

Summit for a New Global Financing Pact

Briefing series on the reform of the international financial architecture #2

The international community is facing a so-called polycrisis, including the impact of climate-related natural disasters and an accelerating debt crisis in the countries of the Global South.¹ This polycrisis has enabled and accelerated several debates on how to reform the international financial architecture (IFA) at the multilateral level.² The resulting reform process aims to make international organisations more responsive to the polycrisis and to overcome the global imbalances that have been entrenched in these organisations since their inception, and that continue to prevent Global South countries from implementing the 2030 Agenda. In addition, it **sets the stage for the nearly USD 4.2 trillion in additional annual financing needed by 2030 for the Sustainable Development Goals in Global South countries.**³ The UN Secretary-General has issued a report setting out his ideas for the reform agenda, and reflecting its importance.⁴

In this context, the **French Government is organising the Summit for a New Global Financing Pact (PACT Summit) on 22-23 June 2023.** The event aims to forge a new pact⁵ to **coordinate international action to reform the IFA and to strengthen the capacity of Global South countries to deliver** on different global public goods. This will require finding common ground to address the development financing needs of the Global South through existing and new avenues. The Summit is expected to provide a shared vision and individual commitments from government leaders.

Hosted by the French President Emmanuel Macron,⁶ the event will bring together several **heads of state and government, high-level representatives from institutions such as international organisations, the private sector, and foundations, and a limited number of participants from civil society.** In order to prepare the potential outcomes of the Summit, these stakeholders have been engaging in discussions over the past months in a steering committee and four thematic working groups, also called ‘pillars’ (see figure 1).

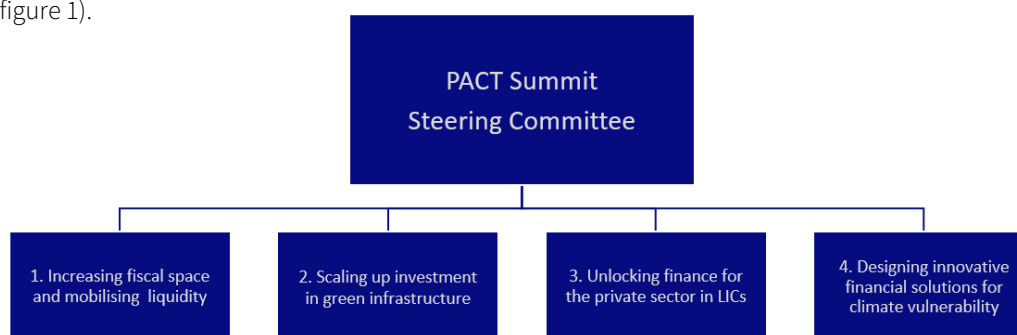


Fig. 1: Structure of the PACT Summit

¹ For a more comprehensive definition of the polycrisis, please see: Kotzias, Micozzi, Ryfisch, Niedermayer, 2023, [Reform of the international financial architecture](#) (last accessed on 15 June 2023)

² Ibid.

³ UNDP, 2023, [Sustainable Finance. SDG Impact Management and Finance Tracking](#) (last accessed on 15 June 2023)

⁴ United Nations, 2023, [Our Common Agenda – Report of the Secretary-General](#) (last accessed on 15 June 2023)

⁵ Élysée Palace, 2023, [Proposition liminaire du Président de la République](#) (last accessed on 15 June 2023)

⁶ Ibid.

