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# International financial system and development

## Report of the Secretary-General**

*Summary*

The present report, submitted in response to General Assembly resolution 67/197, reviews recent trends in the international official and private capital flows to developing countries and current efforts to strengthen the international financial system. It highlights the ongoing challenges in the key areas of financial regulation, the global financial safety net, multilateral surveillance, policy coordination, management of capital flows, governance reform of the international financial institutions and sovereign debt restructuring.

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** The present report was prepared in consultation with staff of the major institutional stakeholders involved in the financing for development process. Responsibility for its contents, however, rests solely with the United Nations Secretariat.

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# I. Introduction

1. In its resolution 67/197 on the international financial system and development, the General Assembly stressed the need to continue to address systemic fragilities and imbalances and to reform and strengthen the international financial system, which it recognized should support sustained, inclusive and equitable economic growth, sustainable development, job creation and efforts to eradicate poverty and hunger in developing countries.

2. Although estimates of the financing needs of economic, social and environmental development objectives are necessarily imprecise, studies conclude, without exception, that sustainable development financing needs are extremely large. Even if all countries meet their development commitments, official resources alone will not be sufficient to cover these needs. Nonetheless, the estimated financing needs of sustainable development still represent a relatively small portion of flows of global savings, which amount to around $17 trillion annually.[1]

3. The challenge lies in promoting a financial system that channels investments towards sustainable global development, including long-term investment in infrastructure, riskier investment in innovation and small and medium-sized enterprises, financing of the global commons and other areas of international cooperation, and additional financing of social needs, in a stable and sustainable manner.

4. Yet, despite recent reform efforts, there continue to be gaps, barriers and misaligned incentives in the global financial system, which have resulted in both heightened instability and a misallocation of capital with regard to financing sustainable development needs. The sovereign debt crisis in Europe, banking system fragilities, policy uncertainty and the uneven global recovery have led to heightened risk aversion and increased volatility of both public and private capital flows. Although global imbalances have been decreasing in recent years, significant structural issues remain.[2] Global imbalances have also been tied to massive international reserve accumulation by developing countries, at the expense of productive investment in sustainable development.

# II. Reserve accumulation and global imbalances

5. A large proportion of existing global savings are currently in the form of international reserves held by central banks. From 2000 to 2012, global foreign exchange reserves increased by 468 per cent, from $2.1 trillion to $11.7 trillion, with emerging and developing countries holding an estimated $7.7 trillion and accounting for 66 per cent of the total. Accumulated reserve holdings are particularly significant in South-East Asia, where they amount to almost 40 per cent of gross domestic product (GDP).[3]

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[1] See International Monetary Fund (IMF), *World Economic Outlook: Growth Resuming, Dangers Remaining* (Washington, D.C., 2012).

[2] See *World Economic Situation and Prospects 2013* (United Nations publication, Sales No. E.13.II.C.2), chap. I.

[3] Department of Economic and Social Affairs calculations based on the IMF, Currency Composition of Official Foreign Exchange Reserves database.

6. Annual reserve accumulation in emerging and developing countries peaked at $1.2 trillion in 2007 prior to the crisis, but fell as a percentage of GDP in the years since (with the exception of 2010) owing to the slowdown in global trade and a drop in cross-border international capital flows. Nonetheless, annual reserve accumulation is still significant, with expectations for 2013 at $635 billion.[4]

7. International reserves tend to be invested in low-risk investments, with around 62 per cent of reserves currently held in United States dollar treasury securities, which, despite being downgraded from AAA to AA+, are considered to be one of the safest forms of global investment. As such, the accumulation of foreign exchange reserves represents a form of constrained saving, since the allocation of national savings to reserves prevents funds from being invested in sustainable development.[5]

8. There are several reasons why countries choose to accumulate reserves. First, for many countries, reserves are a form of "self-insurance" against potential external shocks, which is a main reason why countries choose to hold reserves in extremely safe, liquid assets. Second, reserve accumulation has been the by-product of central bank interventions in foreign exchange markets aimed at smoothing exchange rate volatility and mitigating bubbles associated with excessive capital inflows. As such, reserve accumulation has been highly correlated with global liquidity and changes in international investor sentiment. Lastly, reserves can be a by-product of export-led growth strategies that maintain an undervalued currency through interventions in the currency market.

9. Empirical studies suggest that no single explanation can account for the behaviour of all countries at all times. A recent study by the International Monetary Fund (IMF) found that self-insurance played a prominent role in the increase in international reserves following the East Asian crisis, although mercantilism in the form of an undervalued real exchange rate also appears to have contributed in some cases. The study also found a positive unexplained residual in more recent years,[6] consistent with the role of exchange rate management in smoothing volatility.[7]

10. Views on what constitutes adequate international reserves have changed over time. Until the mid-1990s, it was generally believed that countries should hold enough reserves to cover three months of imports. However, the emerging market crises in the mid-1990s were triggered by difficulties in refinancing short-term dollar-denominated debt, not by pressures in the current account. This led to the view that reserves should be large enough to cover a country's short-term external debt refinancing needs. This approach did not take into consideration, however, the fact that the emerging market crises of the 1990s were also triggered by reversals in short-term capital portfolio flows and the unwinding of so-called "carry trades". By the end of the 1990s, many emerging market countries chose to engage in larger

[4] See, IMF, World economic outlook database, April 2013 edition. Available from www.imf.org/external/pubs/ft/weo/2013/01/weodata/index.aspx.

[5] That a large share of international reserves is invested in Government bonds of developed countries also implies a net transfer of resources from poorer countries to wealthier ones.

[6] See Atish R. Ghosh, Jonathan D. Ostry and Charalambos G. Tsangarides, "Shifting motives: explaining the build-up in official reserves in emerging markets since the 1980s", IMF Working Paper, No. WP/12/34 (Washington, D.C., January 2012).

[7] See *World Economic Situation and Prospects 2013* (United Nations publication, Sales No. E.13.II.C.2).

self-insurance against volatility associated with international capital flows and open capital accounts.

11. However, precautionary reserve accumulation, while sensible at the national level, increases systemic risk at the international level. Reserve accumulation exacerbates global imbalances. Such imbalances carry the risk of a sudden and sharp disorderly adjustment process through large currency devaluations, which in turn could lead to significant slowdowns in major economies and jeopardize hard-won development gains in developing countries.

