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Fourth International Conference on Financing for Development

Key Issues for Prioritization

This memo highlights key issues for prioritization in the Fourth International Conference on Financing for Development (FfD 4). Two factors guided the inclusion of issues in this memo: 1) it is an area of expertise of the Boston University Global Development Policy Center, backed by rigorous evidence 2) it is an issue that FfD 4 has a unique opportunity to advance relative to other fora. As a result, this memo is neither an exhaustive list of issues that should be covered in FfD4 nor an exhaustive list of global economic governance priorities.

We suggest the following six issues for prioritization at FfD 4:

1. **Addressing unsustainable debt burdens:** With an analytical base provided by reformed debt sustainability assessments, public and multilateral creditors should grant significant debt relief that puts countries on a path to achieving development and climate goals, while private and commercial creditors should be brought to participate in debt relief through a mixture of carrots and sticks.
2. **Scaling up multilateral development banks and national development banks:** MDB finance should be scaled up through capital adequacy reform measures, innovative financing solutions like hybrid capital, and general capital increases. In aggregate, these reforms should produce an additional $390 billion each year.
3. **Reforming concessionality to align with vulnerability:** FfD 4 should encourage a norm that eligibility for concessional finance should be based on multidimensional criteria relevant to the objective of the fund, including climate vulnerability and debt distress.
4. **Reform trade rules to protect developing country policy space and manage spillovers**: FfD 4 should promote policy space for developing countries, including by advancing efforts to reduce exposure to investor-state dispute settlement, and reaffirm the importance of minimizing negative spillovers on developing countries resulting from high-income countries' trade and industrial policies.
5. **Increasing the voice and participation of developing economies in global economic governance:** FfD 4 should set more concrete and timebound targets for increasing the voice and representation of developing countries in global economic governance than the commitments in the Addis Ababa Action Agenda.
6. **Increasing the use of Special Drawing Rights and improving their efficiency:** FfD 4 should promote greater use of SDRs in the future, both through new issuances and re-channeling, and more efficient distribution of SDRs.

Greater detail on these six issues is included below. While this memo does not follow the structure of the Addis Ababa Action Agenda, the heading for each of the six issues notes the relevant action area.

1. Debt and debt sustainability: addressing unsustainable debt burdens

More than any other action area, debt has worsened globally since 2015. External public and publicly guaranteed debt levels have more than doubled since 2008, with the years since the start of the COVID-19 pandemic causing particularly sharp blows to debt sustainability.[1] Debt service payments are at an all-time high and are crowding out investment in development and climate.[2] Globally, 3.3 billion people live in countries that pay more on interest on their debts than health or education.[3] As these debt vulnerabilities have spiraled, the global sovereign debt architecture has proven insufficient, subjecting countries like Zambia and Sri Lanka to years of uncertainty and discouraging other countries from undertaking necessary restructuring.

Particularly because there is a lack of an established international architecture for debt, FfD 4 has a unique opportunity to push forward solutions to unsustainable debt. Even the Common Framework, the most coordinated debt governance mechanism, does not offer debt treatment to middle-income countries, underlining the existing lacuna in debt governance mechanisms outside the UN. Despite recognition about the need to reform the Common Framework, progress has stalled.

There is an urgent need for an approach to debt that is both politically feasible and meaningfully addresses solvency challenges. Creation of new, permanent institutions to tackle sovereign debt are unlikely to be politically viable in the near-future, with the urgency of meeting development and climate goals demanding a more feasible approach. However, proposals within the existing institutions have tended to be insufficiently effective or restrict their focus to liquidity challenges. While some countries' debt challenges primarily concern liquidity, the presence of solvency challenges cannot be overlooked: our research has found that in the next five years an estimated 47 emerging market and developing economies (EMDEs) would surpass the International Monetary Fund's (IMF) external debt solvency thresholds as they mobilize capital to meet 2030 Agenda and Paris Agreement needs.[4]

As outlined in the Debt Relief for a Green and Inclusive Recovery Project, our proposed solution rests on three pillars.[5] First, public and multilateral creditors should grant significant debt reductions that not only bring a distressed country back to debt sustainability but put the country on a path to achieving development and climate goals—in a manner that preserves the financial health and credit rating of multilateral institutions. Second, private and commercial creditors should grant commensurate debt reductions alongside public creditors with a fair comparability of treatment. Private and commercial creditors would be compelled to participate through 'carrots,' such as a partial guarantee of new bonds or buybacks funded by rechanneled SDRs, and 'sticks,' such as payment standstills and domestic legal reforms in key jurisdictions like New York and the United Kingdom.[6] One concrete way FfD 4 could push forward such legal reforms is by mandating a process to develop a model law that could be applied in