Six round tables will be organised to discuss the agenda topics:

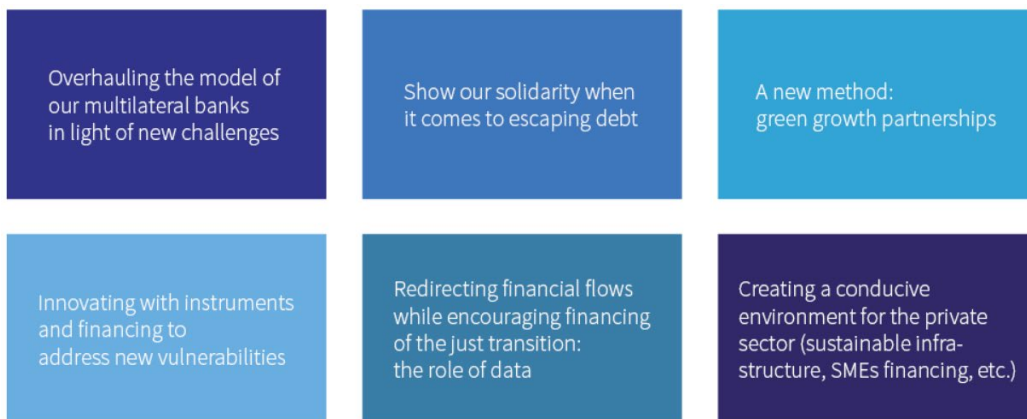


Fig. 2: Structure of the PACT Summit round tables (SMEs: small and medium-sized enterprises)

Three thematic streams to deliver on

The agenda topics to be discussed at the PACT Summit can be grouped into three so-called ‘thematic streams’ on which participants will deliver results. This section provides a description of each of these streams and suggests possible deliverables of the German Government.

1. MDB reform & Bridgetown Initiative: charting the way forward

Multilateral development banks (MDBs) are an important source of climate and development finance. Concerning climate finance, MDBs have jointly committed a **total amount of USD 50.7 billion in climate finance for low and middle income countries in 2021.**⁷ However, countries of the Global South do not consider their operational model fit-for-purpose when it comes to safeguarding global public goods at the necessary scale.⁸ They need to expand lending by adding new resources and making better use of the existing ones. The World Bank is the first MDB to go through the reform process, and its management has therefore published a draft of an Evolution Roadmap in March 2023.⁹ Other MDBs will follow with similar processes, for which the one of the World Bank will set the tone.

The Bridgetown Initiative,¹⁰ on the other hand, focuses on the following elements: Firstly, it plans to increase liquidity in the short-term and investment capacity in the medium-term by creating new, highly concessional financing for the most vulnerable countries. Secondly, its agenda focuses on the issuance and reallocation of Special Drawing Rights (SDRs), some of which are expected to be allocated to the MDBs.

⁷ African Development Bank; Asian Development Bank; Asian Infrastructure Investment Bank; Council of Europe Development Bank; European Bank for Reconstruction and Development; European Investment Bank; Inter-American Development Bank; Islamic Development Bank; New Development Bank; World Bank, 2022, [2021 Joint Report on Multilateral Development Banks Climate Finance](#) (last accessed on 15 June 2023)

⁸ OECD (2022), [Funding to the multilateral development system](#) (last accessed on 15 June 2023)

⁹ The World Bank Evolution Roadmap is a document to discuss and initiate a reform process at the institutions. It was requested by the so-called ‘G7+3 countries’ (the G7 + Australia, Switzerland, and the Netherlands) to the Executive Directors of the World Bank. It focuses on reviewing the Bank’s mission and vision as well as its operational model, and on exploring measures to strengthen its financial capacity and model. Recommendations of the G20 Capital Adequacy Framework (CAF) are also included, please see: Development Committee, 2023, [Evolution of the World Bank Group – A Report to Governors](#) (last accessed on 15 June 2023)

¹⁰ The Bridgetown Initiative is a proposal launched by the Prime Minister of Barbados, Mia Mottley. It focuses on reforming the international financial architecture to make it fairer and more inclusive. It aims to achieve this by increasing global liquidity to support countries of the Global South in the face of the current polycrisis. Its main components are providing emergency liquidity, expanding multilateral lending to governments by USD 1 trillion, and mobilising private sector savings for climate mitigation and post-disaster reconstruction through new multilateral mechanisms, please see: Barbados Ministry of Foreign Affairs and Foreign Trade, 2022, [The 2022 Bridgetown Initiative - Foreign Affairs and Foreign Trade](#) (last accessed on 15 June 2023)

