Priorities for the upcoming

“Summit for a New Global Financial Pact”

Policy Note 5

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About Finance for Development Lab

The Finance for Development Lab is an independent non-profit, non-partisan think-tank dedicated to building a fairer and more effective architecture for international finance. Acting as a hub for policy discussions, the Lab collaborates with think-tanks, researchers, and other key stakeholders across the Global South to generate constructive ideas, craft innovative proposals, and influence global policymakers, with a particular focus on G20 countries and Bretton Woods institutions.

The Lab is housed at the CEPREMAP, a leading French research institute located within the Paris School of Economics. It is supported by the Bill & Melinda Gates Foundation. Its work is directed by the Steering Committee, a group of about fifteen experts and institutions in Africa, Latin America, and Asia. Its founding members are the following institutions, in addition to a group of individual experts.

While steering committee members discuss and shape our research, reports from FDL only represent their authors' views.

Steering Committee Institutions

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cdpr Consortium for Development Policy Research

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On 6th January 2023, the Finance for Development Lab hosted a high-level panel event to put the spotlight on key priority issues to be discussed during the Summit announced by President Macron at COP27 for a "New Global Financial Pact" (Paris, 22-23 June 2023).

The webinar opened with an Address by Chrysoula Zacharopoulou, French Secretary of State for Development, Francophonie and International Partnerships, introducing the rationale for a summit and setting out its objectives. Amélie de Montchalin, French Ambassador to the OECD, then outlined the key work elements to progress, both within the OECD and outside, to ensure a successful summit.

FDL's Chair, Daniel Cohen, then moderated a conversation between Tidjane Thiam (CEO, Freedom Acquisition), Vera Songwe (Chairperson of the Liquidity and Sustainability Facility and Co-Chair of the High-Level Panel on Climate Finance), Masood Ahmed (President, Center for Global Development), Marilou Uy (Director of the Secretariat, G-24) and Deepak Mishra (CEO, ICRIER), whom we would like to thank again for their kind participation.

The following note summarises their priorities for the June Summit in Paris.

From short-term crises to long-term opportunities

In the face of complex overlapping global crises – development, climate, biodiversity, recurring shocks of pandemics and wars – President Emmanuel Macron's call for a New Global Financial Pact strongly resonates, highlighting the need to urgently move forward with meaningful structural reforms in the area of development finance.

Building on a coalition of multiple countries, including the US, India, Barbados, Japan, and China, the Paris Summit will focus on four key themes: 1. Short-term liquidity and debt tensions; 2. Financing the private sector in low-income economies (climate and development); 3. Increasing investment in green infrastructures (building on JETP's lessons, but not only); and 4. Increasing resources for countries vulnerable to climate change. In addition, the One Planet Lab will be reactivated to imagine innovative mechanisms to finance the loss and damage due to climate change as well as the adaptation.

Ultimately, all these themes involve finding new sources of funding, including through new global taxes, better insurance mechanisms to protect projects from natural catastrophes, and better coordination on various infrastructure programmes (e.g.: Blue Dot Network, Global Gateway, or Fast Infra). According to the Bridgetown initiative lead by Barbados Prime Minister Mia Mottley, meeting climate transition needs in emerging and developing countries will require considerable investment in mitigation, borne by the private sector to the extent that is possible; concessional finance towards adaptation and grants finance to compensate for natural catastrophes. Neither of those sources are materialising in the short run, but the summit is an opportunity to raise new funding and mobilise new investments.

The objective of FDL's webinar was to pave the way for the discussions that will take place in June in Paris, by helping advance global thinking on some technical aspects of the Summit's key themes. In doing so, the panel has identified four priorities to progress on by June.

1. In the short term: helping vulnerable financial tensions and avoiding unnecessary crises

The broad economic context of the summit will be one of increased financial tensions for low-income countries. Crises have accumulated: after COVID-19, inflation emerged as early as 2021 for African countries, compounded by the war in Ukraine in 2022. Financially vulnerable countries are pushed towards bankruptcy, and risk both external and fiscal crises. The subsequent increase in interest rates by central banks in advanced economies sent yields in most low and lower middle-income economies soaring. GDP growth has held relatively well despite sharp increases in food and energy prices, but 2023 will be a pivotal year as advanced and emerging economies continue to fight elevated inflation.

For countries with large outstanding debt service payment, the cliffs will be challenging to manage. Without convenient access to sources of liquidity, some countries, including those with strong fundamentals, could face difficult choices. The IMF Poverty Reduction and Growth Trust (PRGT) could deploy its funds rapidly – it has about $30 billion of unused lending capacity. Donor countries can strengthen its ability to make zero-interest loans by continuing to provide grants to the subsidy account. Increasing pledges of Special Drawing Rights (SDR) and securing long term stability of the IMF funds is important in providing a basic safety net. The hybrid capital scheme presented by the African Development Bank (AfDB) to receive SDRs from lender countries is another major step forward in opening the road towards meeting the G7 pledge of $100 billion SDRs rechannelled.

