HIGHLIGHTS OF THE G-24 TECHNICAL GROUP MEETING

Lima, March 14-15, 2019

This note provides highlights of the sessions during the recent G-24 Technical Group Meeting held in Lima, Peru. The full summary is also made available to the G-24.

Coping with Global Uncertainties, the Global Safety Net and the IMF (Keynote and Session 1)

Recent years have seen many new developments in the global context that have had implications for the role of the IMF. These developments include large volatile movements of capital, the creation of bilateral swaps, and the emergence of China. The IMF has also responded to the changing context—adapting its policy recommendations, strengthening its bilateral and multilateral surveillance, and creating new instruments.

Despite the progress, issues remain with respect to the adequacy of IMF resources, the appropriateness of instruments and governance. IMF governance, resources and lending are linked to the quotas of members. Revisions in quotas have tended to lag, and at present, there are misalignments in quotas.

IMF resources are set to decline in the coming years when the New Arrangement to Borrow and the Bilateral Borrowing Agreements expire. In view of the global uncertainties and potential shocks, the need to ensure the adequacy of IMF resources remains of utmost importance.

It is not only a question of adequacy of resources that needs to be considered, but also the appropriateness of the currently available instruments. One suggestion is that a "Fast Qualification Facility" be created that would have the same goals as the precautionary lines but would be *unconditional* as it would be designed for strong economies to support them in the face of sudden liquidity needs. It would be cheaper than a permanent commitment to a precautionary line and would be a temporary arrangement. The characteristics of capital flows to EMDEs, which are much more driven by global "push" factors than are capital flows to advanced economies, and the relatively frequent occurrence of sudden stops in capital flows, heighten the need for such liquidity facilities.

In terms of issues going forward, the IMF will need to focus on two key additional questions: i) how to deal with debt sustainability issues when countries are facing very large infrastructure financing needs; and ii) how to deal with issues of climate change which are central to both growth and financial stability.

Participants strongly agreed with the criticality of ensuring an adequate global financial safety net, as well as the importance of the quota reviews and the need to continue to push for IMF governance reforms going forward. A suggestion was made that, were the quota realignment to stall, the G-24 could push for some elements of the 2010 quota review that have yet to be addressed.

Global Financial Governance and Growth: G-20 Eminent Persons Group Report (Special Session)

The world is facing unprecedented challenges especially in creating jobs and in ensuring environmental and financial sustainability. At the same time, there is a steady trend towards a multipolar world and decentralized decision-making on the one hand, and a growing interconnectedness between countries through flows of trade, capital, and ideas on the other. These trends heighten the need for, and the challenges to, creating a credible and well-coordinated global financial system that benefits all countries.

Reforms are needed in three key areas: i) achieving greater development impact in countries; ii) strengthening the resilience of the global financial system in the context of large volatile capital flows; and iii) improving the governance of the system of international financial institutions. There is much to be gained by governing the system as a system rather than as individual institutions.

To achieve a greater development impact with the aim of meeting the SDGs, there is a recognition that attracting private investment will be key. Thus, MDBs should focus on helping countries to improve their human capital and investment climate and provide instruments and approaches to de-risking both the overall investment climate and individual projects in order to facilitate private investment.

The report emphasizes the need for MDBs to strengthen collaboration across development actors, including bilateral financial institutions, and recommends improving the joint capacity of IFIs, MDBs, and other stakeholders to respond on the challenges of the global commons.

One recommendation is that countries consider building country platforms that would enable them to ensure that development partners provide more consistent and better coordinated support. It could also help in facilitating private sector involvement. It would be important however, to ensure that these government-led platforms are designed to suit the country's objectives and conditions, and are flexible enough to enable governments to engage with different partners to varying degrees as they wish.

In terms of strengthening the resilience of the financial system, a key recommendation is that three IFIs most involved on the financial side (i.e. IMF, BIS, FSB) also develop a policy framework for the capital-sending countries (and not only for capital-receiving countries) that would enable them to meet their domestic objectives, while avoiding large international spillovers.

Overall, it was felt that the report is important for the G-24, and that the Group could refer to these recommendations—especially with respect to the IMF quotas, governance, and global financial safety net issues—to strengthen its position in discussions. There was some concern that the report's recommendations are very ambitious however, and that their success would depend on countries' institutional capacities. Some of these recommendations also rely on actions that advanced countries need to implement.

Combating Illicit Financial Flows (Session 2)

IFFs can have serious negative impacts, including undermining financial and economic stability, political stability. There is, however, no consensus with regard to the definition of IFFs, although there are a few broad categories that constitute illicit flows: i) funds derived from illegal acts; ii) funds transferred using illegal means; iii) and funds used for illegal purposes. The big debate is whether funds transferred using illicit means (e.g., tax avoidance), which is not necessarily illegal, should be captured in the broad definition. The definition of IFFs matter, as each element would require different policy responses.

Given the debate on the definition and their nature, IFFs are also difficult to quantify. This can lead to inaccuracies and over-estimates with respect to cross-border activities.

The World Bank, IMF, and IFC are all engaged in this area, with the WB and IMF working at a macro policy level and the IFC at a micro/ firm and project level. Measures include enhancing integrity and due diligence, developing the tools to assess IFFs, providing technical assistance and capacity development at the country level, enhancing entity transparency, addressing governance and corruption issues, strengthening tax compliance and AML/CTF framework, and monitoring payment gaps.

