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Building a shared European vision on the reforms of the international financial architecture for sustainable development

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Background

As world leaders are packing their bags to travel to Washington for the Spring meetings of the World Bank (WB) and the International Monetary Fund, these discussions will offer the first opportunity of the year to collectively deliver on some of the propositions to reform the WB and the international financial architecture for sustainable development to make them fit for the polycrises of the 21st century. The May G7 Summit in Japan, the June Summit for A New Financial Pact in Paris, the September Finance in Common Summit in Colombia, the SDG Summit in New York, the G20 Summit in India, the WB and IMF annual meetings in the autumn, and the COP28 in Dubai at the end of the year, are other opportunities to move the reform agenda forward.

Against this backdrop, on March 22, the European Think Tanks Group (ETTG) organised a closed-door roundtable under the Chatham House rule, to create a space for sharing and sharpening European views on this agenda. Building a possible shared European vision on main priorities is key, given their political and economic weight in the international financial institutions (IFIs) and fora, as well as their responsibilities as key implementing actors in countries of operations.[1]

This workshop is the first of a series organised throughout the year which will mobilise relevant experts within ETTG, and other think-tanks or civil society organisations from Africa, Latin America, and Asia, national policy makers, and representatives of

[1] Note that "Europeans" here purposefully includes the United Kingdom, as part of a broader "Team Europe" approach, key implementer in the international cooperation arena, and potential ally to weigh in the board of MDBs

international organisations with the view to create bridges between different visions and parallel negotiation tracks.

The role of Europeans in reforming the international financial system for sustainable development

Multiple calls to reform the international financial system for sustainable development require the European Union (EU) to establish a shared approach to the proposed changes, and establish alliances with like-minded partners. This is of particular importance given the political and financial weight of Europeans at the global level, and in IFIs in particular.

The EU and its 27 member states collectively remain the largest international donor as they provided over 40% of global Official Development Assistance in 2021.[2] Beyond EU institutions and member states, Europeans also avail of a network of national development finance institutions working both with the public and private sector for development. They also own the European Investment Bank (EIB) and are a majority shareholder of the European Bank for Reconstruction and Development (EBRD), which are key and growing actors in terms of promoting EU external investment and priorities. Last but not least, EU member states are key shareholders of some of the major multilateral development banks. Collectively, they own around one quarter of the World Bank's voting shares; and 4 to 5% more if we also include the UK.[3]

Yet, the EU and its member states often do not operate as a collective actor, somewhat underplaying the policy agenda, adequacy and efficiency of their financing of and participation in such architecture. Europeans are thus challenged to demonstrate their added value and distinctive approach in a multipolar world where various development and financing models compete, particularly at a time when trust between sGlobal North countries and Global South countries appears to have eroded. If well-coordinated along a clearer set of shared priorities, based on an open and constructive approach to Southern

[2] https://stats.oecd.org/
[3] https://www.worldbank.org/en/about/leadership/votingpowers

voices, Europeans could position themselves as some of the champions of this reform agenda and, when joining conscious and progressive alliances for change, restore some of this trust.

Insights from the reform process of the European financial architecture for sustainable development

In fostering shared views on the international financial architecture, the EU can draw on its past internal process of reforming the European financial architecture for development, which included objectives of rationalising the existing landscape, better integrating new challenges such as the fight against and adaptation to climate change, enhancing complementarities among a range of financial and development actors, and adapting various tools and institutions, including the EIB and EBRD.[4]

Three areas particularly stood out:

- Adapting multilateral development banks operations to an evolving agenda

With the adoption of the Green Deal and the emphasis of a policy-first approach, combined with the Paris Agreement and successive COPs, the EU and its member states have taken increasing commitments to boost climate finance. This has led to further efforts to build on the potential of existing development finance institutions and public development banks to tackle both climate and development as intertwined and complementary goals (as opposed to substituting one for the other). This is the case for instance of the EIB which became the EU Climate Bank and also set up its dedicated international branch in January 2022, EIB Global, with a view to do more on international

[4] See https://neighbourhood-enlargement.ec.europa.eu/news/eu-external-action-budget-european-commission-welcomes-final-adoption-eus-new-long-term-external-2021-06-09_en; https://www.consilium.europa.eu/media/40967/efad-report_final.pdf

development while combining this ambition with climate action and environmental protection.

