

## **EU-CELAC MINISTERIAL MEETING**

### **SESSION II: Current State of the Global Financial Safety Net**

Friday, 15 September. 17:00 – 18:30

Plenary hall. Museo Centro Gaias. Cidade da Cultura

**The global rules-based monetary and financial order born after WWII has provided the world with a multilateral set of institutions and instruments contributing to financial stability and financial support to countries suffering severe imbalances.** Bretton Woods institutions, together with other development banks and international fora such as the WTO, G20, G7, etc. have underpinned economic globalization and trade with a network of financial instruments and funds creating a global financial safety net throughout the world.

**Although all these mechanisms proved once more to be key in supporting coordinated, consistent, and sustainable policies and preserving stability during the COVID-19 pandemic, there are growing calls for an in-depth reform.** In a world of increased geopolitical tensions and trade fragmentation, new economic realities, higher interest rates and food and energy insecurity, there is a clear need for a strong, modern and effective Global Financial Safety Net, with the IMF at its centre, helping different countries and regions deal with current global challenges and supporting low-and-middle income countries on a path of sustainable and inclusive growth.

**European, Latin American and Caribbean countries have a key role to play in this debate as core stakeholders in these institutions.** The IMF, the World Bank Group and other multilateral institutions have increased their support to most vulnerable countries since the onset of the pandemic. However, financing needs remain high and different legal and economic obstacles have limited the impact of recent efforts to reinforce the Global Financial Safety Net. Time is of the essence and different options have been flagged to put the process on track during the upcoming Annual Meetings in Marrakech in October:

#### **1. Enhancing debt treatments**

**The evolving landscape, with a shift from the Paris Club to commercial and non-Paris Club creditors, underscores the critical need for effective coordination among creditors.** Significant efforts to improve debt sustainability of several countries have already been made and should be recognized. This is the case of Zambia, Chad and Ghana, as well as the coordinated response to Sri Lanka's financial situation. Furthermore, the Global Sovereign Debt Roundtable —co-chaired by India's G20 Presidency, the IMF and the World Bank—is facilitating a common understanding on key issues, including debt transparency and information sharing, a promising avenue that should be exploited to achieve tangible outcomes.

**Additionally, climate-resilient debt clauses and climate debt swaps are being explored to enhance countries' resilience to shocks and promote climate-related investments.** Further work on these mechanisms could complement existing tools, strengthen the debt ecosystem, and help build resilience to climate change in countries facing limited financing options.

**There is a clear need to improve debt restructuring mechanisms to provide further relief and set economies on a more sustainable path.** Among the issues to be considered: the role of private creditors, automatic debt service suspension during good faith negotiations, the extension of the Common Framework to middle-income countries, or improved creditor coordination on debt treatment for countries outside the Common Framework.

## **2. Strengthening the International Monetary Fund**

**A successful conclusion of the 16th General Review of Quotas by December 2023 is needed to boost confidence and reinforce the Global Financial Safety Net, with the IMF at its centre.** It is essential to maintain a strong, quota-based and adequately resourced IMF, so that it may continue to meet countries' financing needs, while promoting sound macroeconomic policies.

**Important steps have already been taken towards a pragmatic compromise by the upcoming Annual Meetings.** Building on the Spring's IMFC agreement to at least maintain the Fund's current resource envelope and progress at the informal IMFC Deputies' meeting in Málaga in July, there is convergence on potentially increasing quotas by transferring resources available under the Bilateral Borrowing Agreements. Other aspects of the Review, including how the quota increase should be distributed or the potential inclusion of other elements of the IMF's lending toolkit (such as access limits and surcharges), are still to be decided but will be key in ensuring shared ownership of the reform process.

**Furthermore, a structural funding gap remains in the Poverty Reduction and Growth Trust (PRGT) and the Resilience and Sustainability Trust (RST).** It is therefore crucial for countries to provide additional resources and make existing pledges effective. In particular, demand for RST funding for climate-resilience measures goes beyond current resources and the PRGT-subsidy account continues to face a financing gap with respect to the fundraising target. Beyond immediate measures, medium-term solutions, such as the use of the IMF's internal resources (mainly gold sales), will be discussed.

**The IMF should continue to review its lending toolkit to respond to members' needs in the face of uncertain challenges.** Among others, this includes considering the level of IMF financing that is made available to countries and a review of the precautionary instruments that serve as a signal to markets of sound policy-making and provide stabilization.

**The magnitude of the challenges that the global economy continues to face highlights the need to do more with existing resources, including via the re-channelling of Special Drawing Rights (SDRs).** In the 2021 G20 Summit in Rome, Leaders committed to channelling 100 billion dollars, or 20% of their SDR allocations, to help vulnerable countries. This goal was recently achieved in terms of pledges, although more effective contributions are still needed. In any case, there is a vast pool of largely unutilized SDRs, particularly in advanced economies. To meet increasing financing needs, innovative proposals could be explored, such as channeling SDRs to Multilateral Development Banks or hybrid capital issuance financed by SDRs and SDR-denominated bonds issued by Multilateral Development Banks, while respecting relevant legal frameworks and the reserve assets character and status of SDRs. Moving forward with these alternatives faces feasibility concerns, particularly related to central banks' institutional frameworks.

### 3. Reforming Multilateral Development Banks

The G20 Roadmap for the implementation of the recommendations of the Independent Review of Multilateral Development Banks' Capital Adequacy Frameworks (CAF), to optimise their existing capital resources and enhance available funding, provides forward momentum, with initial measures delivering an estimated additional lending headroom of approximately \$200 billion over the next decade. The Roadmap, adopted by Finance Ministers in July, aims at implementing the recommendations of the Independent Review of Multilateral Development Banks' Capital Adequacy Frameworks, with the ambitious objective of unlocking funding in the range of \$500 billion to \$1 trillion, accounting for heterogenous mandates and governance structures and preserving credit ratings.

**While most efforts by Multilateral Development Banks have focused on “quick-win” reforms, such as the removal of statutory lending limits or the increase of their risk appetite, pilot programs to share risks with the private sector have also been agreed upon.** More ambitious proposals such as redefining callable capital, hybrid capital instruments and risk transfer solutions or channelling SDRs to Multilateral Development Banks, will need further study. Reforms should be accompanied by parallel efforts in capacity building and, above all, greater coordination of financial actors in order to avoid overlaps, crowding out and inefficiencies. Reform should consider the specificities of each institution and favour best-practice sharing. In this regard, the World Bank Group's Evolution Roadmap, launched in 2022, aims to tackle emerging global challenges as well as to increase financial capacity, catalyse private capital and promote domestic resource mobilization.

**To amplify the impact of these reforms and properly address global challenges, the possibility of new concessional resources is also being evaluated.** The externalities attached to some global challenges, such as climate change, justify concessional financing not only for low-income countries, which have increasing needs, but also for middle-income countries under certain circumstances. The concrete implications and financial instruments that would be deployed to achieve this should be studied further.

#### Questions for discussion:

1. *How can we reinforce our Global Financial Safety Net and better address debt vulnerabilities?*
2. *What are key deliverables in the Annual Meetings in Marrakech to ensure multilateral institutions, financial instruments and other fora remain fit for purpose?*
3. *What concrete priorities should we concentrate on in the ongoing reform process of Multilateral Development Banks?*