12. In order to be able to reallocate reserves towards sustainable and productive investment, it is therefore imperative to reduce risks in the financial system. Several proposals have been put forward in this regard. The Commission of Experts of the President of the General Assembly on Reforms of the International Monetary and Financial System recommended that the international reserve system make greater use of IMF special drawing rights (SDRs) as a way to reduce systemic risks associated with global imbalances and as a low-cost alternative to accumulation of international reserves. SDRs would provide necessary access to foreign currency for countries experiencing capital account pressures. It has also been recommended that mechanisms use SDR allocations as a potential source of innovative financing for development, although care needs to be taken to preserve the role of SDRs as a monetary instrument.[8] However, to date, the idea of using SDRs for development has not gained sufficient support in policy discussions.

13. Other important measures for reducing risks in the international financial system include managing international capital flows and reducing capital market volatility, reducing systemic risks associated with the banking and shadow banking systems, increasing the predictability of official development assistance (ODA), reducing systemic implications of sovereign debt crises and strengthening global social safety nets, all of which is discussed in the following sections of the present report.

## III. International private financial flows to developing countries

14. Given their large financing needs, private investment will be crucial to achieving sustainable development objectives. Economic literature generally shows a clear correlation between investment and growth,[9] with international investment an important instrument for countries whose savings are insufficient to meet sustainable development needs. However, much of the literature does not distinguish between short- and long-term investment.

15. Foreign direct investment (FDI) remains a major component of private capital flows to developing countries. FDI also has the potential to advance economic development in a number of ways, including by generating knowledge spillovers (although public policies are often necessary for spillovers to be effective). However, much of cross-border portfolio flows to developing countries has been speculative and short-term oriented. There is significant evidence that such short-term

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[8] See *World Economic and Social Survey, 2012: In Search of New Development Finance* (United Nations publication, Sales No. E.12.II.C.1).

[9] See Ross Levine, “Finance and growth: theory and evidence”, in *Handbook of Economic Growth*, vol. 1A, Philippe Aghion and Steven Durlauf, eds. (Amsterdam, 2005).

volatile capital flows complicate macroeconomic management, may lead to exchange rate overshooting and asset price bubbles and carry risks for economic stability. Furthermore, sudden withdrawals of capital owing to heightened global risk aversion can contribute to the spreading of financial crises and, paradoxically, to a decline in long-term investment.[10]

16. The increasing volatility of cross-border capital flows is reflected in recent trends in net private capital flows to developing countries. These flows collapsed during the financial crisis, more than doubled from $206 billion in 2008 to $510 billion in 2010 and then contracted again in 2011 to approximately $393 billion. Estimated levels for 2012 are sharply lower at $51 billion. However, this sharp decline is mostly due to a large swing in other net investments (comprising mainly commercial bank flows) to China, which went from a surplus of about $27 billion in 2011 to an estimated deficit of $310 billion in 2012.[11]

17. Portfolio equity flows have been an important source of volatility in private capital flows. Equity flows fell in the second half of 2011 owing to concerns about the sustainability of public finances in Europe, which led to a general “flight to safety”, as well as worries over an economic slowdown in leading emerging economies such as Brazil, China and India, before increasing in the first part of 2012 on a more favourable growth outlook and then falling again. In mid-2013, speculation regarding a possible slowing of quantitative easing by the Federal Reserve of the United States of America led to large redemptions from emerging market equity funds and significant capital outflows.[12]

18. Bond portfolio flows (both foreign and local currency) have generally been steadier, driven in part by improved fundamentals in a number of economies, but also by aggressive monetary easing in advanced economies. In particular, weakness in developed economies and extremely high global liquidity has depressed yields in some developed countries to close to zero. A “search for yield” by some international investors led to capital inflows in developing country markets with higher local interest rates.[13] However, speculation on a slowing of quantitative easing led to a sell-off in emerging market bond markets, as well as volatility in domestic interest rates, something which risks impacting long-term direct investment in the real economy.

19. Commercial bank flows to developing countries have been the most volatile form of capital inflows, owing to the deleveraging of international banks, especially

[10] See Joseph Stiglitz and others, *Stability with Growth: Macroeconomics, Liberalization and Development*, Initiative for Policy Dialogue Series (Oxford University Press, 2006).

[11] IMF, World economic outlook database, April 2013 edition and Department of Economic and Social Affairs calculations. The IMF categorization of “emerging and developing economies” differs from the Department of Economic and Social Affairs categorization of “developing economies” in terms of the countries included. Hence, the figures on net private financial flows to developing countries published by the Department of Economic and Social Affairs are different from the figures on net flows to emerging and developing economies published by IMF in the World economic outlook database.

[12] See “World economic situation and prospects”, Monthly Briefing No. 56 (9 July 2013). Available from www.un.org/en/development/desa/policy/wesp/wesp_mb/wesp_mb56.pdf.

[13] See IMF, *Global Financial Stability Report: Old Risks, New Challenges* (Washington, D.C., April 2013).

in Europe, which is expected to continue in the near term.[14] Of particular concern is evidence that long-term financing from banks has been constrained during the past few years. For example, the number of international claims of European banks with a maturity of over two years has been falling and there are, moreover, indications that these institutions have been reallocating lending in emerging market and developing economies towards shorter maturities.

20. There is also evidence that institutional investors, including those with longer-term liabilities (such as pension funds, life insurance and endowments), have in recent years shifted asset allocations towards more liquid assets and shorter-term investments.[15] Even FDI flows, which tend to be longer-term and more stable than other components of private capital flows, may be becoming more volatile. It has been argued that there has been a shift in the composition of FDI, from equity to debt components, which has made it easier to move funds between host and home countries.[16]

21. Conventional approaches to managing cross-border capital flows focus on macroeconomic policies, including the adoption of exchange rate, monetary and fiscal policies to enhance an economy's capacity to absorb inflows. However, these policies may not be sufficiently targeted to stabilize financial flows and may have undesired side effects. For instance, fiscal and monetary tightening to avoid overheating can affect economic growth prospects, while currency appreciation can harm export industries. Attempts by policymakers to counteract the expansionary impact of excessive capital inflows by tightening monetary policies could be partly self-defeating, as the higher interest rates may induce additional capital inflows, thereby exacerbating upward pressure on the exchange rate and further limiting domestic policy space.

22. Instead, a number of emerging economies (including Brazil, Indonesia, Peru, the Republic of Korea, Taiwan Province of China and Thailand) have recently taken measures to manage inflows through direct and indirect regulations on the capital account. These measures have included macroprudential measures, management of domestic capital markets (including derivative markets) and direct measures on capital account transactions.