Furthermore, institutions including UNCTAD and Tax Justice Network (TJN) are working on ways to measure IFFs. As a co-custodian of the SDG Indicator 16.4.1, UNCTAD faces the difficult challenge of reaching agreement on quantifying inward and outward IFFs, and consensus has not been reached. The TJN measurement approach is based on two proposed indicators: i) misaligned profits with two-sided accountability; and ii) undeclared offshore assets that capture tax evasion as well as broader criminal illicit flows. Both indicators provide a global number based on country-by-country reporting and accountability. Raising international standards on financial transparency within the UN framework and international tax reform are encouraged to combat IFFs.

Country perspectives on IFFs touched on the challenges arising from an open economy and under-reporting problems of firms, as well as the importance of, not only the policy framework, but also implementation effectiveness. Participants further raised the issue of how to tackle illicit financing flows in cases where fintech (e.g. crypto currencies) is used to finance terrorism. There were also questions on how countries can develop the political will to tackle the issue. It was pointed out that FATF standards have become more stringent and that countries that are not compliant risk being blacklisted by international standards and stakeholders.

<u>Fiscal Reforms and Governance (Session 3)</u>

The Philippines Comprehensive Tax Reform aims to redesign the tax system to make it simpler, fairer, and more efficient. The reform has a multi-pronged approach, and is being implemented in stages. The full package involves addressing personal income taxes, corporate taxes, property taxes, and capital income taxation. The package also involves a tax amnesty program complemented by tax transparency measures, and stakeholder consultations. Results—in terms of revenues—are already being achieved. Emphasis is also placed on infrastructure development and social protection programs.

The Public Expenditure and Financial Accountability (PEFA) framework assesses the state of countries' public financial management (PFM) at the national and subnational levels. The framework is one of the few tools that covers the entire PFM cycle. It has already been used in 150 countries (13 G-24 countries have undertaken assessments since 2016. 11 more G24 countries have undertaken assessments before 2016. Five of these 11 countries are in the process of undertaking new assessments). The average overall PEFA scores show that there has been some progress. In view of debt sustainability issues arising in many countries, MDBs are increasingly focusing on debt management, transparency, and disclosure and accounting standards. A PEFA Gender Module is currently being piloted as is guidance on how to use PEFA reports for PFM reform design and implementation.

<u>Managing Sustainable Investment and Growth (Session 4)</u>

Sustainable infrastructure is central to supporting inclusive economic growth, increasing access to basic services, and promoting environmental sustainability. The stock of infrastructure in the global economy is expected to double in the next 15 years, with a small window of opportunity to make the shift to a new growth path that does not rely on polluting technologies and inefficient capital, to meet the SDGs.

There are two current impediments to achieving this investment: a) the inability of countries to translate the needs for investment into realized demand; and b) difficulties in mobilizing long-term finance—despite the large pools of available savings globally—at a reasonable cost to match the risks of the infrastructure project cycle.

The biggest opportunity is to tap private financing, particularly institutional investors, through the creation of an infrastructure asset class. This can be facilitated through the creation of country platforms of the type discussed in the G-20 EPG report—as this would help in the articulation of country's infrastructure program and in the standardization of documentation and standards for the private sector. It can also bring together intermediaries and long-term investors and enable the scaling up of investments. The MDBs have an important role to play in helping to reduce and mitigate risks especially in the difficult early stages of an infrastructure project.

Taxation Challenges: A Focus on the Digital Economy (Special Session)

Digitalization has allowed firms to separate the location of production and consumption of services. Thus, businesses can be heavily involved in a jurisdiction without physical presence. Since taxing rights are currently allocated to jurisdictions primarily on physical presence, market jurisdictions are losing out on their share of taxes.

The G-24 has submitted a proposal based on the concept of significant *economic* presence (SEP) in considering the nexus for taxation. This proposal, along with the two others that were put forward in the 2018 Task Force on the Digital Economy (TFDE) at the OECD, have been circulated for public consultation. It is expected that a consensus proposal will be presented in 2020.

Ensuring Adequate Social Safety Nets (Session 6)

Social protection consists of social assistance, social insurance, and active labor market policies. Progress has been made in social assistance programs worldwide in terms of both the number of countries and programs. An increasing number of countries have also introduced non-contributory social pensions. Some progress has been made on the provision of social insurance; however, social insurance coverage of the informal sector remains limited.

There are difficult tradeoffs involved in social protection—coverage, adequacy of benefits, incentives, and fiscal sustainability are all elements that need to be considered. These choices need to be made in highly varied contexts and are also likely to be influenced by different approaches—for example, whether one gives more weight to growth and efficiency considerations, poverty and social justice, or human rights.

The IMF has used different instruments to deal with social safety nets in its programs including: i) protecting or creating fiscal space for social spending through floors; ii) social benefits and transfers; iii) social security programs; iv) unemployment assistance/minimum wage; and v) active labor market policies. The choice of instruments used has depended on the availability of fiscal space, country preferences, appropriateness, and adaptability of existing instruments and administrative capacity. Empirically, social spending has increased at a faster pace, or has remained protected, under Fund programs. Over the longer-term, structural conditionality, such as arrears payment or accounting and financial reporting, has a lasting impact on increasing social spending.