

Making the Global Financial System Work for All

G20 Eminent Persons Group
Global Financial Governance

Presentation to the G24

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Eminent Persons Group on Global Financial Governance (EPG)

- Group was established by the G20 Finance Ministers and Central Bank Governors in April 2017
- Mandate was to **recommend reforms to global financial architecture and governance of the system of international financial institutions**
- Comprised senior officials with knowledge and experience in global development and finance issues (Chair: DPM Tharman)

EPG Report

**MAKING THE
GLOBAL FINANCIAL SYSTEM
WORK FOR ALL**



Report of the
G20 Eminent Persons Group
on Global Financial Governance

EPG completed work in October 2018:

- Final Report presented to the G20 at its meetings in Bali in October 2018 (www.globalfinancialgovernance.org)
- Developed recommendations in three areas: **Development; Finance; and Overall System Governance**
- Recommendations being followed up by G20 and other foras/institutions

Context

Face different realities from a few decades ago and vastly different from Bretton Woods:

- **Domestic economic, social and political divides have widened** in most advanced nations, undermining long standing social contracts and support for international cooperation
- A **steady and irreversible shift towards a multipolar world** resulting in new poles of economic growth, more equal players and greater decentralization in international economic decision-making
- **Interlocking challenges of unprecedented scale, urgency and complexity** in the next decade – especially in securing jobs, and environmental and financial sustainability. Large number of youth entering work place, grave and multiple threats to environment, growing risk of pandemics and challenges to financial sustainability (increases in debts).
- A **world more deeply inter-connected** not only by trade but also capital and ideas that poses challenges to stability and cannot be tackled by nations on their own

EPG Approach

- **Build a credible and well-coordinated global financial architecture** for a world that is more decentralized in decision-making, yet more interconnected and more collectively challenged in the future
- **Mold this decentralized system into a new multilateralism** that is more resilient and stronger than the sum of its parts
- Recognize that **helping countries get their national policies right** is at the heart of achieving mutual prosperity
- Focus work and recommendations in three areas: **Development; Finance; and Global Governance**

EPG work streams

- **Development track**
 - Leverage private sector (infrastructure)
 - Institutional coherence (operational, policy, financial, shareholder)
 - Global public goods (working with the rest of the global system)
- **Finance track**
 - Capital flows and financial stability
 - Global financial safety net (multiple layers)
 - Financial surveillance... (BIS, FSB and IMF)
- ***Make system function as a system (development & finance)***

Development Context

- **Greater development impact needed in every region, especially Africa**, to achieve the major step-up in growth, job opportunities and sustainability required by 2030
- **Urgent reforms in development policy and financing needed** to attain greater impact
- Requires **organizing the world's multilateral development capabilities and resources in a new way** to address these challenges and seize existing opportunities
- To do this, **maximize IFIs ability to reduce risk** to attract private investment to LDCs:
 - Helping countries to **de-risk their whole investment climates**
 - **Pioneering investments in lower income countries** (+ those with features of fragility) to reduce perceived risks and pave the way for private investments
 - **Mitigating risk through instruments** such as co-investments and first-loss guarantees
 - **Pooling & diversifying risks** across development finance system => new asset classes

DEVELOPMENT: ACHIEVING GREATER IMPACT BY COLLABORATING ACROSS THE SYSTEM

Bolder reforms needed to **harness complementarities and synergies** in the system:

- **Refocus IFI efforts to help countries strengthen governance and human capital**, as foundation for attractive investment climate, job creation & social stability
- **Exploit untapped collaboration potential** among IFIs and development partners **through country and regional platforms** convergence around core standards
- **Embark on system-wide insurance and diversification of risk**, to create a large-scale asset class and mobilize significantly greater private sector participation
- **Develop regulatory framework and explore liquidity backstops for MDBs**
- **Strengthen joint capacity to tackle the challenges of the global commons**
- **Mainstream trust funds and leverage more actively the non-official sector**