Thirdly, the Initiative gives attention to further instruments to increase liquidity. These include temporarily suspending debt repayments and interest surcharges, making available extremely long loans which could allow debt to be restructured, and making the Resilience and Sustainability Trust fully operational.¹¹ Its **second, updated version is currently undergoing a consultation process to ensure that there is broad agreement on the goals and instruments.**¹²

The PACT Summit provides an **opportunity to advance both the MDB reform and elements of the Bridgetown Initiative.** Announced by French President Emmanuel Macron after discussions with Barbados Prime Minister Mia Mottley, the Summit has been supported from the outset by some countries of the Global South, showing their support for and active participation in the reform process. It could contribute to making significant progress ahead of the UNSG Climate Ambition Summit in September and the Annual Meetings in Marrakech by:

- securing **high-level commitment to a far-reaching MDB reform beyond the World Bank** that ensures that both global public goods and specific national development needs are addressed, culminating in the World Bank Annual Meetings in October;
- **delivering on the existing commitment to reallocate SDRs of a total of USD 100 billion.** A way forward should be presented for the reallocation of SDRs to MDBs, so that states have options to start reallocating their SDRs as soon as possible;
- supporting **an early replenishment of the World Bank's International Development Assistance (IDA)**, as it is a critical source of grant financing for the least developed countries. However, it is facing a fiscal cliff, as funding has been frontloaded because of the COVID-19 pandemic.

Germany has been at the forefront of the MDB reform agenda. The German Minister for Economic Cooperation and Development, Svenja Schulze, has been a strong advocate of the reform from the outset. At the Summit, German Chancellor Olaf Scholz could build on this commitment by:

- positioning **Germany as a facilitator of dialogue and a mediator between the shareholder countries of the MDBs.** To date, in particular countries of the Global South have questioned the current approach, which has been pushed strongly by the G7 and other developed countries. Countries of the Global North and the Global South should agree on a comprehensive and profound reform of the World Bank;
- indicating support for a larger bank, which means an increase in capital in the different MDBs after a profound reform process. To ensure short-term support for the most vulnerable, **Germany should also support an early replenishment of the IDA;**
- demanding the MDBs to make better use of their **various financing instruments. Guarantees are a low-cost risk-sharing instrument** that can unlock significant private sector investment.

¹¹ Élysée Palace, 2023, [Propos liminaire du Président de la République](#) (last accessed on 15 June 2023)

¹² Barbados Government Information Services, 2023, [Bridgetown Initiative 2.0 highlights six key action areas](#) (last accessed on 15 June 2023)

2. Advancing Innovative Financing Instruments for Solidarity

Countries of the Global South stress the need for grant-based climate finance,¹³ as it is currently mostly loan-based.¹⁴ Adaptation and Loss and Damage projects rarely generate financial revenues.¹⁵ As a result, the private sector finds little incentives to invest. Hence, the public sector finances nearly 98% of adaptation needs, and there is still a significant shortfall in annual adaptation funding.¹⁶ To date, there is no holistic data on Loss and Damage finance, but the Heinrich Böll Foundation **estimates that its costs will be close to USD 1 trillion to 1.8 trillion per year by 2050**.¹⁷ Closing the gap in adaptation and Loss and Damage finance will require **new sources of grant funding**, as public sector coffers are already severely constrained.¹⁸

Consequently, a set of economic instruments to price CO₂ emissions are proposed as possible sources to capitalise Loss and Damage finance mechanisms. Therefore, fiscal instruments such as domestic and international taxes and levies on different economic activities are currently being studied and discussed.