> **" The best equity we can put in the system right now is additional SDRs."**
> Vera Songwe

Reforming the debt architecture to allow rapid debt treatment. While most countries are not at risk of a major debt crisis, the increase in debt service is heavily straining their resources and impeding necessary investments in development projects. The June Summit will need to put a spotlight on this growing development threat. The process should be accelerated: countries cannot wait two years or longer, as has been the case with Zambia. At a minimum, a standstill should be agreed for countries applying to the Common Framework, in order to provide them with temporary relief. More ambitiously, the applicability of Comparability of Treatment should be reviewed as it hampers creditors coordination.

> **"I don't think we are going to have many defaults – the cost of default is very high. (...) What we are going to see is that unsustainable debt service is going to lead to development crises rather than debt crises. There will be default for future generations, cutting back on investments for the future."**
> Masood Ahmed

Recommendation 1 :

Continuing to enhance existing financial safety nets, including by actually providing to the IMF the SDRs that were pledged, and broadening rechannelling towards Multilateral Development Banks. The IMF should continue to provide rapid loans through its emergency windows as it is done through the Food Security Window.

Countries in liquidity crisis should be supported and those at risk of solvency crisis should be encouraged by a commitment to reform the Common Framework.

2. Redeploying multilateral lending

The Multilateral Development Banks reform agenda holds high promises, and the June Summit in Paris is well placed to advance some of its key decisions: the CAF reform and the World Bank roadmap provide a clear pathway for additional funding for development challenges. In Paris, there should be a clear signal that shareholders support the optimisation of the balance sheet of MDBs. A new capital increase might be necessary as a complement to increased leverage, thus multiplying the impact of new capital. But reforms in financing models have to go hand-in-hand with adapting operations and strategy. The country-level engagement which has been the capstone of MDBs model will have to evolve when considering global public goods.

> **"There is a clear opportunity now to show how MDBs could increase their lending capacity (cf. G20 Panel of Experts 2022 Review on MDB lending). One cannot put a number now but should aim perhaps for a 50% increase"**
>
> Marilou Uy

There is a risk that increasing MDBs lending and focusing on climate would be at the expense of the poorest. To counter this perception, reforms focusing on countries which have the ability to borrow or on more bankable sectors, should not be taking money away from low-income countries. This is particularly important for the World Bank's concessional arm, IDA. Its ability to provide grants or very concessional loans could decline, and there should be a clear commitment to securing its funding to protect low-income countries. Those countries contribute the least to climate change and are often the most vulnerable. In terms of climate finance, this would imply a significant increase in funds going to adaptation – aiming at doubling commitments.

> **"We need to make sure we don't forget the LICs. 75% of Africa is middle income or blend but there is a low-income collection of countries that has 25% of the economy that depends entirely on IDA, i.e. grant resources."**
>
> Vera Songwe

Solidarity should take the form of innovative sources of finance, provided in the form of grants. Debt has risen in many fragile economies, and their ability to raise revenues is limited. Many development objectives cannot be achieved on loans, especially in fragile countries. While development assistance budgets are limited, the summit is an opportunity to discuss new fundraising at global level, for example with a global tax or levy on carbon. Other options would be to find a way to redistribute a small share of the large transfer of resources from oil consumers to oil producers. A well-designed carbon offset market could also compensate countries which reduce their emissions.

COP27 marked the adoption of the Loss & Damage Fund but important questions relating to its implementation still remain: How can the money be raised (i.e., the missing 100 billion USD in annual climate finance that were pledged to developing nations back in 2009)? How can the funds be accessed? How to ensure it will help LMICs effectively implement their development projects, even the smallest? There are more questions than answers and the summit should help in preparing an agreement for COP 28.

Recommendation 2 :

The system of Multilateral Development Banks needs considerable expansion and rethinking. The June Summit should lead to commitments by the main shareholders to achieve precise quantitative targets in increased lending of some of the main MDBs, as well as new deployed instruments such as guarantees.

It should also make sure that these reforms are not at the expense of existing concessional windows, and that the objectives of meeting adaptation pledges remain a priority.

Grant resources will be needed as many countries are already reaching their limits on borrowing, even concessional, and face high costs of climate change.

