental bodies. There are significant risks of the world fracturing into multiple rival geopolitical blocks with lower levels of trust and cooperation. This may have direct costs in reduced growth and trade,⁵⁷ as well as indirect costs in reduced trust in multilateralism, weaker social contracts and inability to address global challenges such as climate change. The Fourth International Conference on Financing for Development will provide a venue to directly address these risks and continue to build policy coherence aimed at delivering on the ambitious and transformative 2030 Agenda for Sustainable Development.

Figure III.F.11
Representation of developing countries in standard-setting bodies, 2010–2022
 (Percentage of voting rights or members)



Source: UN DESA.

Notes: 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 Infrastructures (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.

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