T20 Policy Brief

Task Force 03

REFORMING THE INTERNATIONAL FINANCIAL ARCHITECTURE

Towards Another Formulation of the Financing Problem: Can the G20 Serve as a Driver of Policies for Prosperity and Sustainability?

Tatiana Oliveira, Policy Advisor for the Institute of Socioeconomic Studies (Brazil)

Carola Mejia, Coordinator of Climate Justice, Transitions and the Amazon y the Latin American Network for Economic and Social Justice (Bolivia)

Marcela Vecchione-Gonçalvez, Associate Professor at the Center for Advanced Amazonian Studies from the Federal University of Pará (Brazil)

TF03

Abstract

The debate on reforming the global finance architecture is no news, dating back to the mid-1990s. Recently, though, the necessary transformations in the monetary and finance international policies has been driven by a new environment of experimenting through new strategies, behaviors and financial instruments have become part of the repertoire of diverse state actors. Based on the paradigm of market-based finance, a new pack of regulatory, monetary and fiscal policies have served as a premise for the current adjustment proposals of the global finance architecture, and of the so-called "green recovery" policies, an emerging debate dating back to the pandemic of Covid-19. In this policy brief, we make suggestions to promote sustainable growth and reduce inequalities by arguing that the public budget is still the way to go to finance climate action and sustainable development.

Key-words: Global Finance Architecture - Economic Development - Climate Finance

Diagnosis of the issue

The debate on reforming the global finance architecture is no news. Dating back to the Bretton Woods System's crisis in the 1970s, the understanding of the necessary transformations in the monetary and finance international policies has been driven by analyses and diagnoses based on causes and repercussions inherent to the finance sphere. In recent years, however, external shocks, such as the pandemic or the numerous extreme weather events witnessed in many regions of the world have been key to the financial challenges of our day, which, in turn, more frequently than ever, depend on the stabilization of non-financial events to recover. In the context of a long-standing economic and financial recession, we have seen an atmosphere of experimenting through which new strategies, behaviors and finance instruments became part of the repertoire of diverse state actors and multilateral institutions.

Since the crash of 2008, the risky behavior of fast-paced buying and selling of currency and securities, in addition to expanding foreign indebtedness through loans and bond issuance, popularized as instruments to manage private and public balance sheets alike. During the pandemic of Covid-19, a greater role in the economy was attributed to central banks. In addition, the coupling of monetary and fiscal policies was perceived as beneficial to many market agents. By then, the neoliberal state was allowed to intervene in the economy as long as governments took responsibility for the consequences of the hyper-liberalization of economic relations on a global scale while putting in place a weak social protection system and promoting an unprecedented role for private finance in the offering of public services.

Based on the paradigm of market-based finance, a new policy pack has been rapidly absorbed by governments and advanced as conditionalities by multilateral institutions.

Market-based finance has been defined as financial relations mediated by the capital market itself, in which non-banking loans are granted and securities as well as associated derivatives are bought, sold, rebought, and resold. Serving as a premise for the so-called "green recovery" policies, market-based instruments began to lead the way over which the global finance architecture is now being reengineered to respond to climate finance. In this, the financing of public policies is readdressed towards the creation of markets and money (of last resort) either by promoting the attractiveness of investments or buying and selling bonds, currency, and securities directly at the market. Therefore, recovery has made its way more into an economic recovery than into a sustainable pathway forward.

Green recovery policies are intended as environmental, labor, regulatory, monetary, and fiscal reforms aimed at rebuilding the economy in the best interest of the financial markets after a major extreme weather event causing a critical breakdown or based on any impending threat. Since climate change risks have become a tangible reality, electoral democracies have been mandated to adopt mitigation, adaptation, and reconstruction strategies (loss and damage control) across the board of public policies. As the need for capacity, technology, and finance expands, governments and international intergovernmental institutions turn to the financial sector as a pool of encapsulated assets and resources. However, the problem with this financing model is that it does not favor economic prosperity, equity, or social and climate justice because of its regressive distributional effects.

As showcased in many studies, the tendency is that growing indebtedness or the pressuring demand for de-risking the investment winds up channeling great amounts of scarce public resources to private stakeholders. This way, servicing public external debt, stabilizing currency risks, and bailing out corporations, banks, and shadow-banking institutions would result in concentrating wealth while dilapidating treasury. When it comes to taking the environment or the climate in consideration against this economic backdrop, one realizes the reframing of nature as an asset class (along with its historical status as a wealth deposit to be extracted).