Detailed Development Recommendations

- [P1] Refocus on supporting countries' efforts to strengthen governance capacity and human capital**, which are critical foundations for an attractive investment climate, job creation and economic dynamism.
- [P2] Join up IFIs' operations, as well as with those of other development partners, to build effective country platforms** to maximize their contributions as a group, including by convergence around core standards.
- [P3] Implement regional platforms to facilitate transformative cross-border infrastructure projects**, that enable regional connectivity and open new supply chains and markets.
- [P4] Multiplying private capital** by adopting system-wide approaches to:
 - [P4a] Shift the basic business model of the MDBs** from direct lending towards risk mitigation aimed at mobilizing private capital;
 - [P4b] Develop system-wide political risk insurance** and expand use of private reinsurance markets; and,
 - [P4c] Build a developing country infrastructure asset class** with the scale and diversification needed to draw in institutional investors.
- [P5] 'Right-size' capital requirements for MDBs and other infrastructure investors**, given their default experience by **[P5a]** establishing tailor-made capital and liquidity frameworks for the MDBs and **[P5b]** reviewing the regulatory treatment of infrastructure investment by institutional investors
- [P6] Strengthen joint capacity to tackle the challenges of the global commons** through tighter and more effective coordination mechanisms among the diverse organizations in each field to enhance response capacity and to ensure adequate financing with the IFIs mainstreaming support into their core activities.
- [P7] Integrate trust fund activities with the MDBs' strategies and operations**, to avoid parallel structures that pose significant costs to efficiency and impact.
- [P8] Invest in data and research** to support sound, evidence-based policies.
- [P9] Achieve stronger synergies with business alliances, NGOs and philanthropies** to benefit from their on-the-ground perspectives, innovations and delivery capacity.

Country Platforms

...country platforms can be transformational. They maximize the contributions of development partners as a group and scale up private investments...

Country platforms, centered around government ownership, can:

- Exploit **complementarity among a country's development partners** to utilize their combined strength and knowledge.
- Enable **consistent and coordinated support for policy and institutional reforms**
- **Facilitate adoption of common core standards** to lower the cost of working with a range of partners
- **Scale up private sector investment**
- **Strengthen crisis response capacity** as a country platform can be utilized for immediate response

Proposed approach:

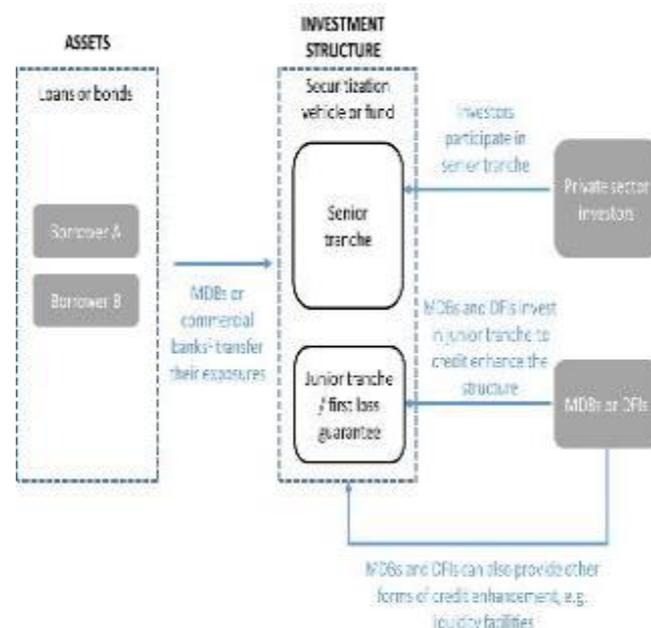
- **Involve all parties:** multilateral-bilateral; public-private; domestic-external
- **Core standards => 5-6 principles:** (debt sustainability, ESG standards, pricing policies, procurement, transparency and anti-corruption, local capacity building)
- **Joint assessments:** strategies, policy challenges, investment plans, and performance measurements
- **Common project preparation platforms/templates:** standardize documentation, data and benchmarks
- **Bring together intermediaries and long-term investors**
- **Risk mitigation and sharing replicated and scaled**

Building Large & Diversified Asset Class of Developing Country Infrastructure

...the development of a standardized, large-scale asset class, that diversifies risk across the development finance system, will help to mobilize the large untapped pool of investments...