When appropriately designed, these new taxes and levies would reward climate-friendly behaviour and penalise climate-damaging behaviour in a redistributive manner. **Polluters would actually pay, and the private sector would start to bear some of the costs, not just the profits**, of climate change impacts. In this respect, innovative sources of finance have the potential to reduce global inequalities related to greenhouse gas emissions and the negative impacts of the climate crisis.

The PACT Summit could **make a contribution to the promotion of several innovative sources of finance**. However, it is **not necessary for the Summit to determine how these levies will be collected and redistributed**. A significant share of the funds could help refashion the sectors from which they originated. Another share could be used for international climate finance (beyond sector transformation), **in particular to provide a constant flow of grant finance for the forthcoming Loss and Damage Fund**. The PACT Summit should give the political signal that heads of state support the implementation of these global levies and demand that the respective international bodies advance discussions. These levies could include:¹⁹

- an international and universal emission-based levy on maritime fuels. **The International Maritime Organization (IMO) is already discussing such a levy**. Its next meeting will take place in London in July 2023. The financing potential of this levy is estimated to be high (about USD 40-75 billion per year);
- an aviation levy. The levy could take a number of different forms, such as **a passenger levy on airline tickets or a frequent traveller tax**. The financing potential of an aviation levy is calculated to be medium to high (close to USD 6–150 billion per year) depending on form and price;
- a windfall tax on oil and gas companies. The windfall tax **is imposed on companies that have made large profits that are considered excessive or unfairly obtained**. Its financing potential is estimated to be high (the EU alone expects it to raise up to EUR 140 billion between 1 December 2022 and 31 December 2023);

¹³ Carbon Brief, 2023, [Explainer: How can climate finance be increased from 'billions to trillions'?](#) (last accessed on 15 June 2023)

¹⁴ OECD, 2022, [Aggregate trends of Climate Finance Provided and Mobilised by Developed Countries in 2013-2020](#) (last accessed on 15 June 2023)

¹⁵ Carbon Brief, 2023, [Explainer: How can climate finance be increased from 'billions to trillions'?](#) (last accessed on 15 June 2023)

¹⁶ Climate Policy Initiative, 2023, [Global Landscape of Climate Finance 2021](#) (last accessed on 15 June 2023)

¹⁷ Heinrich Böll Stiftung, 2023, [Unpacking finance for Loss and Damage](#) (last accessed on 15 June 2023)

¹⁸ Ramos, L., Ray, R., Bhandary, R.R., Gallagher, K.P., and W.N. Krings, 2023, [Debt Relief for a Green and Inclusive Recovery: Guaranteeing Sustainable Development](#) (last accessed on 15 June 2023)

¹⁹ Hirsch, T., Gueck, M., *Shortlist: New and innovative funding sources for international climate finance*, in press.

- a tax on financial transactions (using part of the revenue generated by a financial transaction tax): An instrument to be **potentially imposed on the trading of financial instruments such as stocks, bonds, or derivatives** (a small percentage of the value of the traded asset is levied). Its financing potential is calculated to be medium to high (depending on the tax rate and scope).

The EU has recently included shipping and aviation in its Emissions Trading System (EU ETS). However, **an international levy could complement rather than replace the EU ETS**. It would help level the playing field and ensure a broader impact. The German Chancellor Olaf Scholz could support the agenda by:

- demonstrating that **he is willing to take the lead on international solidarity levies**. He has been successful in implementing highly ambitious global initiatives, such as the global minimum tax;
- expressing his readiness to take the lead on an ambitious levy in the IMO.²⁰ German Minister Svenja Schulze spoke in favour of a levy at the Petersberg Climate Dialogue in May 2023. Chancellor Scholz may want to take up her proposal. Countries such as **Denmark, the Republic of the Marshall Islands, and Japan have already voiced their support for a levy, as has the largest shipping company, Maersk**;
- using his influence to bring together a **coalition of countries to push for ambitious pricing in general and a redistribution of a share of the fund for Loss and Damage** purposes.

