Preparatory Process for the Third International Conference on Financing for Development

Substantive informal session

9 December 2014, 10:00 a.m. to 1:00 p.m.
Trusteeship Council Chamber, United Nations, New York

A stable monetary and financial system, as well as other systemic issues, such as trade and global governance, are crucial elements of an international enabling environment that will facilitate the implementation of the post-2015 development agenda and achievement of the Sustainable Development Goals (SDGs). The need to address systemic issues and strengthen the international monetary and financial systems in support of development was recognized in the Monterrey Consensus, which also emphasized that reforms to the international financial architecture should aim at poverty eradication.

The 2008 world financial and economic crisis highlighted significant systemic flaws in the financial system. Since the crisis, important reforms have been put in place to improve the functioning, stability and resilience of the international monetary and financial system. The global financial safety net has been strengthened, new coordination mechanisms have been

Draft Programme

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monetary and financial system;

There are also concerns of higher risk activities moving from regulated banking to unregulated
to activities of financial intermediaries that were not subject to regulatory oversight. In recent years, the term has been used more broadly to refer to any type of credit intermediation outside the conventional banking system.[3] In the 2008 financial crisis, highly leveraged shadow banking activities contributed to the crisis, highlighting risks inherent in unregulated financial intermediation.

The size of shadow banking assets is difficult to estimate. However, estimates put it at over $70 trillion.[4] While shadow banking is larger in developed countries, it has been growing more quickly in developing countries. Nonetheless, shadow banking in developing countries is often of a different nature than in developed countries, incorporating areas of inclusive finance, which could have positive impacts on sustainable development financing. The challenge lies in determining how these activities should be regulated, and in designing regulations to incorporate the full scope of activities while balancing risk mitigation with the imperative of an inclusive financial system.

On a global level, the FSB has been working to further strengthen the oversight and regulation of shadow banking entities, including through information-sharing.[5] These reforms are complemented by additional efforts, including reducing systemic risks associated with securities financing and -big-to- entities and strengthen the oversight and regulation of global systemically important financial institutions, implications of domestic banking reforms on financial institutions and markets in third countries,[6]and reforms of derivatives markets though implementation on the national level has at times been slow. Other regulatory initiatives under discussion include work on accounting standards, reduction in the reliance on credit rating agencies and reform of certain compensation practices.

The Basel Committee has reached out to countries that are not FSB members to facilitate the implementation of Basel III in these countries. There are, however, questions on how to apply the full range of Basel III rules to developing and emerging economies, especially since the rules were designed for financial institutions in major advanced economies. On the other hand, it is argued that differing regulations can create room for regulatory arbitrage.

Despite outreach efforts, formal representation in international financial regulatory bodies remains limited to advanced economies and a number of major emerging market economies. The development and implementation of international financial regulation could benefit from greater representation of and participation by developing countries in the regulatory reform process.

[3] IMF (2014). Global Financial Stability Report October 2014: Risk Taking, Liquidity, and Shadow Banking: Curbing Excess While Promoting Growth. Washington, D.C.:IMF.
[4] United Nations World Economic Situations and Prospects, 2014.
[5] FSB Chair's Letter to G20 Ministers and Governors on financial reforms, 4 April 2014.
[6]
Reforms on Emerging Market and Developing Economies: A Review of Potential Unintended Consequences

Strengthening the global monetary system

Global imbalances on the current accounts of major economies have narrowed considerably over the past few years, representing a reduction of risk in the monetary system.[7] Nonetheless, many of the structural issues underlying global imbalances remain, creating the potential for a future build-up of risk while diverting resources that could otherwise be used for financing sustainable development. In particular, a proportion of existing global savings are currently in the form of international reserves held by central banks. From 2000 to 2014, global foreign-exchange reserves increased more than fivefold from $2.1 trillion to $12 trillion, with emerging and developing countries holding an estimated $8 trillion.[8]

Several factors explain the continued build-up in international reserves. For many countries,

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accumulation can also be an outcome of central bank interventions in foreign exchange markets aimed at smoothing exchange rate volatility, managing excessive capital inflows during boom periods, or maintaining an undervalued currency to support export-led growth strategies. Empirical studies suggest that no single explanation can account for the behaviour of all countries at all times,[9] though reserves have been higher than what would be predicted solely by

capital flows, better coordination of monetary and exchange rate policies and providing more robust financial safety nets.

Cross border capital flows remain highly volatile

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

targeted to stabilize financial flows and may have undesired side effects. Attempts by policymakers to counteract the expansionary impact of excessive capital inflows by tightening monetary policies could also be partly self-defeating, as the higher interest rates may attract additional capital inflows, thereby exacerbating upward pressure on the exchange rate and further limiting domestic policy space. Greater attention is therefore being given to other tools to manage volatile capital flows. Macro-prudential policies as well as more direct controls have gained recognition among experts and policymakers as important tools to complement traditional policy approaches. Many economists recommend that policymakers consider a toolkit of options to manage capital flows.[14]In 2012, the IMF changed its earlier position of opposing the use of capital account management techniques in all cases, to

Size and paid-in capital of global and regional financial arrangements (billion USD)

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Source: IMF; Rhee, Changyong, Lea Sumulong and Shahin Vallée (2013). Global and regional financial safety nets: lessons from Europe and Asia. Bruegel Working Paper, 2013/06. Brussels: Bruegel. November

The involvement of major central banks will remain pivotal for a functioning and sufficient global financial safety net. In some cases, more permanent frameworks of liquidity lines among key central banks have been introduced. Moreover, regional financing arrangements can play an increasingly important role in the global financial safety net. Existing regional financial arrangements include the Arab Monetary Fund (established in 1976), the Latin American Reserve Fund (established in 1989), the European Union Balance of Payments Assistance Facility (established in 2002), the Chiang Mai Initiative Multilateralization (established in 2010), the Anti-Crisis Fund of the Eurasian Economic Community (established in 2009), as well as the European Stability Mechanism (established in 2012) and the BRICS Contingency Reserve Agreement, among other arrangements (see Figure).

Guiding questions

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