- **Large scope for system-wide approaches** to reduce, manage and diversify risk, and draw in private capital
- **Re-orientating MDB business models to focus on risk mitigation**
- **Using system-wide political risk insurance** and private reinsurance markets (leveraging MIGA more as a global risk insurer in development finance)
- **Developing country infrastructure asset class** with scale and diversification (e.g. scaling up initiatives like IFC MCPP)

Generalised schematic of credit-enhanced investment structure



Commercial banks' jurisdiction would be sold bonds or their commitment to repay fixed up capital towards financing in developing countries.

Approach to the Global Commons

...the international community has a critical role to play in protecting the global commons and in supporting countries in their own national actions...

The **global commons face a wide range of challenges**, including environmental challenges and specific health-related threats from pandemics and the rapid spread of antimicrobial resistance.

These challenges span national borders and require international action.

IFIs have a critical role to play in helping support global standards and developing market-based approaches that would crowd in the private sector into action on the global commons:

IFIs should **integrate activities in support of the global commons into their core programs** and coordinate them within country platforms

The **designated UN agency and the World Bank should create global platforms to develop an effective international response** that requires strong action within and across countries, and across international agencies, as well as philanthropies and the private sector.

The **alignment of responsibilities should be based on its comparative advantage in the 'value-chain' of activities:**

- **R&D and innovation** - The IFIs together with the specialized UN agencies, should collaborate to collect data and undertake the analytical work necessary to develop early warning indicators, and prevention and resilience plans
- **Mobilizing finance** - The MDBs are best positioned to crowd in private resources into the global commons.
- **Prevention and resilience** - The combined data and knowledge of the IFIs can be used to develop early warning indicators and design appropriate prevention and resilience programs.
- **Crisis response** - Effective crisis response requires tight and speedy coordination between the IFIs, UN agencies and other development partners.

Finance: Securing the Benefits of Interconnected Financial Markets

...we must make it possible for developing countries to finance sustainable current account deficits without the recurring bouts of instability that set back growth...

- Create an IFMS (**International Finance and Monetary System**) that:
 - enables countries to reach their full growth and development potential; *yet*
 - averts the damage caused by financial crises.
- IMFS has been strengthened in important respects since the crisis,
 - especially through more robust prudential regulations and standards; *yet*
 - **still has features that lead to crises occurring too often** – in individual countries or groups through contagion or globally
- Reforms must support countries' own efforts to strengthen the environment for long-term, reliable flows of capital, *but* they must also repair and strengthen **THREE** interdependent pillars of the IFMS system:
 - *Getting the Benefits of International Capital Flows Without Risks Arising from Excessive Market Volatility*
 - *Strengthening Risk Surveillance to Avoid the Next Major Crisis*
 - *Stitching Together the Fragmented Global Financial Safety Net*

Getting the Benefits of International Capital Flows Without Risks Arising from Excessive Market Volatility

...even well-run economies are exposed to spillovers from policies in advanced countries and shifts in global risk sentiment in today's highly interconnected global financial markets...

Domestic financial markets and cross-border investments have brought major benefits globally. Countries with sound macroeconomic policies, reliable rule of law and deep domestic financial markets have benefited the most.

Yet, **excessive volatility has reduced the space for policymaking, leading to responses that hurt growth, and led countries to diverge from a path towards openness to protect domestic financial stability**

Policy thinking has too often been shaped by whether one sits in sending or receiving countries.

The EPG, therefore, recommended **the development of a rules-based international framework** to provide policy advice to avoid domestic policies with large spillovers, develop resilient markets, and derive the benefit of capital flows while managing risks to financial stability, by

the **IFIs strengthening and coordinating their technical assistance and partnership to help deepen domestic financial markets**

the **IMF evolving and extending its Institutional View** to (i) provide a reliable assessment of a receiving country's capital flows at risk and macro-financial stability, (ii) build on experience on the effectiveness of various instruments, including macro-prudential policies, and (iii) aim at providing assurance to the markets when countries are pursuing a policy mix consistent with the framework.

the **IMF developing a policy framework for sending countries that meets their domestic objectives while avoiding large international spillovers**

Strengthening Risk Surveillance to Avoid the Next Global Crisis

...we do not know where the next crisis will start. But it will become a full-blown crisis, with broader global consequences, when we are not prepared for it...