3. Debt relief for countries of the Global South

Since 2009, countries of the Global South have been facing rising levels of public and publicly guaranteed debt.²¹ The sovereign debt of countries of the Global South **increased by 177% between 2008 and 2021 (from USD 1.3 trillion to USD 3.6 trillion), and countries vulnerable to climate change face some of the most severe debt distress**.²² For 61 countries at high risk of debt distress, more than USD 812 billion of debt will need to be restructured across all creditor classes to achieve debt sustainability.²³ Public and private creditors will have to grant estimated haircuts between USD 317 billion to USD 520 billion in debt relief to stabilise the budget of affected countries. Evidence shows that higher climate vulnerability correlates with a lower sovereign borrowing capacity and high debt service payments.²⁴ The debt architecture is currently failing to address the needs of Global South countries and support their development pathways.²⁵ While the Debt Service Suspension Initiative (DSSI)²⁶ and the G20 Common Framework for Debt Treatments

²⁰ European Commission, 2023, [Reducing emissions from the shipping sector](#) (last accessed on 15 June 2023)

²¹ Colodenco, M., Horas, Y., and A. Wiedenbrüg, 2023, [Southern Debt Report: Characteristic and Challenges](#) (last accessed on 15 June 2023)

²² Ramos, L., Ray, R., Bhandary, R.R., Gallagher, K.P., and W.N. Kring, 2023, [Debt Relief for a Green and Inclusive Recovery: Guaranteeing Sustainable Development](#) (last accessed on 15 June 2023)

²³ International Monetary Fund, 2023, [World Economic Outlook, April 2023: A Rocky Recovery \(imf.org\)](#) (last accessed on 15 June 2023)

²⁴ Heinrich Böll Stiftung, 2023, [Unpacking finance for Loss and Damage](#) (last accessed on 15 June 2023)

²⁵ Georgieva, K., Pazarbasioglu, C., and R. Weeks-Brown, 2020, [Reform of the International Debt Architecture is Urgently Needed](#) (last accessed on 15 June 2023)

²⁶ University of Toronto, G20 Information Center, 2023, [Communiqué - Virtual meeting of the G20 finance ministers and central bank governors, Riyadh, Saudi Arabia, April 15, 2020](#) (last accessed on 15 June 2023)

beyond the DSSI²⁷ have contributed significantly to resolving debt distress in the most vulnerable countries, they have proven insufficient to address sovereign debt issues in the face of the current global crises.^{28, 29, 30}

In this context, the PACT Summit could contribute to this process by reaching a political agreement to reform the current debt architecture. The main criticisms of the G20 Common Framework relate to its lack of 'fit for purpose' characteristics. These include its **limited applicability to low-income countries, low creditor participation, a lack of clarity on how to implement comparability of treatment** as well as **a missing standstill on payments** while debtor governments negotiate.^{31, 32}

The PACT Summit could advance the following proposed instruments as sub-elements of a reform of the current debt architecture by:³³

- reactivating the idea of **Brady bonds, swapping old debt for new debt with creditors** (both public and private) in a restructuring process, **and combining it with a guarantee fund** (of USD 37 billion to USD 72 billion) and sustainability bonds;³⁴
- expanding the use of debt-for-climate/nature swaps. While limited in scale and insufficient as a stand-alone instrument, they can unlock important resources for climate action. **Ecuador has recently used such a swap;**³⁵ **however, the rating agency Moody's interpreted it as a default.**³⁶ Discussions with rating agencies will be necessary to avoid such an interpretation, as it discourages the use of these swaps;
- introducing **debt suspension clauses to provide immediate short-term liquidity in the event of a disaster**. This element, included in the Bridgetown Agenda and the G7 Global Risk Shield, could be enforced bilaterally or multilaterally. It is **estimated to unlock about USD 30 billion** for countries in debt distress;
- agreeing on debt restructuring processes for **USD 812 billion, addressing the debt from 61 debt distressed countries**.

