A Half-hearted Effort: The G20's finance track*

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Even as the war in Ukraine and intensifying hostility between China and the US and its allies have increased global geopolitical uncertainties, less developed countries that host a majority of the world's population have gained voice in an increasingly multipolar, even if less liberal, world. In utilising that space, the leadership of the G20 has proved to be an advantage, with the Presidency of that grouping shifting to 'emerging market countries' for a prolonged period; it was held by Indonesia over much of 2022, then taken over by India for much of 2023, and would shift to Brazil in 2024. Though these are countries that are more developed when compared with their counterparts in the less developed category, they are being looked to as agents that would give voice to the concerns of the poorest countries as well.

Framework for enabling Finance

Each year, senior leaders and officials of the 19 countries and the European Union, which together constitute the G20 and account for two-thirds of the world's population and 85 per cent of its GDP, meet in several working and engagement groups and a final summit and launch initiatives that touch on all the problems seen as of concern to the global community. Thus, through the G20, developed and less developed member countries sit across the table in a semblance of a dialogue among political equals to try and shape a consensus of what needs to be done and how. Nothing is binding about the outcomes of these discussions. And given the increasingly polarised global environment consensus often eludes the group, as is the case with security issues, especially after the outbreak of war in Ukraine. However, there is one lead track of the discussions the Finance Track in which agreement in principle has been easier to achieve, though obstacles to implementation remain.

This unevenness in effectiveness over subject areas was reflected in the decisions taken in the first meeting of the group's Finance Ministers and second meeting of its Central Bank Governors (FMCBG) that took place in Bengaluru between 22 February and 25 February 2023. While declaring in the context of the Russia-Ukraine conflict that the G20 is not the forum to discuss security issues, notwithstanding their importance, the participants went on to set a number of goals in the global finance area.[i] The meeting called on its International Financial Architecture Working Group to work with the multilateral development banks (MDB) to prepare a roadmap for implementing the recommendations of the G20 Independent Review of MDBs Capital Adequacy Frameworks (CAF). It has asked the International Financial Architecture Working Group to draft a G20 Note on the Global Debt Landscape and the ways to address debt and vulnerabilities in low- and middle-income countries (LMICs) in a fair manner. It called on the Sustainable Finance Working Group to develop an analytical framework for enabling finance for Sustainable Development Goals (SDGs), with an initial focus on nature- or environment-related data and reporting and social impact investing.

Widening debt treatment efforts

These elements of the agenda for the period under India's Presidency are in keeping with the principal pillars of the G20 Finance Track as it has evolved over the years. The first of those pillars is to address the need for external debt restructuring and debt crises resolution in poor and vulnerable countries. The number of such countries has spiked in recent years, as a result of the debilitating impact of the COVID-19 pandemic and the response to it, as well as the disruption caused by the speculation induced rise in global food and fuel prices in the aftermath of the invasion of Ukraine. Foreign exchange receipts shrank in many LMICs, while foreign exchange expenditures rose, resulting in a collapse in reserves and an inability to service foreign debt.

The efforts of the G20 to recommend ways to address these problems began with the Debt Service Suspension Initiative (DSSI)[ii] launched in May 2020 to address the impact of the pandemic. Under the initiative, bilateral creditors committed to suspending debt service payments for a limited period of time, with the resulting arrears being added to the stock of debt. The initiative was open only to the poorest countries eligible for funding from the International Development Association (IDA) and were in an IMF financing arrangement, or had requested financing from the IMF. The term of the initiative was extended twice till December 2021, before being brought to an end.

It was soon clear that the DSSI was inadequately fit for the purpose. Besides the fact that it was limited to debt owed to bilateral creditors whose shares in total had been falling and was not open to many lower-middle income and middle-income countries, which too were debt stressed to differing degrees, the relief it offered was a mere temporary suspension of payments. That was inadequate support for countries that needed debt restructuring or debt relief to render debt sustainable, and served more as a teaser that postponed payments and shifted an increased burden to the future. More importantly, access to support was linked to IMF-style adjustment programmes, despite evidence that these imposed severe austerity on populations already suffering from increased deprivation without ensuring a return to growth or a traverse to a sustainable external debt trajectory. External and total debt to GDP ratios often ballooned and government revenues fell, eroding the abilities of governments to spend to advance towards the SDGs or provide for adaptation to and resilience in the face of climate change.

That experience possibly drove the November 2020 decision (taken in a virtually held Extraordinary G20 Finance Ministers and Central Bank Governors' Meeting)[iii] to widen the ambit of debt treatment efforts under the Common Framework for Debt Treatment (CFDT). The CFDT was aimed at supporting eligible low income countries by allowing them to request debt treatment, following which a creditor committee would be constituted to start negotiations to work out a debt restructuring arrangement involving Paris and non-Paris Club bilateral creditors and an array of private creditors and sovereign bondholders, who would be subject to comparable treatment[iv] and called upon to accept haircuts in keeping with needs defined by a Debt Sustainability Analysis from the World Bank and the IMF. To ensure future sustainability, this debt treatment exercise was expected to be accompanied by a 'reform programme', similar to an Upper Credit Tranche IMF programme.[v]

The CFDT too has proved to be a disappointment, with few countries requesting treatment under it and even those countries facing in most cases considerable delays in fashioning an acceptable restructuring programme agreed to by all creditors. The fundamental problem here is that despite being a G20 initiative, the CFDT is overly influenced by the Paris Club creditors[vi] and by the IMF, whose voting structure and decision-making is also dominated by the Paris Club.

