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Anchoring the reforms of the international financial system at the regional and national levels

Elise Dufief, Damien Barchiche (IDDRI)

NOTE

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CONTENTS

1. CONTEXT

The Summit for A New Global Financial Pact in Paris last June highlighted both the need and urgency to address the joint climate, nature and development challenges through increased global cooperation and an urgent profound reform of the international financial system. The Finance in Common Summit network, with more than 500 public banks, from multilateral to regional and local ones, across continents, committed to "work as a system, and cooperate in order to align their activities with the SDGs, the Paris Agreement on Climate and the Global Biodiversity Framework".

The 4th edition of the summit held in Cartagena in September 2023 gathered more than 1,000 people from diverse countries and established itself as a key rendez-vous on the international scene. It offered a platform to look beyond the current focus on the reform of multilateral development banks (MDBs) as well as to think of ways to better anchor the reforms according to specific regional and country needs. While the discussions highlighted the gap is not yet fully closed, the closed-door workshop IDDRI organised allowed for important contributions further specifying the way ahead. Here are some of the key takeaways to have in mind ahead of the WB and IMF annual assemblies in Marrakesh.

2. ADDRESSING COUNTRY NEEDS AS THE STARTING POINT FOR REFORMS

While the ongoing discussions on the World Bank and other MDBs rightly focus on a number of important institutional changes, to be successful and meet expectations, these changes should first and foremost contribute to change at the country level. The discussions precisely aim to resolve the discrepancy that may exist in some cases between what shareholders plan on doing and what client countries need or want.

For example, this implies better considering specific regional or national needs. Colombia, where the FICS was organised, is not facing major debt distress. Nevertheless, the political environment of Colombia can be difficult to implement reforms, and it is facing a fiscal space crunch that does not always allow for the necessary investments. Taking these situations into account to work towards more collective agreements and build consensus can help alleviate tough national situations.

Similarly, the example of Colombia highlights some of the needs voiced by middle income countries (MICs). These need to be specified and articulated with other more vulnerable countries, from a socio-economic and environmental standpoint. This has implications for the type of financing these countries will be able to access and use since not all banks' desks or instruments will be accessible to MICs where other domestic solutions can be explored. It also further justifies the need to focus on ways of shifting finance away from socially and environmentally harmful operations, and better promote synergies between development, climate, biodiversity.

3. COORDINATING SUPPORT BETWEEN MDBS AND OTHER DEVELOPMENT BANKS

One way to address country needs is to look at the broad ecosystem of banks. While the reforms focus on the World Bank and MDBs, other development banks(including national development banks (NDBs) and subnational development banks (SDBs) need to be part of the picture as they operate closer to the ground.

Brazil presented itself as an example in terms of structuration of the demand side to then mobilise banks' financing. For its energy production, the country established an infrastructure plan ("growth accelerating plan") along with a pluriannual budget plan to seek financing from institutions so they can fill the identified gaps. Other countries have done or will start a similar exercise as part of the Just Energy Transition Partnership (JETP) processes which is another example of a structured cooperation between financial partners to avoid duplication of efforts while seeking greater complementarity. But some countries do not have such plans in place, and there, MDBs and other banks also have a role to play to help structuring that demand. Country platforms have been mentioned as potentially useful for supporting governments on structuring their demand and making financial needs known to potential investors.

Beyond structuring the demand side, another ambition of the FICS is that money flows from MDBs to NDBs. NDBs need to be brought to the fore as they are closer to the ground. They can receive financing from multiple sources, including from MDBs, and then work with local development finance institutions (DFIs) and banks on lending to national actors. But currently, banks tend to look at cooperation opportunities mostly when they want to limit risk exposure. This is understandable and risk sharing opportunities need to be explored further. But it should not be the only driver for cooperation between banks.

Another way to improve the ecosystem is for various banks to do more co-financing, which is also something countries are interested in. For that to happen, the need for banks to work on shared and more standardised approaches has been highlighted. As things stand, given the variety of banks involved (in terms of costs, speed of delivery, type of instruments, sector expertise, etc), clients are faced with multiple requirements which do not help clarify the way things work and how to access finance. In some situations, NDBs can help fix some of the identified mismatches in terms of finance. On the limitations of access to foreign currency for example, NDBs could be viable options for more local currency lending, especially when hedging remains too expensive for most of them. NDBs have also been identified as actors who can efficiently support domestic revenue mobilisation in countries which have room to do more on this.