23. The majority of the new initiatives have been implemented through macroprudential policies aimed at limiting the build-up through the banking system of systemic risks, such as currency mismatches and credit bubbles due to cross-border flows. Examples of such measures include the decision by the Republic of Korea to levy up to 0.5 per cent on the non-deposit foreign currency liabilities of banks in order to reduce cross-border short-term bank lending and the decision by Peru to increase the marginal reserve requirements for short-term local currency deposits from 65 per cent to 120 per cent in order to reduce short-term capital invested in

[14] See "Long-term investment financing for growth and development: umbrella paper", paper prepared by World Bank staff with input from the staff of the Organization for Economic Cooperation and Development, IMF, the United Nations Conference on Trade and Development, the Department of Economic and Social Affairs, the World Bank Group and the Financial Stability Board and presented at the meeting of the Group of 20 (G20) Ministers of Finance and Central Bank Governors, Moscow, February 2013.

[15] See World Economic Forum USA, "The future of long-term investing", New York, 2011.

[16] See *World Investment Report 2011: Non-equity Modes of International Production and Development* (United Nations publication, Sales No. E.11.II.D.2).

Peruvian sol interest rates (which is often funded in United States dollars in order to take advantage of interest rate differentials).[17]

24. According to IMF research based on emerging economies' experiences over the past decade, such macroprudential measures have had mixed results.[18] While they appear to have lengthened the maturity of capital inflows in some countries (such as Peru and the Republic of Korea), the effect on total net flows has been limited. Moreover, the fact that macroprudential measures tend not to be sufficiently targeted to the source of the shocks, may limit their effectiveness.

25. In recent years, a few countries, including Brazil and Indonesia, have introduced direct controls on capital inflows. Direct controls are similar to macroprudential regulations in that they can be price-based, in the form of levies or taxes on capital inflows, or quantity-based, in the form of direct limits. For example, in 2010, Brazil increased its tax on fixed-income foreign investment in order to raise the cost of speculation[17] (although the tax has since been cut), while Indonesia imposed a six-month holding period for Bank of Indonesia certificates in order to limit short-term hot money inflows.[19] Most new regulations have focused on limiting inflows, although some regulations, such as the controls introduced by Malaysia in 1998, have also been used to limit outflows.

26. Most available studies find that price-based capital controls on inflows have also been effective in changing the composition of inflows away from short-term debt.[17] For example, between 1991 and 1998, price-based controls on inflows in Chile appear to have been effective in altering the composition of inflows, with short-term debt declining as a proportion of total liabilities and the stock of FDI increasing from about 34 to 53 per cent.[20] The impact on the volume of flows is, however, more ambiguous, with regulations appearing to have been more successful in some cases than in others. The varying results of similar mechanisms across countries and time frames suggest that there is no one-size-fits-all solution. The design of regulations needs to take into account the specific circumstances of individual countries, including their economic situation, existing institutions and regulatory framework, and the structure and persistence of inflows.

27. One oft-cited reason why controls may not be effective is the risk of evasion.[21] In particular, capital account regulations may be particularly difficult to implement in countries with a large derivatives market, since speculators can often use this market to circumvent restrictions. For this reason, some countries, such as Brazil and the Republic of Korea, implemented restrictions directly in the derivatives market, albeit at relatively low initial rates. Both countries also adjusted these and other controls countercyclically in response to changes in investor sentiment. For example, the Republic of Korea tightened its limits on domestic and foreign bank

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[17] See *World Economic Situation and Prospects 2012* (United Nations publication, Sales No. E.12.II.C.2).

[18] See Jonathan D. Ostry and others, "Managing capital inflows: what tools to use?", IMF Staff Discussion Note, No. SDN/11/06 (Washington, D.C., April 2011).

[19] See Emma Saunders, "Indonesia pre-empts capital flow reversal", *Financial Times*, 14 April 2011.

[20] See Jonathan D. Ostry and others, "Capital inflows: the role of controls", IMF Staff Position Note, No. SPN/10/04 (Washington, D.C., February 2010).

[21] See Shari Spiegel, "How to evade capital controls … and why they can still be effective", in *Regulating Global Capital Flows for Long-run Development*, Kevin P. Gallagher, Stephany Griffith-Jones and José Antonio Ocampo, eds. (Boston University, 2012).

exposure to foreign exchange derivatives towards the end of 2012 in an attempt to stem volatility in the rapidly appreciating won.[22] Brazil, meanwhile, eliminated its 1 per cent tax on derivatives transactions when foreign inflows fell in June 2013.[23]

28. IMF has framed an institutional view on the liberalization and management of capital flows which suggests that capital flow management measures, including capital controls, can be useful at times, particularly when the room for macroeconomic policy adjustment is limited, when needed policy steps or macroeconomic adjustments require time and when inflow surges raise risks of financial system instability. These measures should not be a substitute for adjustments in macroeconomic policies, although the exact sequencing of the various policies and the composition of the policy mix will depend on country-specific circumstances. The IMF institutional view also suggests that such measures should be transparent and targeted, temporary and, to the extent possible, non-discriminatory.[24] However, where there are risks to financial stability, the view does not rule out the possibility of using long-standing measures. Some experts have also argued that such regulations should be an essential part of the macroeconomic policy toolkit to combat capital flow surges before they lead to bubbles and as such should be seen as permanent tools that can be applied countercyclically to changing economic circumstances.[25]

29. From a longer-term perspective, it is necessary for countries to mobilize stable domestic sources of finance and to develop deep and robust financial systems in order to safely intermediate external flows. This will require sustained GDP growth, a strong enabling environment and improved governance. The development of local currency bond markets is often seen as one instrument for longer-term finance, although steps need to be taken to ensure that these markets do not attract hot short-term oriented funds. The development of domestic long-term investor bases such as local pension markets should also be encouraged, and incentives provided to encourage long-term investment horizons.

30. In addition, steps to reduce the volatility of capital flows should be taken in source countries. Given the cross-border spillover effect of monetary policy decisions, measures that incentivize investors in developed countries to invest at home would both help monetary authorities to respond to slowdowns in developed countries and help to allay asset bubble pressures in developing countries. In addition, better international coordination of monetary policies and better management of global liquidity are needed to reduce global risks. Consideration also needs to be given to incentivizing longer-term investments by bankers and institutional investors, something which necessitates reforms in international financial regulation.

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[22] See Simon Mundy and Song Jung-a, "South Korea tightens derivatives limits", *Financial Times,* 27 November 2012.

[23] See David Biller and Maria Wisa Rabello, "Brazil scraps tax on currency derivatives to stem real drop", *Bloomberg News*, 12 June 2013.