This hangover from the past comes in a context in which three major changes have occurred in the global external debt landscape. To start with, the share of bilateral creditors (as opposed to multilateral and private creditors) in total LMIC debt has come down sharply, and to the extent that the figure is still significant as it reflects a sharp increase in outstanding bilateral credit from China. The current importance of the once dominant Paris Club creditors comes not from their share in total LMIC external debt but from the support they provide to the multilateral development banks like the World Bank and the Asian Development Bank. This does have significant implications for any debt stress resolution process.

MDBs insist that they cannot be called upon to offer debt relief or accept a haircut on credit provided by them, because that would affect their AAA ratings, which ensures they can borrow easily at competitive rates in international markets. In addition, they enjoy the benefit of near zero default on the credit they provide, because debtor nations are stakeholders and bound by treaty to meet debt service commitments to the MDBs. This has resulted in the MDBs staying out of the process of restructuring past debt, and only promising to contribute new and additional financing once an IMF-led restructuring exercise is completed and an IMF adjustment programme initiated.

So, among all official creditors, bilateral creditors must shoulder a disproportionate share of the burden of any debt reduction. A corollary is that China is being called upon to share much of the burden because of its recent emergence as a serious and dominant bilateral creditor. China is clearly not willing to accept this disproportionate responsibility and has called on the MDBs to share a part of the burden as well as questioned why it should substantially fund a process in which the terms of engagement and the nature of restructuring are determined by a Paris Club-dominated IMF.

A second change in the debt landscape is the sharp increase in the share of private creditors in total external debt of the LMICs, and, within that corpus, the increase in the share of private bondholders. Seen through the lens of immediate private interest, these creditors should be easy to bring to the table when rescheduling debt. Much of this debt is traded in private bond markets and receives bids of cents to the dollar that imply huge discounts, given the probability of loss when held to maturity. So, private creditors should be willing to cut their losses by accepting smaller, though significant, haircuts as part of debt rescheduling. But in practice this is not the case. Not only are private creditors, including individual bondholders, unwilling to settle for a discount, but ‘vulture funds’[vii] that have bought some of these bonds at a discount are there to hold out till they can extract every possible cent. Some of these even go to court in jurisdictions like the US to demand full payment when a resolution agreement is in sight.

Private creditors' reticence to settle early is because of the belief, grounded in experience since the time of the Brady Bonds arrangement in Latin America in the 1990s and through the bailout designed after the Southeast Asian financial crisis of 1997, that the governments of the advanced economies work through the IMF to ensure the interests of financial interests from their home countries. Reducing the losses of these interests is crucial to ensuring the stability of financial systems in the metropolitan countries, given the large exposures of the latter in LMICs. This means that both the MDBs and the private creditors are unlikely to accept any or significant haircuts, leaving the initial offers to the bilateral creditors and, therefore again, disproportionately to China.

That this is the likely outcome of restructuring efforts is partly corroborated by the IMF's assurance that an IMF-led restructuring would lead to a resumption of private capital flows into foreign exchange-strapped debtor countries. Not surprisingly, China does not see these programmes as instances of comparable treatment. Moreover, China joining a restructuring programme designed by the IMF, in the functioning of which it has limited, if any, influence, would amount to endorsing that programme, which it possibly sees as inimical to the interests of both official creditors and debtors.

These features of the global landscape require choosing between two responses. One is to take the IMF out of debt resolution negotiations and making 'comparable treatment' a reality. That would not be acceptable to the advanced nations, the Bretton Woods institutions, or the private creditors. Hence, it is an unlikely direction of movement. The other is to reform the IMF, to either change its voting structure and management in keeping with the changed correlation of economic and political power in the global system or to have it modify its conservative, austerity-emphasising 'adjustment' strategies, that have proved to be counterproductive. The problem here is, given the IMF's current voting structure and the US veto it embodies, efforts to reform its architecture and governance style have stalled. And given the global influence of financial interests and the dominance of neoliberal economic thinking among governing elites in almost all G20 countries, there are few takers for fundamental modifications of the IMF's adjustment toolkit.

As a result, focus has shifted to increasing the ability of the MDBs to provide additional funding, especially to LMICs experiencing stress or needing support for much needed expenditures on mitigation, adaptation, and rehabilitation and reconstruction, following climate precipitated loss and damage. Under the Indian Presidency, the emphasis appears to be taking forward the recommendations of the expert panel tasked by the G20 to review the Capital Adequacy Frameworks of the MDBs. The intent of the exercise is to enable shareholders to maximise the MDBs' financing capacity. To that end, it called for risk tolerance measures that are less stringent and independent of assessments from risk rating agencies; giving credit to callable capital in capital adequacy assessments; enhancing reliance on financial innovation; and improving disclosure of MDB data and analysis to give more power to shareholders. The intent of this exercise is clearly to get the most of an MDB architecture that has proved to be inadequately fit for purpose, given the multiple crises that challenge the international community.