Challenges remain on the operationalisation of the dual ambition to tackle both development and climate objectives, just as there is a need to recognise that there are diverse paths to a just and green transition which do not always fit exactly with the European model, or at least expose some of its contradictions, a pushback point already mentioned by some countries in the South.

In this vein, the ongoing work of the EU high-level expert group on scaling up sustainable finance in low- and middle-income countries can contribute to establishing a clearer definition of what sustainable finance should look like, with a view to ensure that supporting transformation and impact at country-level is made a priority for the EU.[5]

- Better serving vulnerable and fragile environments by derisking and mobilising the private sector through a greater use of guarantees

A majority of MDBs operations are currently deployed in middle income countries (MICs). The aversion of some of these banks and the European private sector to invest more in lower income countries (LICs) may be considered justified by the perceived risks attached to more fragile economic and political environments. Further incentivising the use of guarantees is one option on the table to provide more and better access to finances to countries in need, and their private sector.

The European Fund for Sustainable Development Plus (EFSD+), created by the EU in 2021 as part of the Neighbourhood, Development and International Cooperation Instrument – 'Global Europe' includes a significant increase of finances made available for guarantees for the 2021-2027 period (up to 10bn euros against 1.5bn euros for the previous 7 year period). These instruments are designed to be used primarily for private sector mobilisation and job creation, in fragile contexts, especially on the African continent.

[5] https://ec.europa.eu/commission/presscorner/detail/en/ip_22_5724

All EU entities have access to these funds, including the EIB which also adds its own financial envelopes.

As the calls for greater derisking of projects multiply, be it through an enhanced Multilateral Investment Guarantee Agency (MIGA) for the WB, through the implementation of Just Energy Transition Plans (JETPs), Europeans can also share lessons on their experimentation of such tools. The inclusion of the EFSD+ in the broader Global Europe instruments should also fuel discussions on the complementarity between instruments (be it grants, blending and guarantees) depending on the sector, region and type of projects.

- Coordinating action: learnings from the Team Europe approach

The identified need for a greater cohesion at the European level on international cooperation matters was already highlighted during the COVID-19 pandemic and led to the launch of the “Team Europe approach”.[6] The latter aims to gather European actors under one shared umbrella, with each providing some level of financing or expertise, and sharing tasks and responsibilities that build on their respective strengths. This includes European member states’ institutions working with the public sector but also those engaging more with the private sector, through the network of European Development Finance Institutions for example. This approach translated numerous Team Europe initiatives, all with the potential to contribute to the overarching strategies, including the 2030 Agenda, the Global Gateway and the European Green Deal. While efforts have been made to map out various objectives and the expertise needed from various actors involved to seek greater complementarity, there still is a need for a clearer steer on the priorities that would unite Europeans and provide ground for a stronger leadership on the international scene, including on where the reforms of multilateral development banks (MDBs) should focus more and how.

Europeans can build on these past lessons to make the international financial architecture for sustainable development fitter to 21st-century challenges. But more progress and a

[6] https://international-partnerships.ec.europa.eu/policies/team-europe-initiatives_en

fundamental shift are needed to unleash its truly transformational potential and materialise a much-needed EU leadership in international fora.

The EU should speak with one voice beyond its borders

For Europeans to fully weigh in on the reforms by bringing their own ideas and joining progressive alliances with third states, a number of points remain unresolved at this stage and require further consideration.