[24] See IMF, "The liberalization and management of capital flows: an institutional view", 14 November 2012. Available from www.imf.org/external/np/pp/eng/2012/111412.pdf.

[25] See Kevin P. Gallagher, Stephany Griffith-Jones and José Antonio Ocampo, eds., *Regulating Global Capital Flows for Long-run Development* (Boston University, 2012).

# IV. Strengthening international financial regulation

31. The primary role of the financial system is to allocate savings to productive purposes. For the financial system to perform its role effectively, regulatory and other policy measures need to: (a) secure the safety and soundness of financial institutions and the financial system at large; (b) ensure competition; (c) protect consumers; (d) ensure that the financial sector promotes macroeconomic stability and growth; and (e) promote access to credit and other financial services.[26]

32. The importance of many of these factors was underscored during the financial crisis. In particular, there has been an increase in awareness of the need for macroprudential regulations that focus on systemic risks, including the impact of regulations on macroeconomic stability. For example, Basel III incorporates a number of elements aimed at addressing procyclicality and reducing systemic risks, including a maximum leverage ratio and a countercyclical buffer,[27] although these are limited in scope. In addition, the Group of 20 (G20) has requested the Financial Stability Board, IMF and the Bank for International Settlements to work on establishing a macroprudential policy framework for identifying and monitoring systemic financial risk and macroprudential instruments, the outcome of which is still pending. In addition, the importance of comprehensive regulations, inclusive of shadow banking, was underscored during the crisis.

33. Since the crisis, the international community has taken important steps to address vulnerabilities in the financial sector through regulatory reform. However, regulation has still focused primarily on ensuring the safety and soundness of the financial system, centred on the banking sector through the Basel III international regulatory framework for banks, without giving sufficient attention to the other criteria that are important for a well-functioning financial sector. For example, while it is still too early to estimate the full effects of Basel III, there is a concern that, by raising the cost of lending, the Basel capital adequacy rules may have the effect of limiting riskier lending, including access to finance (since smaller entities, such as microenterprises and small and medium-sized enterprises, have higher capital costs). Similarly, Basel III risks further reducing the availability of long-term financing, with a particularly negative impact on developing countries with large infrastructure needs. It also penalizes lending in areas without sufficient data on default histories, such as trade finance and new technologies, including green investments.[28]

34. There are also concerns that tighter bank regulations, in conjunction with the complexity of the Basel III framework, may trigger a new wave of regulatory arbitrage. It is reported that new products are already being created to circumvent the rules.[29] More generally, complex regulations can be difficult to administer and costly. This argues for broad-based, simple regulations that incorporate both balance sheet and off-balance sheet exposures, such as high capital ratios and low leverage

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[26] See Joseph E. Stiglitz, “Principles of regulation”, paper presented at the Initiative for Policy Dialogue, Financial Markets Reform Task Force Meeting, Manchester, United Kingdom, July 2006.

[27] See Financial Stability Board, IMF and Bank for International Settlements, “Macroprudential policy tools and frameworks: progress report to the G20”, 27 October 2011.

[28] For a discussion of trade finance in Basel III, see *World Economic Situation and Prospects 2013* (United Nations publication, Sales No. E.13.II.C.2).

[29] See IMF, *Global Financial Stability Report: Restoring Confidence and Progressing on Reforms* (Washington, D.C., October 2012).

ratios, with simple countercyclical rules built in. Nonetheless, there would still be a risk that activities requiring higher capital would shift from the regulated banking system to shadow banking practices.

35. The value of shadow banking assets has risen from an estimated $26 trillion in 2002 to $67 trillion in 2011, or 24 per cent of total assets in the global financial system.[7] Entities such as money market funds, hedge funds and structured investment vehicles provide alternative market-based sources of funding, but also pose significant risks to the financial system. The Financial Stability Board has formulated a number of principles for regulating shadow banking. Since most shadow banking entities gain leverage through the formal banking system, the Financial Stability Board recommendations focus on the interactions of regulated banks with such entities.

36. Another area that has received global attention is that of “too-big-to-fail” institutions. During the global financial crisis, large financial institutions, in particular, were found to have spread systemic risks. IMF estimates the implicit subsidy to big banks in terms of lower borrowing costs to be about 0.8 percentage points.[30] G20 leaders have agreed to strengthen the oversight and regulation of global systemically important financial institutions with a focus on minimizing the adverse impacts that their distress or failure may have on the financial sector and the broader economy. The Financial Stability Board has suggested that global systemically important financial institutions should have a loss-absorbing capacity beyond the general standards of Basel III and develop recovery and resolution plans and that countries should give this priority in their national regulatory frameworks.

37. Although authorities in several countries have taken steps to develop resolution strategies consistent with the Financial Stability Board’s recommendations,[31] further legislative measures are necessary in order to fully implement the requirements, and put in place the arrangements, for cross-border cooperation on resolution measures. In this regard, European Union finance ministers recently reached agreement on the parameters of a draft directive on bank recovery and resolution, the implementation of which will be significant, since the European Union is home to a number of global systemically important financial institutions.[32] Measures to decrease financial concentration could also be explored, including steps to reduce the size of financial conglomerates by separating different business lines and creating a more competitive banking system.

38. Progress on the reform of the derivatives market has also been slower than desirable. To reduce risks in the derivatives market, the G20 agreed that over-the-counter derivatives that can be standardized should be traded on formal exchanges or electronic platforms by the end of 2012. In addition, improvements in

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[30] See Christine Lagarde, Managing Director of IMF, “The global financial sector: transforming the landscape”, statement to the Frankfurt Finance Summit, 19 March 2013. Available from www.imf.org.

[31] See Financial Stability Board, “Implementing the FSB key attributes of effective resolution regimes: how far have we come? — report to the G20 finance ministers and central bank governors on progress in reforming resolution regimes and resolution planning for globally systemically important financial institutions (G-SIFIs)”, document PLEN/2013/55. Available from www.financialstabilityboard.org.

[32] See Matthew Attwood, “Answering five questions on recovery and resolution”, *Financial News*, 27 June 2013.

over-the-counter markets should include reporting requirements and central clearing of transactions. While progress has been made towards meeting the G20 commitments through legislation, regulation and expansion of infrastructure, much remains to be done to complete the agreed reforms.[33]

39. Other regulatory initiatives under discussion include work on uniform global accounting standards, reduction in the reliance on credit rating agencies, reform of certain compensation practices and the establishment of macroprudential regulatory frameworks and countercyclical buffers. Taken together, these reforms represent important improvements that reduce risk in the financial system. However, implementation, supervision and enforcement remain crucial. Furthermore, significant gaps remain, particularly in aligning incentives with long-term investment for sustainable development.