The imperative of decarbonization, in particular carbon (or the incoming) biodiversity markets, are the utmost example of nature as a tradable asset class. But it has yet another significance for market and finance contemporary restructuring. Indeed, as argued by Gabor and Braun (2023), decarbonization goals may turn out to be mere carbon shock therapy, under which the transition to a green economy is dictated by price mechanisms alone, and market discipline is enforced by an ever-growing competition. So, as the argument goes, decarbonization – a desirable climate action to energy transition and economic adaptation to global warming – should rely on strategic state planning and not on market-led carbon shock therapy.

Analyzing public institutional arrangements of financial regimes associated with green transition, Gabor and Braun (2023) have created a "typology of four regimes, across two dimensions – the scale of green public spending and the degree of discipline imposed on private capital". The typology itself is not so important as the conclusion that the *big green state* "subordinates private capital to the strategic priorities of a state-led green transition" (: 29). This means "state-led planning [is] geared towards green public investments in both green infrastructure and green industrial sectors, and in 'sticks and carrots' coalitions with private capital" (idem). On the other hand, *carbon shock therapy* reenacts the neoliberal inflation targeting of the 1990s while putting in place "[r]estrictive monetary policy and fiscal austerity (...) to contain inflationary pressures and to reinforce price signals for dirty companies, by curtailing their access to cheap credit" (: 29).

From the standpoint of domestic politics, to preserve the state strategic planning role stands by the need to engage in a rights-based republican approach to public policy and sustainable development. The anticolonial accent of the claim to overcome underdevelopment cannot be fulfilled by price-command and market-based investment. In the following pages, the recommendations for the international finance system reform stress the role of public and concessional finance for a just and equitable climate action and sustainable development. The Brazilian presidency of the G20 (2024) and of COP 30 (2025) is a window of opportunity to achieve a just transition led by state-led planning and societal priorities.

Recommendations

To address the ongoing challenges of financing, enabling the G20 to support policies that promote prosperity and sustainability without leaving anyone behind, we have identified four key guidelines for our recommendations: (i) Just and Equitable Finance Architecture Reform; (ii) Adjust Global Economic Governance; (iii) Public Climate Finance; (iv) Direct Climate Finance to Indigenous Peoples Afro-Descendants and Local Communities.

Just and Equitable Finance Architecture Reform

According to UNCTAD (2003b), the international financial architecture reform is a framework of institutions, policies, rules, and practices that orchestrate the global financial system. Its goals range from promoting international cooperation aiming to ensure global monetary and financial stability, enabling international trade and investment, and supporting the mobilization of a stable and long-term financing required for sustainable development and fighting the climate crisis.

Building on the work delivered by India's presidency of the G20, in 2024, Brazil follows up the discussion with a view on the demands of the Global South and the centrality of the historical concept of sustainable development along with its three indispensable pillars (social, environmental, and economic) to fight inequality, hunger, and the climate and biodiversity crises.

Nevertheless, "the current lending model needs to be reformed to better support developmental lending without repeating the public cost–private profit mistakes of some previous models" (UNCTAD 2023b). A just and equitable global economy should engage in the provision of new, additional, accessible, and debt-free finance for low- and middle-income countries and the historically discriminated and marginalized groups. Here are some recommendations to achieve this goal:

- Reforming the Global Economic Governance to a more inclusive, representative, and up-to-date architecture in consideration of today's climate and sustainable financing needs and challenges. Climate finance goals should reflect equity and respond to the principle of common but differentiated responsibilities and respective capabilities (CBDR-RC) in light of different national circumstances;
- Provide public climate finance, making it timely available and structured to facilitate access for the most vulnerable countries, particularly in the areas of adaptation and loss and damages.

The international financial architecture should be structured to fund the implementation of the Sustainable Development Goals (SDGs) and the national climate plans to reach the climate target of 1,5ºC of average global warming, bearing in mind the realization of human rights and land and territorial rights. Ambitious reform through public-led strategic and mission-oriented planning, starting with more inclusive, representative economic governance, is the way to go.