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[1] https://drgr.org/files/2024/04/DRGR-Report-2024-FIN.pdf
[2] https://drgr.org/files/2024/04/DRGR-Report-2024-FIN.pdf
[3] https://unctad.org/publication/world-of-debt
[4] https://drgr.org/files/2024/04/DRGR-Report-2024-FIN.pdf
[5] https://drgr.org/files/2024/04/DRGR-Report-2024-FIN.pdf
[6] https://www.bu.edu/gdp/2024/09/13/bringing-buybacks-back-a-known-debt-restructuring-tool-with-a-principled-twist/

such jurisdictions. Third, credit enhancement should be provided for countries not in debt distress but that lack fiscal space to lower the cost of capital, alongside other forms of support like a temporary debt service suspension to ensure countries remain liquid while increasing fiscal space for investing in a green and inclusive recovery. All three pillars would be calibrated to align with enhanced debt sustainability analyses, which—unlike the current IMF and World Bank model—would account for the level of investment needed to meet global climate and development goals agreed upon under the auspices of the United Nations.

By including calls for the elements of this proposal and underlining their importance to financing development, FfD 4 could provide vital momentum to a largely uncoordinated global sovereign debt architecture. In particular, FfD 4 could create the framework for comprehensive restructuring—like HIPC—as opposed to the current reliance on an uncertain and unpredictable case by case approach.

2. International Development Cooperation: Scaling up multilateral development banks and national development banks

At a time when overall net financing flows to developing countries have turned negative, multilateral development banks (MDBs) have served as a central source of positive flows.[7] Three factors will create large demand for MDBs moving forward. First, meeting climate change and development goals demands a ramping up of investment, and this investment push will require low-cost, long-term finance that MDBs' are uniquely placed to provide due to their development mandate and ability to borrow at low interest rates. Second, especially when interest rates are high, developing countries will struggle to finance investment through private sources without exacerbating debt vulnerabilities. Our research found that just 13 or 108 EMDEs have relative capital market access that allows them to externally borrow at interest rates below their projected growth rates.[8] Third, from the donor perspective, MDBs have great appeal due to their ability to leverage relatively small donor contributions into much higher levels of finance.

As the importance of MDBs to development finance grows, their resources will also need to grow. MDBs should expand their resources through three primary routes. First, they can get more value out of existing resources. This route includes capital adequacy reforms to stretch their balance sheets—measures already initiated are projected to enable $357 billion in additional lending headroom over a decade across the MDBs—and efforts to better value callable capital.[9] Second, MDBs can benefit from hybrid capital or other innovative sources of financing. The rechanneling of Special Drawing Rights (SDRs) as hybrid capital represents one such mechanism, as would Sustainable Future Bonds.[10] Third, MDBs should pursue general capital increases. In comparison to other methods of expanding MDBs' financial capacity, increases in paid-in capital create the least risk for MDBs and provide the most

[7] https://www.brookings.edu/articles/swimming-against-the-tide-on-financing-for-development/
[8] https://www.bu.edu/gdp/2024/02/02/now-or-never-for-sustainable-development-the-imperative-of-raising-capital-for-shared-global-sustainability-goals/
[9] https://www.gov.br/fazenda/pt-br/assuntos/g20/declaracoes/2-3rd-fmcbg-communique.pdf
[10] https://www.imf.org/en/News/Articles/2024/05/14/pr24162-imf-exec-board-approves-sdr-acq-hybrid-capital-instr-issued-prescribed-holders; https://www.bu.edu/gdp/2023/06/19/sustainable-future-bonds-boosting-mdb-lending-and-improving-the-global-reserve-system/

flexibility to design financing appropriate to meet MDB objectives.[11] In aggregate, these reforms should produce an additional $390 billion each year, the amount the G20 Independent Expert Group estimated would be necessary to meet climate and development goals.[12]

While FfD 4 should not overstep the contours of its mandate, the adequacy of MDB resources fits squarely as a financing for development issue relevant to the UN. Indeed, the Addis Ababa Action Agenda "stress[ed] that development banks should make optimal use of their resources and balance sheets" and "encourage[d] the multilateral development finance institutions to establish a process to examine their own role, scale and functioning."[13] FfD4 needs to underscore the need for MDBs to establish such a process especially in light in of the urgent need to scale up resource mobilization and the challenges posed by the global macroeconomic environment on the ability of developing economies to meet their financing needs. There is a need for institutions with a systemic view of global development objectives to provide guidance to a set of MDBs that can be uncoordinated and sometimes competitive, and FfD 4 should call boldly for increases in MDB resources, including general capital increases.