40. In terms of implementation, there have also been delays by some countries in meeting the 1 January 2013 deadline agreed for implementation of Basel III.[34] There is some concern that different rates of implementation could contribute to a dilution of minimum standards.[30] Indeed, one goal of Basel III was to create a globally consistent and harmonized regulatory structure as a way to ensure a level playing field. At the same time, given diverse national structures, the challenge is to strike the right balance between ensuring a level playing field internationally and accommodating country differences, in order not to place an unnecessary burden of adjustment on national financial systems.

41. One of the primary goals of an effective financial system, which has not been fully incorporated into the reform agenda, is the importance of access to finance and financial services for all. There is no one-size-fits-all approach for building an inclusive financial system. Some countries have placed priority on building a nationwide electronic payment system, others have focused on access to credit for SMEs and still others have focused on the need to improve the quality of usage, financial education and consumer protection. In all cases, coordination among a wide array of public and private actors is vital in order to arrive at a regulatory framework conducive to inclusive finance.

42. The development and adaptation of international financial regulation would also benefit from greater representation of and participation by developing countries in the regulatory reform process. Despite some progress, formal representation in international financial regulatory bodies, such as the Bank for International Settlements, the Basel Committee on Banking Supervision and the Financial Stability Board, is limited to advanced economies and a number of major emerging market economies.

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[33] See Financial Stability Board, “FSB reports to G20 on progress of financial regulatory reforms”, press release No. 30/2013 of 19 April 2013.

[34] Fourteen member jurisdictions have issued final Basel III-based capital regulations and 11 of them now have final Basel III capital rules in force. Five jurisdictions (comprising 10 member countries) have published their draft regulations. To maintain a level playing field and prevent arbitrage, the Basel Committee on Banking Supervision is assessing both the consistency of national regulations with the Basel III agreement and the consistency of the outcomes on banks (Financial Stability Board, April 2013).

## V. Official development assistance

43. The landscape of international financial and technical cooperation, like that of private financial markets, has changed significantly in the years since the financial crisis. In marked contrast to the first decade of the millennium, ODA has been falling in real terms for two consecutive years and budgetary pressures in many donor countries indicate that aid levels may stagnate in the medium term. Similarly, efforts to increase the effectiveness of aid have so far yielded only modest results. At the same time, South-South cooperation has expanded rapidly, but so far remains a small fraction of ODA and should not be seen as a substitute for traditional aid. In addition, given the increasing recognition of the vast financing needs of sustainable development, there is increased interest in the role of public resources in leveraging private financing for public goals. Domestic resource mobilization, including the global fight against tax evasion and avoidance, is also an important factor in this respect.

44. These changes have had an impact on the role of official assistance in meeting global development goals. The scope of international public finance, like that of public finance in national economies, should have redistributive, allocative and stabilizing purposes. First, it should help to meet global development goals, such as the eradication of poverty. Second, it should address market failures and facilitate the public provision of goods that are not sufficiently provided by the private sector (e.g. financing of the global commons). Third, it should contribute to international financial and macroeconomic stability, for example, by providing a global safety net through IMF facilities. The changing landscape of international cooperation suggests that, while the need for ODA as a tool for poverty alleviation and the attainment of development goals has lost none of its urgency, the allocative role of international public finance in leveraging private resources will become increasingly important.

45. ODA will remain critical, especially for least developed countries that require considerable financing in order to meet internationally agreed development goals, including the Millennium Development Goals, but lack domestic savings or access to international capital markets. For this reason, renewed commitments are needed by major donors in order to reverse the decline in ODA and to increase disbursements by 2015.

46. Members of the Development Assistance Committee of the Organization for Economic Cooperation and Development (OECD) provided $125.6 billion in net ODA in 2012, 4.0 per cent less in real terms than they did in 2011. In addition, aid is increasingly directed towards middle-income countries and away from those countries with the largest Millennium Development Goal implementation gaps. Indeed, aid to sub-Saharan Africa declined by 7.9 per cent in real terms, to $26.2 billion, and aid to the least developed countries fell by 12.8 per cent in real terms, to about $26 billion. ODA is also expected to stagnate over the medium term. The most recent OECD survey on donors' forward spending plans suggests that gross receipts of country programmable aid by developing countries will increase in real terms in 2013, but remain flat between 2014 and 2016.

47. Budget cuts in donor countries have also had a negative impact on aid predictability, which is critical for aid effectiveness. The OECD survey finds that donors disbursed 5 per cent less aid than planned in 2010 and 8 per cent less in

2011. This represents a marked deterioration from 2009. Overall, the track record on the implementation of the principles set out in the Paris Declaration on Aid Effectiveness is disappointing. At the global level, only 1 of the 13 adopted targets has been met. That said, progress has been made towards achieving many of the remaining targets, especially in the case of indicators where responsibility lies primarily with developing countries.

48. At the same time, several non-Development Assistance Committee donors, including Turkey and the United Arab Emirates, have dramatically scaled up their aid. This reflects the increasingly important role of South-South development cooperation, which also involves trade, loans, technology-sharing and direct investment. South-South development cooperation does not usually contain explicit policy conditions, but is sometimes focused on investments and not necessarily dedicated to alleviating poverty or fulfilling social needs. South-South development cooperation is estimated to have reached between $12.9 billion and $14.8 billion in 2010, and is expected to increase further, with major increases planned by China, India and Venezuela (Bolivarian Republic of). Expanding South-South cooperation may help to cushion the fall in aid receipts from traditional donors, but should nonetheless not be seen as a substitute for traditional aid flows.

49. As the issues of environmental degradation and climate change have become increasingly urgent, climate financing has taken centre stage. However, despite significant synergies with other areas of financing for sustainable development, to date climate financing has largely evolved on a separate track from conventional development finance. In the coming years, it will be necessary to scale up and better incorporate climate financing into the broader global framework for financing for sustainable development, while ensuring that new funds for climate financing are additional to existing ODA commitments.

50. New and innovative sources of finance can make a key contribution. It has been estimated that between $400 billion and $450 billion per year could be raised through international taxes on financial transactions and carbon emissions and through the use of SDRs.[8] However, it is important to ensure that such resources are additional to existing ODA.