3. Boosting the role of the private sector

Improving the domestic business environment is essential for growth. Most of the big announcements, when it comes to this kind of summits, only focus on financing what ultimately goes to governments. When reforms do focus on the private sector, the main goal is to attract foreign capital. This is a double mistake: growth will only come with a radical effort to focus on the domestic private sector. A functioning domestic environment is the foundation upon which to attract foreign capital. Much more efforts should therefore be devoted to measuring and eliminating barriers to local businesses and entrepreneurs. All firms start small, hence why allowing SMEs to grow is essential.

Focusing on new sectors and technologies, especially those providing comparative advantage for green growth. To complement a renewed focus on the private sector, it is importance to embrace technology and digitalisation, in particular in sectors like financial services, energy, logistics and healthcare. The global context is important: the Inflation Reduction Act (adopted in 2022 by the US Congress) considerably lowered the price of Electric Vehicles and solar power in the US. Using this as a model, there is an obvious business case for an accelerated plan to electrify Africa with solar power plants and to transform urban transportation through electric vehicles. African economies have a comparative advantage in sectors

> **"We need capital, not debt. There is too much focus in providing loans. Equity is vital. If you have equity, it is very easy to get a loan because you can leverage yourself."**
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> **"Africa needs to be competitive, which requires political leadership that listens to the domestic private sector. People will not invest where local firms can't thrive."**
>
> Tidjane Thiam

powered with clean energy. It is time for the international community to support this major industrial opportunity. Logistics will be another major sector where new firms can emerge: agriculture is the largest sector of employment, but up to a third of production is wasted through bad transportation and refrigeration. In medicine, proper transportation through drones and warehousing is also a major opportunity.

Today, entrepreneurs lack access to financing to thrive. The financial support should come under the form of equity. When external support is provided, it is largely done through debt financing rather than equity. Loans and debt financing protect the lender, but it shifts the weight of vulnerability to the borrowing economy. In contrast, equity allows firms or infrastructure projects to leverage, thus multiplying its impact. Increasing financial support through equity investment, in particular by mobilising large equity investment in Africa, goes a long way to support a thriving domestic sector. With a young population, domestic pension funds can emerge as a relay: there is a rise of domestic patient capital ready to provide local currency loans, if the equity risk is held by international providers.

Recommendation 3 :

Development finance providers should raise additional equity to boost the dynamism of African entrepreneurs in strategic sectors. They will only be able to unleash their full potential if governments work on providing a conducive business environment for domestic firms. External support should come first and foremost under the form of a managed International Finance Corporation (IFC) fund or other major development finance providers like the European Investment Bank (EIB) or European Bank for Reconstruction and Development (EBRD). The impact would be high, especially with the adoption of complementary reforms in the domestic business landscape.

4. Seizing this year's major window of opportunity

The timing is important, leveraging on the Indian Presidency of the G20 to play a central role in relaying the needs and positions of the developing world. Under the G20 Finance Track, the Indian presidency has high ambitions. A Working Group will address the macroeconomic consequences of food and energy insecurity, the assessment of the macroeconomic impact of climate change and transition pathways, and supporting strong, balanced, and inclusive growth. There is also a commitment under the International Financial Architecture Working Group to work on strengthening Multilateral Development Banks to address current financial challenges, managing debt vulnerabilities, and strengthening safety nets. India is well placed to foster a dialogue between China and Paris Club members, and to advocate for broadening the Common Framework to middle-income countries. Other topics of discussion will be the enhancement of debt transparency and sustainability and the development of guidelines and best practices for low-income countries.

> **"India's Presidency plans to work on addressing the implementation challenges associated with the Common Framework: possibility of expanding it to MICs, discussing how to improve the debt restructuring architecture, enhancing debt transparency and sustainability and developing guidelines for LICs."**
>
> Deepak Mishra

The June Summit should be an opportunity to obtain some "quick wins" and build on this momentum to activate deeper reforms. The MDB reform agenda is more ready for action than ever, with some elements already being broadly agreed upon. From a more political standpoint, perhaps the lowest hanging fruit, would be for the Summit to actually deliver on items that were promised at the G7, to continue channelling the SDRs to the IMF and other institutions. The summit can build on concrete announcements to launch more long-term programs which will take longer to achieve.

2023 offers a unique window of opportunity to move forward on all these issues and make best use of existing diplomatic channels and meetings, such as the Bridgetown agenda, initiated by Mia Mottley and strongly supported by President Macron, India's G20 presidency which is strongly committed to these issues, the ongoing momentum around the reform of the World Bank, and the Sustainable Development Goals agenda which will reach its halfway point this year.

> **"The June summit will be a moment of convergence of many agendas: development, finance, debt issues. New money is needed, this cannot just be a reshuffling exercise."**
>
> Amélie de Montchalin

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