FfD4 is also an important opportunity to highlight the synergies that exist between multilateral development banks and regional/national development banks. National development banks have unparalleled reach and are integrated into national policy ecosystems. Affordable and long-term financing from MDBs can help NDBs be catalysts of structural transformation.

3. International Development Cooperation: Reforming concessionality to align with vulnerability

Methods of allocating concessional finance remain excessively blunt. While income-based metrics are in important guide, they only serve as one justification for concessional finance. There are other vulnerability-based justifications for concessional finance. Risks of debt distress accentuate the need for concessional finance and are a trigger for cheaper IDA finance. However, climate vulnerability—which correlates with but is distinct from countries' incomes—remains an extremely underutilized basis for allocating concessional finance. In addition to needs-based justifications, concessional finance is sometimes used as an incentive, as in the World Bank's recent initiative to begin allocating concessionality to IBRD countries for projects making significant contribution to global public goods.[14]

One of FfD 4's main contributions could be to catalyze global reforms in definitions of vulnerability and the allocation of concessional finance. Building on the Multidimensional Vulnerability Index and a long history of discussing concessionality in FfD Conferences, FfD 4 should encourage a norm that eligibility for concessional funds should be based on multidimensional criteria relevant to the objective of the fund. While national income metrics will typically be one such factor, depending on the purpose of the concessional fund, other dimensions should include debt distress, climate vulnerability, or other sources of vulnerability like fragility, conflict, and violence. However, the addition of vulnerability as a criterion

[11] https://media.odi.org/documents/DPF_EA_Making_sense_of_hybrid_capital_for_multilateral_banks.pdf
[12] https://www.cgdev.org/publication/strengthening-multilateral-development-banks-triple-agenda
[13] Addis Ababa Action Agenda Paragraph 70
[14] https://documents.worldbank.org/en/publication/documents-reports/documentdetail/099042524224016162/bosib12ba0e0350801bb8517ee244526b14

for concessional finance should not compete with the need for concessional finance for the lowest income countries. Broadening the eligibility metrics of concessional finance is closely tied to the scale of finance available through MDBs discussed above.

4. **International trade as an engine for development: Reform trade rules to protect developing country policy space and manage spillovers**

While trade is an important route to advancing development, international trade rules are excessively restrictive of developing countries' policy space, limiting their ability to achieve public policy objectives. In particular, trade rules can limit the use of developmental policy tools that developing countries could use to enable greater value-addition or green development.

One particularly important flaw in the global trade regime that FfD 4 should address is the prevalence of investor-state dispute settlement (ISDS). ISDS constrains developing country use of policy space—both through actual arbitration claims and through a chilling effect on governments—but there is little evidence that it achieves its intended purpose of stimulating investment flows.[15] ISDS also creates significant risks to climate policy and financing for development: our research finds that if countries take 1.5C aligned action to eliminate new fossil fuel extraction and development projects, ISDS claims from oil and gas asset owners could amount to as much as $340 billion.[16] While these flaws in ISDS have led developed countries to begin reducing their own exposure to ISDS, developing countries remain highly at risk.[17]

Still, while policy space is vital, there must also be sufficient multilateral coordination to limit negative spillovers inflicted through trade policies. The evolution of the trade regime has opened up some policy space in recent years, but the expansion of policy space has been asymmetrical and high-income countries have adopted a number of trade policies that produce negative repercussions in developing countries.[18] To counteract these worrying trends, FfD 4 should reaffirm the importance of special and differential treatment and the particular need for policy space in developing countries; encourage the restoration of a functioning WTO Appellate Body, albeit in a reformed structure[19]; and call on developed countries to ensure trade policies are designed to minimize harm to developing countries, including by the elimination of ISDS.

