International Financial Architecture

> *Mains Syllabus: GS II - Important International Institutions, agencies and fora - their Structure, Mandate.*

Why in the News?

Recently Union Finance Minister advocates for reforms in international financial architecture to ensure MDB funds are used for development purposes.

What are the components of international financial architecture?

- **International Financial Architecture (IFA)** – It refers to the comprehensive framework of institutions, policies, rules, and practices that govern the global financial system.
- **Objective** – Its primary purpose is to
  - Facilitate international financial flows
  - Promote global monetary and financial stability
  - Support international trade and investment
  - Enable the mobilization of stable and long-term financing for economic development
  - Addressing global challenges like climate change
  - Achieving the Sustainable Development Goals (SDGs)

Key components of the IFA

• **Public International Financial Institutions** - Such as the International Monetary Fund (IMF), World Bank Group, multilateral development banks, and global funds (e.g., Green Climate Fund).

• **Financial Standard-setters** - Organizations that set norms for private finance governance, including
- Financial Stability Board
- Bank for International Settlements
- International Organization of Securities Commissions
- International Accounting Standards Board.

• **Regulatory Frameworks** - Rules and standards that guide global financial markets and cross-border financial flows.

• **Monetary Arrangements** - Such as regional financial arrangements and the network of bilateral swap lines.

• **Informal Country Groupings** – Those groupings that act as norm-setters, such as the Group of Seven (G7) and Group of 20 (G20)

• Formal but non-universal norm-setting bodies, in particular the Organisation for Economic Co-operation and Development (OECD)

• **Rules, Policies, and Agreements** - This includes a vast array of international treaties, conventions, codes of conduct, and customary practices that govern areas such as:
- Exchange rate regimes
- Capital controls
- Debt resolution frameworks (e.g., Paris Club, Common Framework for Debt Treatments)
- International trade rules (e.g., World Trade Organization agreements)
- International tax cooperation (e.g., efforts to combat tax evasion and avoidance)

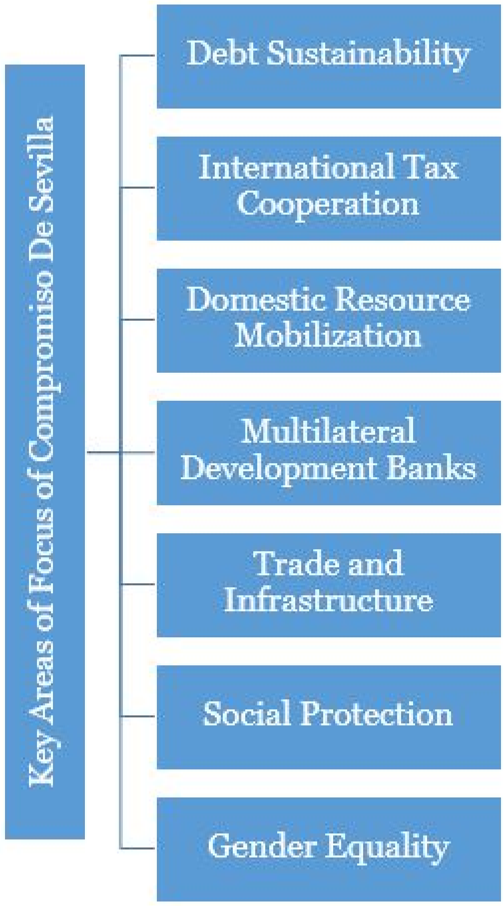
What are issues with international funding ecosystem?

- **Dominance of Developed Countries** - The IFA, particularly institutions like the IMF and World Bank (known as the Bretton Woods Institutions or BWIs), was largely designed by and for industrialized countries after World War II.
- Voting shares and leadership positions are disproportionately held by wealthy nations, giving them undue influence over decision-making and leads to a structural under-representation of the Global South.
- **Gentleman's Agreement** - A long-standing informal agreement ensures that the head of the IMF is European and the head of the World Bank is American, further entrenching the imbalance of power.
- **Massive Financing Gap** - There is an estimated annual financing gap of $4 trillion for developing countries to achieve the Sustainable Development Goals (SDGs) by 2030.
- **Insufficient MDB Lending** - While Multilateral Development Banks (MDBs) are vital, their lending capacity is often seen as insufficient to meet the growing demands
- **Declining Official Development Assistance (ODA)** - ODA from high-income countries is under pressure due to domestic fiscal constraints and competing priorities.
- **One-Size-Fits-All Approach** - Critics argue that IFIs often apply uniform policy solutions that do not adequately reflect the unique political, social, and economic circumstances of individual countries, especially fragile and conflict-affected states.
- **Diversion of Development Funds** – Some countries have allegedly diverting funds from International Monetary Fund (IMF) and the Asian Development Bank (ADB)

towards increased military expenditure rather than towards developmental purposes.

What is Compromiso de Sevilla?

- **Compromiso de Sevilla (Seville Commitment)** – It is the outcome document of the Fourth International Conference on Financing for Development (FFD4), held in Sevilla, Spain.
- **Adoption** - It was intergovernmentally negotiated and adopted by UN Member States to lay the foundation for a renewed global framework for financing sustainable development.
- **Renewed Global Financing Framework** - It serves as a cornerstone for a revitalized global framework for financing sustainable development, building upon previous agreements like the Addis Ababa Action Agenda (2015).



- **Addressing the Financing Gap** - A primary goal is to tackle the widening $4 trillion annual financing gap faced by developing countries in achieving the Sustainable Development Goals (SDGs) by 2030.
- **Mobilizing Resources** - The commitment aims to catalyze a large-scale investment push from all sources (public, private, philanthropic) and make the international financial architecture more responsive to countries in need.
- **Multilateralism** - Despite some divisions and the withdrawal of the United States from negotiations, the adoption of the Compromiso de Sevilla by consensus is seen as a demonstration that multilateralism can work and deliver results.
- **Sevilla Platform for Action (SPA)** - Launched alongside the Compromiso de Sevilla, the SPA brings together over 130 initiatives designed to implement the commitments

of the outcome document.

What can be done?

- India has been demanding reforms to the international financial architecture to enhance inclusivity and equity, including MDB reforms and fairer credit rating systems.
- MDB lending needs to be aligned with long-term development goals and backed by robust monitoring frameworks to ensure that funds are used as intended.

References

1. The Hindu | Multilateral bank lending
2. UN | Compromiso de Sevilla

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