4. CLARIFYING THE ROLE OF THE PRIVATE SECTOR

Calls for a bigger role for MDBs to help solve the development, climate and biodiversity crises have often been paired with renewed calls for more and better leverage of private finance. But this needs to be nuanced. Beyond a need to specify the type of private sector that is called upon (be it international and/or national), various actors raised the question of additionality of private sector operations and conditions under which public money is mobilised to leverage financing from the private sector. This is to avoid MDBs and other banks' expansion crowding out the private sector. Sometimes MDBs are putting money where the private sector can. The question is how to ensure that the money goes where it is really needed, and in particular how to ensure that public development banks (PDBs) funding is really used to finance what could not be financed otherwise. PDBs are still competing to finance certain projects in a country, while other projects are unable to find financing because they are less attractive or profitable. A key challenge is to bring external money where most needed but also to ensure that scarce public finance is being used to fill a gap that other actors cannot. This was identified as a question that could be grappled by the G20 Brazilian presidency. If this question is not adequately addressed, the same issues around financing not flowing to the right places are likely to repeat.

5. OPENING UP THE BLACK BOX ON THE HIGH COST OF ACCESSING FINANCE

The difficulties and high costs associated with accessing long-term financing remain at the forefront of the discussions. Ecuador's recent world's largest debt for nature swap highlighted some of these difficulties. While the operation was lauded as one of the solutions available to give more fiscal space to countries in need, Ecuador also faces high transaction costs linked to the 10 various institutions involved. The deal also highlighted the various interpretations of risks existing in credit rating agencies. One agency identified a default risk, while others did not. Differences in the methodology used for a similar operation in Gabon were also questioned. While each country and government has specificities that need to be reflected and accounted for in the financial arrangements of those deals, even when using the same financial instruments, more clarity and transparency need to be brought around the risk assessment models used by credit rating agencies. They also need to sit at the table and be part of these conversations.

6. THE CHALLENGE OF MEETING GLOBAL GOALS AT NATIONAL LEVEL

The FICS aims to strengthen coordination and cooperation to promote sustainable development and align financial flows with the 2030 Agenda and the Paris Agreement. However, two weeks before the UN SDG Summit, halfway through the 2030 Agenda timeline, the discussions around the reforms of the international financial system made barely any concrete reference to SDG alignment. In terms of alignment, it was pointed out that money might not be the real problem. Money is available, as are appropriate instruments, but ambition is missing to mobilise and use them more effectively to address SDGs. One example is the Integrated National Financing Framework (INFF) that is being developed in more than 86 countries to strengthen planning processes and overcome obstacles to financing sustainable development and the SDGs at the national level. PDBs could better contribute to these processes in order to effectively finance the SDGs in the countries. In this regard, the *Elements for the implementation of SDG alignment by Public Development Banks* proposed by the International Development Finance Club, and the FICS decision to set a working group to further define and mainstream sustainable development investment principles could be an opportunity to find solutions to make the financial system more consistent with achieving the SDGs.

7. PUSHING FOR CHANGE FROM THE OUTSIDE CAN WORK

The FICS organised in Cartagena on the Latin American continent happened at the same time as the African Climate Week held in Nairobi. The high number of participants to this year's FICS is also a testimony to all the Latin American actors on the continent sharing expertise and knowledge so as to identify responses that are adequate to the region. Some of these solutions may in fact not be new but working towards building a continental voice can help advance some of them further. Some actors from the region expressed the need to be more vocal and explicitly learn from the African voice emerging from Nairobi. Joining forces, as much as possible, with the rising voices from the African continent, coupled with the voice of Mia Mottley from Barbados who contributed to breaking the ice, was identified as a concrete way to raise the voices of the Global South even higher.

These are a reminder that so far, push for change of the financial architecture for international development has not come from shareholders themselves, or from usual places of power such as Washington, New York or European capital cities. Instead, it came from the work done by outsiders, such as independent experts, civil society or think tanks who actively contributed to the discussions and put solutions forward. This needs to continue, at speed and scale, to be translated into lasting political decisions.

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CONTACT
elise.dufief@iddri.org
damien.barchiche@iddri.org

Institut du développement durable
et des relations internationales
41, rue du Four – 75006 Paris – France
WWW.IDDRI.ORG
@IDDRI_ENGLISH