Financial crises have lasting costs, disrupting investment and affecting the poor disproportionately, with consequences that can last a generation or longer.

We will not know where the next crisis will start, therefore it is therefore **critical that we strengthen our ability to detect risks early and anticipate how they can be transmitted through a complex and highly interconnected global financial system.**

Ten years since the Global Financial Crisis, while risk surveillance has advanced, it is still too diffused. Therefore, we need:

- **a more integrated system of risk surveillance**, bringing together the distinct lenses of the IMF, the Financial Stability Board (FSB) and BIS (while preserving their independence), **to construct and continually update a global risk map** of financial linkages and vulnerabilities.

This **global risk map**:

- must also **solicit regular inputs from central banks and regulators**,
- **seek contrarian views**, including those from the non-official sector, and
- should be **used to facilitate regular discussion of policy actions to pre-empt crises through the IMF-FSB Early Warning Exercise (EWE)** to enable follow-through.

Stitching Together the Fragmented Global Financial Safety Net

...the global financial safety net that has evolved over the last decade is highly uneven in scale and coverage, is untested in a crisis, and lacks effective coordination and the predictability to be effective...

Incentives remain for countries to 'self-insure' by accumulating more reserves, or to avoid or reduce current account deficits even where they are needed to achieve their full growth potential.

We need **an effective global financial safety net (GFSN) to sustain open markets and support global growth, as it would help avoid moral hazard, minimize contagion between countries, and promote openness and growth.**

It is, therefore, critical to put in place **an effective and reliable GFSN** that ensures:

an adequately-resourced global layer in the IMF through timely conclusion of quota reviews;

the IMF works with Regional Financial Arrangements (RFAs) to enable consistent actions during a crisis to achieve the necessary scale and global impact; and,

a standing global liquidity facility is put in place to strengthen countries' ability to withstand global liquidity shocks, forestall deeper crises and avoid the need to build up excessive reserves.

The EPG also noted, without proposing a solution, that the inadequacy of the global safety net in the event of a large and severe future crisis needs to be addressed, as the solutions effected amid the last crisis, especially the large liquidity swaps, could be unavailable in the future.

Governance Recommendations

G20 providing strategic guidance in global financial governance

- **Refocus on multi-year, strategic agenda**, rationalize workstreams, and devolve work to IFIs

Governance of system-wide reforms

- **A G20-led group**, with representation from key non-G20 constituencies and the IFIs, **should steer the reorientation of development finance** over the next three years before handing coordinating role to IFI Heads.
- **Building complementarity among all development partners, and clear system of metrics to track impact and value for money.**
- **A biennial strategic forum convened by the IMFC and DC should identify development risks** before they manifest, and the required collective responses.

Governance within IFIs

- **Executive Board of each IFI to focus on strategic priorities and advancing system-wide goals**
- **Adopt practical, risk-based approach to delegate responsibility to IFI Management** & hold them accountable
- **Increase diversity and skills of IFI Boards and Mgmt** – match shift in business models & increased complexity

Taking forward the recommendations/proposals

- The **work of the EPG is now complete** and the final report is available for all interested parties to access at www.globalfinancialgovernance.org
- The G20 and relevant IFIs have started the important exercise of distilling key takeaways from the EPG report to follow up on. This will be on-going and iterative work.
- **Key stakeholders like the G24 must remain engaged** in this follow up work.
 - For example, **countries interested in piloting the Country Platforms proposals should reach out to key IFIs/development partners** to discuss on how best to commence this work.
 - The **G20 via the International Finance Architecture (IFA) working group has been appointed the coordination platform to develop and follow through with EPG proposals**, including country platforms. This on-going work would be carried forward through different G20 Presidencies. It would be useful to keep the co-chairs of the IFA working group (France and Korea) updated on all relevant developments.

Thank You