Adjust Global Economic Governance

The current economic governance is unfair, considering that high-income countries, responsible for 92% of total excess CO_2 emissions, although responsible for the current climate crisis (Hickel, 2020) are the main leaders of multilateral financial institutions. The Bretton Woods institutions were created eighty years ago under the guidance of post-war rationale. Nevertheless, the geopolitical equilibrium of today's world changed as middle power countries entered the scene and reclaimed historic reparations, while competing for the global market share. For a more democratic and fair global economic governance, in which low- and middle-income countries have greater participation in the decision-making of multilateral financial institutions and in climate funds allocation, it is urgent that their needs be at the core of any international financial architecture reform. In what follows, we highlight three recommendations to the democratization of global economic governance:

- The governance of global economic institutions should be structured on a voting-based system that involves all parties, and is not restricted to the contributive capacity of member-states;
- Greater coherence among the institutions that make up the financial safety net in the global economy is needed, and should care for the needs and access of the most vulnerable;
- Support for the creation and implementation of the United Nations Framework Convention on International Tax Cooperation (UNCITC), while ensuring civil society participation in debates and decision-making processes, will be crucial to guaranteeing new and additional resources to finance climate action and sustainable development.

Public Climate Finance

In 2023, various reports have launched assessments describing disappointing results on the delivery of climate finance. What’s more, the climate finance target of USD $100 bi a year has never been met. OECD and OXFAM stand by different accounting results, with the former showing the enthusiastic number of approximately USD $89,6 bi in 2021 (OECD, 2023) in climate finance, and the latter the overwhelming figure of USD $21-24 bi a year.

UNCTAD (2023a) establishes that 87% of climate finance to low- and middle-income countries comes from public sources, in comparison to 82% registered by OECD. In public climate funding, multilateral resources have grown the most since 2013 (USD $15,5 bi to $38,7 bi), overtaking bilateral public funding as of 2019, and reaching USD $34,5 bi in 2021 (OECD, 2023). The imbalance of investing in mitigation over adaptation is of the order of 60% to 30%, the public funding share of adaptation bypassing that of mitigation (UNFCCC, 2023).

According to the OECD numbers, in 2021, loans accounted for around 60% of the total volume of resources earmarked for climate finance; grants, 30%; direct private investments and others, that could not be detailed, share the remaining 10% (OECD, 2023). In total private financing, direct investment accounted for 41% under the aegis of impact investments and the trading of debt securities associated with decarbonization objectives. On average, private investment between 2019 and 2020 channeled into climate finance fell short by 6 percentage points compared to the previous period, 2017-2018, ranging from 14.6% to 13.8% (OECD, 2023).

Asia (36%) and Africa (27%) are the regions receiving the most climate finance from public sources. These countries are followed by LAC (16%). The remaining 21% was divided between southern and eastern European countries, as well as Oceania. South-to-South funding made available varied between USD $1,7 bi and USD $2,2 bi in 2019 and 2020, respectively, which represents a drop from 2018 levels. However, the contribution of non-OECD developing countries to MDBs increased from USD $9 bi to USD $11 bi. The Asian Infrastructure Investment Bank and the New Development Bank are also increasing their participation in financing the climate. LDCs and SIDS receive, respectively, between 1 and 8% of the total private climate finance mobilized. To address such imbalances and inequalities, we recommend the following measures:

- Setting a new and ambitious climate finance goal that is science- and needs-based, and that shows improvements not only regarding quantity, but also quality of funds, and that keeps responding to the CBDR-RC principle in light of Article 9 of the Paris Agreement (2015), with the support of G20 countries;
- Capitalize the funds under the umbrella of the UNFCCC to meet their critical role in delivering funds to low- and middle-income countries' green transition by building on G20 countries capacity to make bigger donations while improving accessibility criteria;
- Raise the level of funding from the G20 countries to MDBs, while de-linking access to resources from quotas and conditionalities unilaterally imposed by those financial institutions; lowering the cost of sovereign borrowing; implementing a binding debt restructuring mechanism for all creditors; debt service cancellation and moratorium for countries affected by extreme climate events, in addition to facilitating access to non-debt creating mechanisms for recovery after catastrophes; and bearing in mind that the adoption of local currencies lending is a solution to be considered;
- The IMF should review the rules for accessing liquidity in times of crisis, granting a bigger share of special drawing rights (SDRs) allocated to low- and middle-income countries, in addition to possibly adopting UNCTAD’s proposal on the “aid-link concept” aiming to trigger World Bank’s action in the case of issuing SDRs;
- Crowding in private capital and institutional investors should result in a more balanced allocation of risks among public and private partners, following transparency criteria, while obeying monopoly laws and public contract rules, therefore, moving away from the de-risking paradigm to a more risk-sharing attitude.