51. At the same time, it is clear that official financing will be insufficient in terms of meeting necessary long-term investments in infrastructure and technology and riskier investments such as those in low-carbon technologies and innovation and in terms of protecting the global commons. There are a number of ways in which the official financing sector can complement and leverage private finance, including through direct financing, cofinancing, risk mitigation tools such as guarantees, capacity-building and other advisory support initiatives that enhance project development and other measures that enhance the investment climate. Such mechanisms can be implemented at the global, regional or national levels. As such, multilateral, regional and national development banks can all play an important role.

52. Ultimately, countries should aim to achieve the levels of domestic resource mobilization needed for development. In this respect, a fair and effective domestic tax system is key. For resource-rich countries, transparency in the extractive industries is pivotal in ensuring that economic activities by multinational entities are taxed appropriately and that public revenue is spent on sustainable development. International efforts should focus on curtailing illicit financial flows, including cross-border tax avoidance and evasion and transfer mispricing. In the Lough Erne

Declaration, adopted at the Group of 8 (G8) Summit held in June 2013,[35] G8 members reiterated the importance of information exchange in enabling developing countries to collect taxes owed to them. Other positive developments in this area, such as the ongoing work of OECD on base erosion and profit shifting and efforts in other international forums, such as the World Bank Group, the United Nations and IMF, should ensure that such processes are accessible and beneficial to all countries, especially developing countries.

# VI. Multilateral reform

## A. Global financial safety nets

53. The capacity of the multilateral system to provide liquidity in times of systemic crisis is an important element in ensuring global financial stability. A reliable global financial safety net could also reduce the incentive for countries to accumulate reserves as a form of self-insurance against adverse shocks.

54. IMF has made several reforms to its lending facilities, with a view to increasing the flexibility of its financial arrangements. This new flexibility in the Fund’s lending framework seeks to allow for more effective responses to the varying circumstances of member countries. For example, the Fund has introduced several new facilities since the crisis, including the Flexible Credit Line, which provides large and up-front access to IMF resources for members with very strong fundamentals and institutional policy frameworks and a track record of, and a commitment to, implementing very strong policies,[36] and the Precautionary and Liquidity Line, which provides financial support to countries with sound policies but moderate vulnerabilities,[37] with focused ex-post conditionality in order to address these remaining vulnerabilities. In addition, the Fund’s previous instruments for emergency assistance have been consolidated under its new Rapid Financing Instrument, which can be used to support a range of urgent balance-of-payments needs without the need for a fully fledged Fund programme.[38]

55. IMF has also refined the overall lending framework for low-income countries with a view to increasing the flexibility of existing instruments, including by relaxing timing restrictions on access under the Standby Credit Facility, providing options for Extended Credit Facility arrangements with longer initial durations, increasing flexibility in the phasing of disbursements, and easing the Poverty Reduction Strategy documentation requirements of the Extended Credit Facility and the Policy Support Instrument. In addition, the Rapid Credit Facility, which was created under the Poverty Reduction and Growth Trust, provides a disbursement with limited conditionality for low-income countries. Given the global interest rate environment, with interest rates close to zero in many countries, a new interest rate mechanism was introduced to ensure the concessionality of IMF financing to low-income countries. In this context, temporary interest rate relief was also approved by setting the interest rate on all concessional loans at zero until the end of 2014.

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[35] Available from www.gov.uk.

[36] See Flexible Credit Line factsheet. Available from www.imf.org/external/np/exr/facts/fcl.htm.

[37] See Precautionary and Liquidity Line factsheet. Available from www.imf.org/external/np/exr/facts/pll.htm.

[38] See Rapid Financing Instrument factsheet. Available from www.imf.org/external/np/exr/facts/rfi.htm.

56. The challenge ahead is to preserve the Fund's ability to provide financial support to low-income countries in the face of a prospective drop after 2014 in its capacity for concessional lending, especially in the Poverty Reduction and Growth Trust. In September 2012, the IMF Executive Board approved a partial distribution of the general reserves attributed to gold sales profits, with the aim of making the Trust sustainable in the longer term.

57. Altogether, the global financial safety net has continued to evolve towards a multilayered structure comprising global, regional and bilateral components.[39] For example, the bulk of the liquidity needed to ease funding pressures during the financial crisis was provided through a series of ad hoc arrangements among key central banks. The involvement of major central banks will remain pivotal for a functioning and sufficient global financial safety net. Calls for the creation of a more permanent framework of liquidity lines among key central banks should therefore be given consideration.

58. Regional financing arrangements can play an increasingly important role in the global financial safety net. Such arrangements have the advantage of close ties between borrowers and lenders, which may allow for the provision of support to countries and boost programme ownership. An important development in this regard was the establishment, in February 2012, of the European Stability Mechanism, which replaced two earlier temporary European Union funding mechanisms and which, to date, has approved two financial assistance facility agreements, with Cyprus and Spain, respectively. Enhancing cooperation and increasing complementarities between IMF and regional financing arrangements is important for global financial stability and sustainable growth. The G20 Principles for Cooperation between IMF and Regional Financing Arrangements, and the IMF stocktaking paper on its engagement with regional financing arrangements may provide a basis for enhanced cooperation in this regard.

59. However, a global mechanism for ensuring the swift and sufficient availability of substantial resources in order to stabilize market conditions in times of systemic liquidity crisis continues to be lacking. Efforts to further strengthen crisis-lending facilities should therefore focus on enhancing the various layers of the global financial safety net and strengthening coordination and consistency among the mechanisms at different levels. A key element in strengthening the global financial safety net is closer cooperation among IMF, national central banks and regional and subregional mechanisms. In this regard, a stronger role for IMF in coordinating and managing the various layers of the global financial safety net system might be envisaged.

## B. Multilateral surveillance and policy coordination

60. In recent years, the IMF has taken a number of important steps to strengthen the quality and coverage of its surveillance activities, including placing greater emphasis on cross-border and cross-sectoral linkages and paying closer attention to the spillover effects of economic policies in the world's largest economies and to linkages between the financial sector and the real economy. The latest triennial

[39] See Pradumna B. Rana, "The evolving multilayered global financial safety net: role of Asia", S. Rajaratnam School of International Studies Working Paper, No. 238 (Singapore, 2012). Available from www.rsis.edu.sg/publications/WorkingPapers/WP238.pdf.

surveillance review, completed in October 2011, found that IMF surveillance remained fragmented, with a lack of depth in risk assessments and insufficient focus on interconnections and transmission of shocks. In response, in July 2012 the IMF Executive Board adopted the decision on bilateral and multilateral surveillance (integrated surveillance decision), with a view to strengthening the legal framework for surveillance. This decision, which took effect in January 2013, makes consultations under article IV of the IMF Articles of Agreement a vehicle not only for bilateral surveillance, but also for multilateral surveillance, and allows for discussions on the full range of spillover effects of member countries' policies on global economic and financial stability. Furthermore, the decision defines, for the first time, the scope and modalities of multilateral surveillance, including by providing a framework for potential multilateral consultations.[40]

61. Multilateral surveillance was further enhanced by a pilot external sector report on the world's largest economies. This report expands IMF external stability assessments beyond exchange rates to include a broad and multilaterally consistent analysis of the external sector of the world's largest economies. In the light of increasingly interconnected economies and financial systems, such in-depth periodic external sector evaluations are a critical aspect of multilateral surveillance. In addition, developing countries have emphasized that the effectiveness of surveillance depends on the quality and even-handedness of the analysis and advice provided.

