Priorities for the G20 Finance Track

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Summary

Emerging markets and developing economies are currently facing major challenges from global shocks including: a slowdown in global growth; food and energy price increases; a decline in risk appetite of international investors; unsustainable debts in low-income countries; and ongoing climate risks. To be sure, emerging-market economies in particular have made significant progress in strengthening their policy frameworks and institutions over the past two decades. They have brought down formerly high rates of inflation, often through the adoption of inflation targeting as a monetary framework, and by strengthening the independence of their central banks. They have turned to greater exchange rate flexibility to facilitate adjustment; and have accumulated foreign exchange reserves to allow intervention. They have strengthened fiscal rules and institutions, and have maintained sustainable public-debt-to-GDP ratios. They have embraced macro-prudential policies, and have communicated well their monetary, fiscal and regulatory policy frameworks and actions to financial markets and other stakeholders.

Yet progress at the national level alone is not enough. These efforts need to be complemented by changes in the global economic and financial architecture, as a part of the G20 discussions and other wider engagements, designed to make the world a safer place. In this paper, we focus on the financial aspects of this agenda, important aspects of which have remained unaddressed. The financial agenda as we see it has six key elements: (i) reform of central bank swap lines; (ii) reform of IMF-contingent credit lines; (iii) SDR reallocation; (iv) reform of credit rating agencies; (v) inclusion of climate-resilient debt clauses in new debt instruments; and (vi) steps to streamline the debt restructuring process.

In this paper we detail this agenda, and urge the G20 members to get on with it. Our main recommendations are detailed below.

i) Generalize central bank swap lines

Central bank currency swaps have been shown to have positive effects of financial stability and financial efficiency in periods of significant volatility. The G20 should therefore encourage central banks to broaden their networks of currency swaps. The Federal Reserve can extend swaps to additional central banks. Other central banks with partners that do business in their currency can provide swaps more widely. Temporary swaps can be made permanent.

Central banks with ample dollar reserves can make these available to partners. Such arrangements should be formalized where they are ad hoc, and the terms should be made transparent. This would help to fill the gaps in the global financial safety net.

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ii) Reform IMF-contingent credit lines

The G20 should endorse measures to enhance the role of IMF-contingent credit lines, another important element of the global financial safety net. The IMF could prequalify countries rather than requiring them to apply. It could include in the Article IV report whether a country qualifies or not and the amount of the credit line. Charges attached to initial qualification could be eliminated. Lines could disburse automatically when there is an "EM sell off" identified by IMF staff and verified by the Executive Board.

iii) Reallocate SDRs

The historic decision of IMF members to authorize a new $650 billion allocation of Special Drawing Rights (SDR) in response to the COVID-19 economic crisis was supposed to be accompanied by reallocation of those SDR resources to low-income countries in balance-of-payments and fiscal distress. Yet more than a year later, there has been little such reallocation.

To facilitate that reallocation process, the IMF agreed to create in October 2022 the "Resilient and Sustainability Trust", or RST. This is progress, but relative to ambitions attached to the 2021 SDR allocation the RST remains underpowered. Among the measures that can be taken are: the 150 percent of quota cap can be lifted; conditions attached to the associated staff monitored programs can be further simplified and streamlined; the G20 can resolve that additional advanced-country governments beyond the pioneering six should contribute to the trust.

Relatedly, the imbalance between the votes and voices of advanced and emerging G20 members in the IMF has continued to grow, rather than shrink. Continued quota reform should be an integral element of the G20 agenda.

iv) Reform rating agencies

Compared to advanced G20 countries, emerging markets receive lower ratings, which remain inexplicable even after accounting for a comprehensive set of debt and macroeconomic indicators. Emerging markets with no history of debt default receive lower ratings than what their observed debt loads and macroeconomic performance would otherwise lead one to expect.

Statistically, this differential can be accounted for by institutional and governance indicators. But the weight attached to such indicators is arbitrary and opaque, and the measures are of dubious quality. Concerns that credit ratings are arbitrary and unfair for emerging markets are fueled by rating agencies' lack of transparency and by their reluctance to acknowledge uncertainty surrounding their judgments.

Addressing these concerns requires efforts on the part of multilaterals and others to improve the quality of the institutional/governance measures they produce, while being more transparent about how they produce them. It requires more transparency on the part of rating agencies to indicate exactly how they use the resulting measures and other indicators in their assessments.

v) Insert climate-resilient debt clauses into debt contracts

The G20 countries should include climate-resilient debt clauses in their own bilateral, regional and multilateral lending to climate-sensitive low-income countries in order to deepen the market and reduce any adverse signaling. They could use regulation to persuade and incentivize private creditors to do likewise. They could subsidize the interest premium for such contingent lending through multilateral institutions. A standard template for such bonds will make for a more homogenous, liquid market. It will reduce the transactions cost of issuance. The G20 should encourage and endorse this initiative.

vi) Create hedging instruments

Many low-income and middle-income countries have no choice but to borrow in foreign currencies. This exposes them to financial risk and economic dislocation from exchange-rate volatility. Hedging instruments at the relevant maturities and affordable cost would help to mitigate these dangers. Developing such markets for additional countries and currencies would be a significant step toward reducing financial fragility. A G20 agreement to provide the funding needed to scale up hedging significantly would help to address the currency mismatch problem that creates financial fragility.

vii) Create a more efficient mechanism for restructuring debts

The World Bank and IMF have suggested that distressed debtors seeking relief under the Common Framework should receive statutory protection from asset seizures by national courts when suspending debt service payments. But that protection needs to be implemented by creditor-country governments through legislation or an executive order. The G20 can adopt a resolution to this effect.

Beyond the immediate need to fix the Common Framework, there is a need to address the increasingly diverse and fragmented nature of the creditor base, which heightens free-rider problems and complicates debt restructuring. To this end, new creditors such as China should be admitted as official members of the Paris Club.

Most new debt issues by emerging markets and developing countries now include collective action clauses (CACs). However, other instruments such as newly-issued syndicated loans and foreign-law-governed sub-sovereign bonds still do not include CACs; these should be added. More creditor countries can adopt “anti-vulture fund” legislation, along the lines of acts adopted by the United Kingdom, Belgium and France. Doing so will prevent private creditors from holding up renegotiation.

In 2021, the OECD launched a “Debt Transparency Initiative” encouraging private creditors to provide more complete information on their loans and investments. Few private creditors have participated so far. The G20 governments can make this a regulatory requirement.