One area in which more radical action is needed is in the flow of climate finance from advanced countries that are responsible for a disproportionate share of cumulative emissions. While even the modest promise of ensuring a flow of $100 billion a year

of credible climate finance by 2020 has not been met, estimates of climate finance requirements have ballooned. The report of Working Group III included in the sixth assessment of the IPCC places the cumulative share of North America, Europe, Japan, Australia and New Zealand in anthropogenic carbon emissions at 43 per cent. Add on Eastern Asia, which includes China, and that share rises to 55 per cent. Calling on all countries to contribute to mitigation and adaptation purely on the basis of their own resources is obviously unfair. According to the report, available partial and imperfect data suggests that, to meet assessed needs, yearly flows of climate finance would have to rise by between four- to eight-fold in developing countries, and two- to five-fold in developed countries. The International Energy Agency estimates that as much as two-thirds of future collective climate investments would have to occur in developing countries, which make cross-border financial flows crucial.

Addressing developing nation concerns

Unfortunately, adequate responses to these concerns of the international community are not reflected in the transformational Roadmap that the World Bank has chalked out for itself. The Roadmap has very modest ambitions. In the name of enhancing vision, it seeks to broaden its current 'twin goals' of "ending extreme poverty and boosting shared prosperity" by 2030, by including in its stated agenda sustainability and resilience and the creation of global public goods to address challenges such as climate change and pandemic preparedness, prevention and response. The 'review' is not one of the World Bank's past performance, but an exercise on "how to strengthen the focus" of its mission.[viii] To that end, the Roadmap makes a case for tweaking the World Bank's goal to "serve all clients". As the Roadmap explains: "While the 2018 capital increase for IBRD and IFC interpreted `serving all clients' as reorienting lending towards lower income countries, the need to make progress on global challenges would require a rebalancing of this strategy to identify opportunities to better respond to MIC clients."

That appears to be a new version of 'trickle down' development, since the perception is that "WBG involvement with MICs offers the opportunity to learn from these countries' experiences and apply these lessons to LICs". However, this could involve pushing non-concessional lending into poor countries or depriving them of low-cost credit and grants from the International Development Association. It could also lead to the adoption of a one-size-fits-all approach with policy recommendations to the poorer countries that are not based on an understanding of their often-exceptional circumstances. Attention to challenges faced by middle-income countries is welcome, but not be at the cost of already inadequate attention to the low-income countries.

This has implications for the role that the G20 can play under the emerging market troika Indonesia, India and Brazil that together hold the Presidency from 2022 to 2024. These are middle income countries that are to be the new focus of a multilateral like the World Bank. This could divert attention from the need for them to serve as the voice of the poorest countries in international forums. The actions of emerging market leaders in the G20 would be closely watched to see the direction their advocacy would take. As of now, it does appear that the substance of the discussions has moved out of excessive emphasis on the concerns of the advanced nations, and the financial and real economy instabilities they have been experiencing to matters that affect the lives and livelihoods of a majority of the world's poorest. Whether that

would make a real difference to the policies adopted by members of the international community only time would tell.

End Notes

[i] https://www.g20.org/content/dam/gtwenty/gtwenty_new/document/1st%20FMCBG%20Chair%20Summary.pdf

[ii] For details see https://www.imf.org/en/About/FAQ/sovereign-debt#s2q1.

[iii] https://www.imf.org/-/media/Files/News/news-articles/english-extraordinary-g20-fmcbg-statement-november-13.ashx

[iv] The working principles for debt rescheduling of the informal Paris Club group of creditors include "a 'comparability of treatment' clause, which aims to ensure balanced treatment of the debtor country's debt by all external creditors. In accordance with this clause, the debtor country undertakes to seek from non-multilateral creditors, in particular other official bilateral creditor countries that are not members of the Paris Club and private creditors (mainly banks, bondholders and suppliers) a treatment on comparable terms."

[v] "Under the Credit Tranche Policies, the IMF makes credit available in four tranches (segments), each equal to 25 percent of a member's quota. The First Credit Tranche represents use of IMF resources up to the limit of the first tranche on fairly liberal terms.Requests for use of IMF resources beyond the first credit tranche (in the upper credit tranches) require substantial justification for the expectation that the member's balance of payment difficulties will be resolved within a reasonable period of time." https://www.imf.org/external/np/fin/tad/docs/glossary.pdf.

[vi] The members of the Paris Club are the governments of Germany, Australia, Austria, Belgium, Brazil, Canada, Denmark, Spain, the United States of America, the Russian Federation, Finland, France, Ireland, Israel, Italy, Japan, Norway, the Netherlands, the Republic of Korea, the United Kingdom, Sweden, and Switzerland. Additionally, South Africa has been a prospective member since 2022.

[vii] https://www.investopedia.com/terms/v/vulturefund.asp

[viii] https://us.boell.org/en/2023/04/11/world-bank-groups-roadmap-and-human-...

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