62. IMF has also increased its focus on the impact of risks to global stability emanating from the financial sector. A new financial surveillance strategy lays the foundation for developing a unified macrofinancial framework that takes account of the interdependencies of financial sectors and of linkages and interactions between macroeconomic and macroprudential policies in the medium term.

63. The evolving international architecture of multilateral surveillance and policy coordination is based on close collaboration among IMF, the G20, the Financial Stability Board and standard-setting bodies. One example of such collaboration is the G20 International Monetary and Financial Committee Data Gaps Initiative, which aims to improve the timeliness and accuracy of information on global systemically important financial institutions. One of the stated aims of the Russian Federation's G20 Presidency in 2013 is to work towards further strengthening the IMF surveillance framework and multilateral analysis, including through further work on global liquidity indicators.

64. However, global policy coordination remains ad hoc and piecemeal and largely within the purview of global groupings such as the G20. Recent efforts within the G20 to strengthen policy coordination among the world's major economies represent important steps forward. However, the achievement of global development goals and calls for strengthened policy coherence and coordination among all partners in global development cooperation, as well as macroeconomic coordination, should take into account countries' development needs. While the G20 represents most of the world's population and economy, it excludes many countries, particularly small States, and does not represent the world's poorest and most vulnerable citizens. Multilateral discussions should be institutionalized within the multilateral system, as part of a stronger and more inclusive framework for global economic governance.

[40] See Integrated Surveillance Decision factsheet. Available from www.imf.org/external/np/exr/facts/isd.htm.

Given its universality and unquestioned legitimacy, the United Nations has a central role to play in multilateral cooperation and decision-making. In this regard, it is important that the G20 continues to strengthen, enhance and systematize its engagement with the United Nations.

## C. Governance reform in the international financial institutions

65. The 2010 governance reforms of IMF and the World Bank Group are considered important steps towards a more representative, responsive and accountable governance structure. The IMF reform foresees shifts in quota shares to emerging market and developing countries of over 6 per cent, along with greater representation for such countries on the IMF Executive Board. The World Bank Group shareholding reviews, meanwhile, increased the voting power of developing and transition countries in the International Bank for Reconstruction and Development by 4.59 per cent to 47.19 per cent.[41]

66. The 2010 IMF quota reform ratification process has advanced, with two of the three thresholds that need to be reached in order for the reforms to take effect having now been passed. With regard to the remaining threshold, as of 10 July 2013, 140 members representing around 76 per cent of total voting power had consented to ratify the changes to the IMF Articles of Agreement, thereby falling short of the 85 per cent needed. In this context, the IMF Managing Director urged member countries to quickly ratify the measures needed to implement this important agreement. In addition, the IMF Executive Board completed its review of the quota formula in January 2013 and has committed to continuing these discussions with a view to arriving at a new quota formula as part of its work on the Fifteenth General Review of Quotas, to be concluded by January 2014.

67. Complementary discussions by the G20 have contributed to the process. In its communiqué of 19 April 2013, the G20 highlighted that completion of the ongoing reforms of IMF governance is indispensable for enhancing its credibility, legitimacy and effectiveness, while the distribution of quotas based on the new formula should better reflect the changing relative weights of IMF members in the world economy.

68. Another important component of IMF governance reform was the adoption of changes to the procedures for selecting the fund’s Managing Director. The new procedure adopted for the 2011 selection process allowed the selection of the current Managing Director to take place in a more transparent manner.[42] In an important change, IMF Governors — usually finance ministers or central bank governors of member countries — are now able to nominate candidates for the post of Managing Director. This had hitherto been restricted to members of the IMF Executive Board.

[41] See World Bank, “World Bank Group voice reform: enhancing voice and participation of developing and transition countries in 2010 and beyond”, background document prepared by World Bank staff for the Development Committee Meeting, April 2010. Available from http://siteresources.worldbank.org/DEVCOMMINT/Documentation/22553921/DC2010-006(E)Voice.pdf.

[42] See IMF, “Managing Director (MD) Selection”, 18 June 2012. Available from www.imf.org/external/np/exr/faq/mdselection.htm.

# VII. Sovereign debt restructuring

69. After a hiatus of over a decade, the ongoing debt crisis in the eurozone has once again highlighted gaps in the international financial architecture with regard to timely and effective solutions to sovereign debt distress. Debates on sovereign debt restructuring have direct implications for the financing of sustainable development, as countries with unsustainable debt burdens spend a large proportion of public resources — resources that could otherwise be spent on development goals — on debt servicing. In addition, uncertainty surrounding sovereign debt restructuring increases both country-specific and systemic risks.

70. For the first time, debt overhangs are more pronounced in developed countries than in developing countries. Developing countries are currently running historically low public-debt-to-GDP ratios, posing virtually no systemic risks. In 2012, public debt as a percentage of GDP in developing countries as a whole was 45.9 per cent.[43] Many low-income countries in sub-Saharan Africa have benefited from comprehensive debt relief programmes including the Heavily Indebted Poor Countries (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI) over the past two decades. Nonetheless, sovereign debt challenges remain in some small States and low-income countries. The problem is most acute among countries in the Caribbean, which were negatively impacted by the financial crisis owing to strong links with the United States and Europe, a high dependence on tourism and the erosion of trade preferences. In response to the slowdown in growth, several countries ran fiscal deficits and increased borrowing. As a result, in 2013 Belize, Grenada, Jamaica and Saint Kitts and Nevis all sought to restructure portions of their debt.