- Mobilising more finances

The magnitude of the challenges highlighted in the Capital Adequacy Framework (CAF) reform, MDB reforms and the Bridgetown agenda,[7] call for an quantum leap in the quality and volume of sustainable finance made available to countries in need. Yet, Europeans have given no sign yet of any new additional funding. ODA levels have already increased in some countries, although with rising criticism about the so called “inflated aid”,[8] while they are under threat in some others, including some big donors, with looming cuts rather than new injections that would help to collectively reach the 0.7% GNI on ODA target. The pledge of $100b a year of Climate Finance has yet to be met, although research suggests that Europeans are among those that lead the way and have provided their fair share.
There is some level of interest in new forms of financing (with regards to taxation) along with reservations on their feasibility in the current political context. Special drawing rights (SDRs) re-channelling by richer countries brings some optimism: some European member states have already pledged to rechannel a total equivalent of € 28 billion through the IMF, among others, and there is room for additional commitments by Europeans.[9]

More discussions are urgently needed, however, with third parties, to join the pledge and reach the US$ 100 billion reallocation target, starting with the US, whose pledge to

[7] https://www.foreign.gov.bb/the-2022-barbados-agenda/
[8] https://concordeurope.org/2022/10/24/aidwatch-2022-1-euro-in-every-6-not-going-towards-those-left-furthest-behind/
[9] https://data.one.org/data-dives/sdr/

reallocate some of its SDRs remains stuck in the US Congress. Mechanisms to rechannel SDRs beyond the IMF, and notably through MDBs - as currently made possible by the African Development Bank and Inter-American Development Bank - would also require lifting the blockage from the European Central Bank based on the interpretation of the EU Treaty.

- Evolving MDBs business models to better respond to borrowers' needs

While the WB may already announce at the Spring meetings the availability of new finances, more discussions are needed to clarify how these funds should be used and ways in which the business models of these multilateral development banks need to evolve. Europeans call for a clearer division of labour between all institutions involved: between MDBs, between MDBs and the broader banking ecosystem (with PDBs and the private sector), as well as with state authorities.

Most importantly, European players support the idea that the reforms should help move away from a project-based approach to a portfolio one that fully takes into consideration the integrated nature of the challenges at hand and sets the right criteria for access to such financing (as opposed to increasing its cost because of new imperatives). An integrated approach would further support the shifting of existing finances away from negative impacts (such as with fossil fuels).

- Solving governance issues and reconciling tracks for better engagement beyond the EU

The absence of truly transformative decisions at the moment can partly be attributed to the standoff between some parties (from various ministries or different parts of an institution) opposing more sustainable development-oriented approaches to finance-oriented ones. Such divisions impede some member states from having a unified position, and this is mirrored at the EU institutions level between different directorates, and further in the governance bodies of MDBs where European voices are not necessarily unified. EU coordination between tracks and within boards is a key area where further progress is needed to join the dots and ensure greater political buy-in of various initiatives taken so far in a fragmented way. This should also play out in the context of the MDBs reform to ensure that they all move forward in a coherent manner, not just exchanging information but truly collaborating on the basis of their respective strengths and the mission set by their shareholders. In the European players' view, such coordination would also allow greater credibility in the discussions with credit rating agencies.

These governance issues also negatively impact discussions with EU's partners. A change of narrative and stronger policy dialogue have been identified as needed to ensure that change happens at country-level where Europeans are also collectively often very present to implement their international development and cooperation work. Such changes would also contribute to making the voice of Europeans heard more strongly in international processes such as the G20 or the G7. Pressing on identified priorities and meeting the demands of borrowers will require a better understanding of where the EU collectively sits on some of the proposals on the table and who it can and wants to engage with, including with China which has been engaging only at the margins so far, if at all.

Conclusion

The EU context illustrates that the type of reforms for the MDBs and international financial architecture for sustainable development on the table have in fact long been discussed in various forms and fora but there is, this year, a conducive platform to address these burning issues and concretely deliver on a substantial reform agenda. Europeans should be central to making it happen. Broad support already emerges on a number of issues and there will be numerous occasions to finetune them throughout the year. If an EU coalition of the willing can emerge from this process to concretely and urgently implement some of the proposed actions and join progressive coalitions with countries from the Global South, this would go a long way in its attempt to restore trust and credibility with partners throughout the world.