5. **Addressing systemic issues: Increasing the voice and participation of developing economies in global economic governance**

Reforms to increase the voice and participation of developing economies have made little progress since 2015. While the creation of the New Development Bank and Asian Infrastructure Investment Bank have

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[15] https://onlinelibrary.wiley.com/doi/full/10.1111/joes.12392
[16] https://www.bu.edu/gdp/2022/05/05/investor-state-disputes-threaten-the-global-green-energy-transition/
[17] https://www.bu.edu/gdp/2024/07/23/chart-of-the-week-whats-next-after-the-ect-the-top-investment-agreements-posing-a-threat-to-climate-policy/
[18] https://www.bu.edu/gdp/2022/03/11/the-global-impact-of-a-carbon-border-adjustment-mechanism-a-quantitative-assessment/
[19] https://www.bu.edu/gdp/2023/05/31/a-framework-for-a-reformed-wto-appellate-body/

added new MDBs, the governance of the Bretton Woods Institutions has evolved little, despite the Addis Ababa Action Agenda's language stating, "We reiterate our commitment to further governance reform in both IMF and the World Bank to adapt to changes in the global economy."[20] The World Bank established the Lima Shareholding Principles in 2015, but only modest changes to governance came with the 2018 capital increase.[21] The IMF has been even slower to reform governance, with no agreement for quota realignment coming since 2010. While the IMF Board of Governors approved the addition of a 25th chair reserved for sub-Saharan Africa, deeper realignment is required.[22] The most recent quota review ended with an equi-proportional increase in quotas, meaning there was no realignment despite IMFC commitments to advance realignment dating back as far as 2012.[23]

2025 is a major year for governance in the Bretton Woods Institutions, and the Financing for Development Conference has an opportunity to help global economic governance catch up with the realities of today's world. The International Bank for Reconstruction and Development (IBRD) and International Finance Corporation are undergoing a shareholding review in 2025. After the most recent quota review ended without realignment, the IMF set a deadline for "possible approaches as a guide for further quota realignment, including through a new quota formula" of June 2025—a timeline that ties closely to FfD 4.[24] Especially as global economic governance has become even further out of line with the global economy since 2015, FfD 4 has ample justification for adopting more ambitious language than the relatively unspecific language in the Addis Ababa Action Agenda. In particular, setting concrete targets for the content of governance reform and the speed of governance reform would encourage follow-through.

6. Addressing systemic issues: Increasing the use of Special Drawing Rights and improving their efficiency

The 2021 allocation of $650 billion in SDRs constitutes one of the most important contributions to financing for development since the Addis Ababa Action Agenda, and this contribution came at essentially no cost to donor budgets. Important lessons can be drawn from this allocation and FfD 4 can play an important role in maximizing the development potential of Special Drawing Rights while preserving financial stability and the role of the IMF. First, the 2021 allocation showed the importance of SDRs, and FfD 4 can encourage more regular use of SDRs to address chronic liquidity challenges facing developing countries, challenges that exogenous shocks and climate change severely exacerbate.[25] Second, it took a significant amount of time after the onset of the COVID-19 pandemic to agree on the allocation and the majority of SDRs went to advanced economies that did not use them, pointing to the importance of mechanisms to allocate SDRs more quickly in response to shocks and to distribute them on a more appropriate metric than IMF quotas. Third, rechanneling SDRs that have been allocated to

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[20] Addis Ababa Action Agenda Paragraph 106

[21] https://www.devcommittee.org/content/dam/sites/devcommittee/doc/documents/mgr/DC2021-0008%20Final%20Shareholding%20paper.pdf

[22] https://www.imf.org/en/News/Articles/2024/08/02/pr-24299-imf-board-of-governors-issues-resolution-to-create-a-25th-chair-at-the-imf-exec-board

[23] https://www.imf.org/en/News/Articles/2015/09/14/01/49/pr12391

[24] https://www.imf.org/en/News/Articles/2023/12/18/pr23459-imf-board-governors-approves-quota-increase-under-16th-general-review-quotas

[25] https://publication.aercafricalibrary.org/items/b0185468-6704-4746-9909-5c512e4b2e88

advanced economies carries significant development potential, and rechanneling them to MDBs as hybrid capital provides one important option. Re-channeled SDRs should also be easily accessible. Policies such as the requirement to have a concurrent IMF program to access the Resilience and Sustainability Facility limits access. FfD4 should encourage a re-examination of how efficiency of SDR rechanneling can be improved, such as by establishing a working group to identify effective rechanneling options that are compatible with potential donor countries' legal frameworks. While the IMF will remain the primary forum for decisions on SDRs, there is significant precedent for addressing SDRs within the United Nations System: the Secretary-General has proposed more active use of SDRs and past Financing for Development Conferences have addressed SDRs in their outcome documents.[26]

[26] Monterrey Consensus Paragraphs 44 and 59; Addis Ababa Action Agenda Paragraph 107