German Chancellor Scholz has expressed his interest in leading the debt relief agenda. Thereby, he could support the reform of the global debt architecture by:

- building a **coalition of countries to support the reform of the global debt architecture**. Together, they could launch a global expert review on debt and climate. Furthermore, they could set up a **commission of experts to review the G20 Common Framework for Debt Treatments beyond the DSSI**, which has proved to be an important step in the right direction, but as a stand-alone measure is woefully inadequate. This should include revising the debt sustainability analysis to consider climate and nature investments. Proposals for other upcoming fora should be envisaged;

²⁷ Club de Paris, 2023, [Microsoft Word - Annex Common Framework for Debt Treatments beyond the DSSI.DOCX \(clubdeparis.org\)](#) (last accessed on 15 June 2023)

²⁸ Climate Policy Initiative, 2023, [Global Landscape of Climate Finance 2021](#) (last accessed on 15 June 2023)

²⁹ Ramos, L., Ray, R., Bhandary, R.R., Gallagher, K.P., and W.N. Kring, 2023, [Debt Relief for a Green and Inclusive Recovery: Guaranteeing Sustainable Development](#) (last accessed on 15 June 2023)

³⁰ Hirsch, T., Gueck, M., *Shortlist: New and innovative funding sources for international climate finance*, in press.

³¹ Climate Policy Initiative, 2023, [Global Landscape of Climate Finance 2021](#). (last accessed on 15 June 2023)

³² Heinrich Böll Stiftung, 2023, [Unpacking finance for Loss and Damage](#). (last accessed on 15 June 2023)

³³ Ibid.

³⁴ For examples, please see: UNDP Latin-America, 2023, [Uruguay issues the first bond aligned to climate change indicators for 1.5 billion dollars](#). (last accessed on 15 June 2023)

³⁵ For examples, please see: Inter-American Development Bank, 2023, [Ecuador Completes World's Largest Debt-for-Nature Conversion with IDB and DFC Support](#) (last accessed on 15 June 2023), International Monetary Fund, 2023, [Debt-for-Climate Swaps: Analysis, Design, and Implementation](#) (last accessed on 15 June 2023)

³⁶ Fitch ratings, 2023, [Fitch Revises Ecuador's Outlook to Negative: Affirms IDR at 'B-' \(fitchratings.com\)](#) (last accessed on 15 June 2023)

- promoting **debt-for-climate/nature swaps**, which can provide an immediate source of finance for climate investments. Germany could lead a **coalition of countries wishing to use debt-for-climate swaps as a tool to mainstream the process** and to work with rating agencies to ensure that they do not classify swaps as credit defaults. Germany already has a budget of EUR 150 million for debt swaps. To underline his willingness to take the lead, Chancellor Scholz could announce that Germany will increase its available budget for debt-for-climate swaps;
- making KfW, the German development bank, **lead the way in using natural disaster debt suspension clauses in bilateral loans**. Germany should also push for the inclusion of these clauses by the MDBs. As this element is a pillar of the German-led G7-V20 initiative ‘Global Shield’, it should constitute a straightforward deliverable. Germany should clarify whether it is proposing temporary suspensions or insurances to cover debt and interest payments for a limited period of time.

Conclusion

The PACT Summit offers an opportunity to deliver on various components of the IFA reform. It could **give countries of the Global North and the Global South a chance to reach agreements** on issues relevant to advancing the IFA reform agenda ahead of the IMF and World Bank Annual Meetings in Marrakech in October. With questions being raised about the transparency of the IFA reform process as well as about the participation of civil society organisations, the **German Government could play a proactive role** in encouraging dialogue among the participating countries. This could lead to a common understanding on the issues that are key for the countries of the Global South to obtain financial support and close the finance gap related to implementing the 2030 Agenda. In this context, the PACT Summit is expected to show positive results which will **provide a basis for further work on the IFA reform agenda at the G20 Leaders’ Summit and the UNSG Climate Summit** this September.

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