71. In contrast, public debt as a percentage of GDP in OECD countries jumped from around 70 per cent in the 1990s to almost 110 per cent in 2012. This increase in debt levels has been accompanied by downgrades of credit ratings in some countries, which for years carried AAA ratings. In particular, debt problems in Europe have once again highlighted the interlinkages between sovereign debt problems and the financial sector. Given the size of sovereign debt generally held by the banking system, sovereign debt crises can trigger bank runs and/or banking crises, potentially leading to regional or global contagion. Similarly, given the prevalence of too-big-to-fail institutions that can require Government bailouts, banking crises can trigger sovereign debt distress, with potential systemic implications owing to regional and international holdings of debt. This has opened new sets of challenges in managing debt problems and international financial stability.

72. A central issue for domestic and international economic policy is how to reduce the occurrence of sovereign debt problems in both developing and developed countries. First and foremost, responsible lending and borrowing in order to reduce the chance of debt distress is crucial. Governments need to make regular use of analytical tools aimed at assessing alternative borrowing strategies, to better manage their assets and liabilities and to restrain from irresponsible borrowing. At the same time, lenders need to better assess credit risk, to improve credit screening and to reduce irresponsible lending to high-risk countries.

[43] See United Nations, *MDG Gap Task Force Report, 2013* (forthcoming).

73. Nonetheless, debt distress does occur and can be costly. When debt burdens become excessive, there is a need for an effective mechanism that minimizes economic and social costs, enables countries to restructure their obligations in an effective and fair manner and gives countries a clean slate so that they may resume growth and investment. For countries with market access, the current system has relied on voluntary approaches to writing down debt, such as the inclusion in bond issues of collective action clauses, which are intended to resolve some of the creditor coordination issues in debt restructuring. However, collective action clauses are incorporated only in bond issues and do not therefore address issues of priority for all creditors, including commercial banks and other providers of non-bonded lending. Furthermore, aggregation problems arise when more than one series of bond issues are involved in the restructuring. The benefit of collective action clauses in creditor coordination is further limited, as holdout creditors still have the ability to take blocking positions in individual bond issues.[44]

74. For low-income countries, the HIPC Initiative and MDRI, while important initiatives, accounted for debt relief as development assistance, thereby sidestepping the broader issue of how to address issues associated with debt overhang in a comprehensive manner. The international community has agreed to certain broad principles for debt restructuring, including "fair burden-sharing" between debtors and creditors, as per the Monterrey Consensus of the International Conference on Financing for Development,[45] and "legal predictability", as per the Doha Declaration on Financing for Development: outcome document of the Follow-up International Conference on Financing for Development to Review the Implementation of the Monterrey Consensus.[46] However, these principles have yet to be institutionalized in concrete practices.

75. The lack of an international bankruptcy procedure for sovereign debt restructuring has implications for the cost and speed of the resolution of debt problems. Historically, it has been shown that this delay in restructuring can be extremely costly.[47] A lack of legal predictability creates uncertainties for both debtors and creditors and raises important issues of equity. Recently, the issue of holdout creditors has elicited international concern, with litigation against Argentina potentially increasing the leverage of holdout creditors, thereby undermining the sovereign debt restructuring process.

76. The international community should more actively pursue the development of an agreed rules-based approach to sovereign debt workouts in order to increase predictability and the timely restructuring of debt when required, with fair burden-sharing, including by potentially providing a "safe harbour" for social protection floor outlays in the budget. Such an approach would reduce risk in the global financial system and free up resources for investment in sustainable development.

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[44] See IMF, "Sovereign debt restructuring: recent developments and implications for the Fund's legal and policy framework", 26 April 2013. Available from www.imf.org/external/up/pp/eng/2013/042613.pdf.

[45] See *Report of the International Conference on Financing for Development, Monterrey, Mexico, 18-22 March 2002* (United Nations publication, Sales No. E.02.II.A.7), chap. I, resolution 1, annex, para. 51.

[46] See General Assembly resolution 63/239, annex, para. 60.

[47] See Barry Herman, José Antonio Ocampo and Shari Spiegel, *Dealing Better with Developing Country Debt* (Oxford University Press, 2010).

# VIII. Conclusions

77. **The estimated financing needs of sustainable development, while large, still represent a relatively small portion of annual flows of global savings. The challenge lies in promoting a financial system that channels investments towards sustainable global development.**

78. **Foreign exchange reserves have grown over the past few decades, fuelled to an extent by the desire for self-insurance against global systemic risks. The accumulation of such reserves represents a form of constrained saving, since it prevents funds from being deployed for development purposes, and exacerbates global imbalances and risks. Policies to address these issues could look at, inter alia, increasing SDR issuance, reducing global risks and strengthening the global financial safety net.**

79. **Private capital flows to developing countries remain volatile and short-term oriented. Increasing attention is therefore being given to capital account management. In addition, steps to reduce the volatility of such flows should be taken in source countries and international coordination of monetary policies and management of global liquidity should be improved. Consideration should also be given to incentivizing longer-term investments by bankers and institutional investors.**

80. **In order to effectively facilitate investments in sustainable development, financial regulation needs to be viewed in a broader context than is currently the case. In addition to a focus on stability, more attention should be given to promoting access to finance and ensuring that the financial sector promotes stable long-term sustainable growth.**

81. **Global ODA has declined in real terms over the past two years and is expected to stagnate in the medium term. At the same time, South-South cooperation has expanded rapidly, but should not be seen as a substitute for traditional aid. While the need for ODA as a tool for poverty alleviation has lost none of its urgency, given the size of financing needs, the role of official financing in leveraging private resources will become increasingly important.**

82. **Another important issue that pertains to the enhancing of international financial stability is the strengthening of multilateral surveillance by IMF and the global financial safety net. In recent years, IMF has taken a number of steps to strengthen its surveillance activities, including increasing its focus on cross-border and cross-sectoral linkages. A key element in this regard is closer cooperation among IMF, national central banks and regional and subregional mechanisms.**

83. **The 2010 governance reforms of IMF and the World Bank Group are considered important steps towards a more representative, responsive and accountable governance structure. However, according to many developing countries, these measures fall short of the objective of achieving fully legitimate representation of all countries, including the least developed countries. Moreover, the challenge now is to implement the agreed reforms in a timely manner.**

84. **The ongoing debt crisis in the eurozone has once again highlighted gaps in the international financial architecture with regard to sovereign debt distress.**

**Countries with unsustainable debt burdens spend a large proportion of public resources — resources that could otherwise be spent on development goals — on debt servicing. Uncertainty surrounding sovereign debt restructuring increases both country-specific and systemic risks. The international community should more actively pursue the development of an agreed rules-based approach to sovereign debt workouts.**