Direct Climate Finance to IPADLCs

The need of developing countries to face the climate crisis is estimated at 5.8-5.9 trillion dollars by 2030 (UNFCCC, 2023), therefore, different, agile solutions are needed to grant access to FAIR FINANCING. This must relate to the IPCC recognition of the contributions by IPADLCs to combating climate change, also recommending that these populations and their knowledge be included in the efforts to fight climate change and assure a healthy planet for future generations. These urgent actions could include:

- Strengthening of adaptation finance by double of present resources used to this end, considering it has been estimated that developing countries need around USD $215 to $387 bi annually until 2030 (UNFCCC, 2023);
- Developing new indicators that reflect the economic, social, and climate vulnerabilities of the peoples of low- and middle-income countries, to have comprehensive criteria to fair financing and allowing for simplified access to resources;
- Financing criteria must align with the principles of responsible borrowing and lending to reflect the human rights obligations of states and the already existing safeguard principles held on international law, such as the Free, Prior, and Informed Consent Recommendation n. 169 of ILO, the Nagoya Protocol on Access to Genetic Resources and the Fair and Equitable Sharing of Benefits Arising From Their Utilization to the Convention on Biological Diversity, the Cancun Safeguards and the Warsaw Framework for REDD+ to the Climate Convention.
- Strong evidence shows that there is a vicious circle between debt, climate crisis, and extractivism, which is unfairly affecting most developing countries and the most vulnerable groups of the population. G20 countries should support real land-based solutions to climate change, with direct finance to IPADLCs.

References

Ali, Mona. Reforming the IMF. Phenomenal world. 2023. Available at https://www.phenomenalworld.org/analysis/reforming-the-imf/

Gabor, Daniela. Securitization for Sustainability: Does it Help Achieve the Sustainable Development Goals? Heinrich Böll Stiftung. Washington, D.C, 2019

Dafermos, Yannis; Gabor, Daniela and Michell, Jo. The Wall Street Consensus in pandemic times: what does it mean for climate-aligned development?, Canadian Journal of Development Studies / Revue canadienne d'études du développement, 42:1-2, 238-251, 2021.

_________ and Braun, Benjamin. Green Macrofinancial Regimes. 2023. Available at: https://osf.io/preprints/socarxiv/4pkv8/.

Hickel, Jason Quantifying national responsibility for climate breakdown: an equality-based attribution approach for carbon dioxide emissions in excess of the planetary boundary, 2020. Available at: https://www.thelancet.com/journals/lanplh/article/PIIS2542-5196(20)30196-0/fulltext

Latindadd. More SDRs for Latin America and the Caribbean: An Effective Tool in an Era of Multiple Crises, 2023. Available at: https://latindadd.org/informes/more-sdrs-for-latin-america-and-the-caribbean-an-effective-tool-in-an-era-of-multiple-crises/

OECD. Climate finance provided and mobilised by developed countries for the period 2013-2021 (2023). Available at: https://www.oecd.org/climate-change/finance-usd-100-billion-goal/

OXFAM. Climate Finance Shadow Report 2023: Assessing the Delivery of the $100 billion Commitment, 2023.

UN. Reforms to the international financial architecture. Our common agenda - Report of the Secretary-General, policy brief 6, 2023.

UNCTAD. The need for financial reform for climate-aligned development. In.: Trade and Development Report: Growth, Debt and Climate Realigning the Global Financial Architecture, 145-174, 2023a

_________ . Reforming the international finance architecture: The view from UNCTAD. In.: Trade and Development Report: Growth, Debt and Climate Realigning the Global Financial Architecture, 102-116, 2023b

UNFCCC. Decision -/COP.28, 2023. Available at: https://unfccc.int/sites/default/files/resource/cma2023_L17S.pdf

_________ Summary and Recommendations by the Standing Committee on Finance: Fifth biennial assessment and overview of climate finance flows, 2022.

G20 BRASIL 2024
BUILDING A JUST WORLD
AND A SUSTAINABLE PLANET

T20 Brasil 2024
Let's rethink the world

Let's
rethink
the world

CEBRI
Rethink Tank

FUNDAÇÃO
ALEXANDRE
DE GUSMÃO

ipea
Instituto de Pesquisa
Econômica Aplicada