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In search of financial justice

The global financial system is dysfunctional. And yet, calls for reforms that better meet the needs of the Global South continue to face resistance

For the first time in 50 years, the annual meeting of the International Monetary Fund (IMF) and the World Bank is taking place on the African continent. It comes at a time of a rampant debt crisis in the Global South, a dysfunctional financial architecture in dealing with these debt crises, and, at the same time, a growing resentment in the Global South for not being sufficiently represented in this global financial architecture.

In the run-up to the meeting from 9 to 15 October in Marrakesh, the 'Vulnerable Twenty' - a collective of more than 50 climate-vulnerable countries - called for not only a reform but a meaningful overhaul of the global financial architecture. At the Africa Climate Summit, the African states involved demanded that a new financial architecture be created, with improved debt restructuring procedures that better meet Africa's needs. Only the previous week at the United Nations, Pakistan and Argentina called for sovereign insolvency procedures, independent of creditors and debtors, to offer countries a quick and fair way out of a debt crisis.

The Global North is not playing along

But so far, the Global North has resisted making decisions on reforming the global financial architecture in a way that would give equal weight to debtors' voices. The US, along with some fellow G7 countries, sought to block formulations on debt and financial architecture reform in September's UN Sustainable Development Goals (SDG) Summit statement. They argue that these issues should be dealt with exclusively by the IMF and the World Bank. In 2014 and 2015, Global North countries used the same argument to prevent an initiative by the G77 (an association of 134 countries of the Global South) in the United Nations to create a sovereign insolvency procedure. The underlying agenda is clear: countries in the Global North want to retain their power and

influence. In the IMF and the World Bank, the G7 countries hold more than 40 per cent of the voting rights and can thus decisively determine their policies. In the United Nations General Assembly, the principle of one country, one vote applies, so that the G7 countries together hold just over three per cent of the voting rights there.

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If this initiative hadn't been blocked at the time and had a sovereign insolvency procedure been created in 'simpler times', as IMF head Kristalina Georgieva put it at the spring meetings of the IMF and the World Bank in 2021, perhaps countries today would have a greater incentive to start debt restructuring negotiations early on. But constructive, meaningful discussions, particularly on the matter of what a fair debt architecture could look like, have repeatedly fallen victim to the same blocs we see today in the UN and the international financial institutions between countries in the Global North and those in the Global South.

Given the various initiatives and coordination between debtor countries, there is now an opportunity to launch multilateral initiatives that transcend the blocs. The German government can play a crucial role here. In its coalition agreement, Berlin pledged to support a codified sovereign insolvency procedure — as Pakistan and Argentina recently called for. But it needs to be bolder and challenge the G7's unspoken rule that debt decisions should remain largely within the remit of the IMF.

The IMF's international gatekeeper role

This becomes all the more important when we look at the choice of meeting location: for the IMF and the World Bank, meeting in Marrakesh sends a signal to involve the Global South more closely. But it is precisely this region, where the global financial elite will gather in the coming days, that falls through the cracks when it comes to resolving the debt crisis. The *G20 Common Framework*, the debt restructuring framework for creditor countries, which aims to provide governments with a more coordinated and swifter way out of a debt crisis, regulates access not according to actual relief needs, but by per capita income in the countries. Only countries considered low-income in line with the World Bank's categories will have access — all the others will not. Many countries in the Middle East and North Africa (MENA) region fall outside of this. This has already been the case with the creation of more

coordinated debt relief initiatives in debt crises gone by, such as the multilateral debt relief initiative for heavily indebted poor countries (HIPC initiative).

The IMF's forecasts for economic growth are systematically too optimistic.

State debt is actually the only type of debt whose restructuring process needed in the event of a crisis is not regulated by a legal framework. In the Global South, instead, it is the IMF that plays a key role in both identifying and resolving debt crises. And not just because many countries turn to the IMF as the international lender of last resort in a crisis. The IMF also serves as a *de facto* gatekeeper for further multilateral and bilateral financing, as well as for debt relief by public creditors. These require an IMF programme to negotiate with severely indebted countries to restructure their debt. The IMF's role is therefore far greater than that suggested by its own level of lending.

Since the outbreak of the Covid-19 pandemic, IMF director Kristalina Georgieva has been one of the loudest voices calling for rapid debt relief for critically indebted countries. But things still look rather different in practice: a study of 179 debt sustainability analyses of 117 states between 2020 and 2022 shows that, although the IMF points to high debt risks in 86 countries, debt relief is invoked by the IMF as a preventive measure in just four cases (which had not already stopped payments or entered into restructuring negotiations). In all other countries with similar levels of debt risk, there are no recommendations or scenarios where debt relief comes into play. Instead, the IMF unilaterally recommends the debtor country take adjustment measures to reduce the debt ratio. This means that the creditors avoid losses, while the population alone bears the burden.

Another problem is that the IMF's forecasts for economic growth, for example, are systematically too optimistic. As a result, these overestimate the future repayment capacity of debtor countries, while underestimating the need for debt relief. This is particularly problematic because the remission requirement calculated by the IMF is the most important basis on which public creditor countries rely when it comes to debt restructuring negotiations.

We need a meaningful overhaul of the

In the case of Sri Lanka, the IMF itself wrote in its debt sustainability analysis that the calculated debt relief will not result in a

international financial architecture in favour of fair and transparent rules-based sovereign insolvency procedures.

sustainable debt situation. However, there is no incentive to produce realistic forecasts, because the larger the remission requirement calculated by the IMF, the more difficult it becomes to get all creditors around the table and persuade them to actually agree to it.

Once again, we see how dysfunctional the current system is, which relies on creditors to voluntarily grant debt relief. For as long as this does not change, and debt cancellations depend on the goodwill of the creditors (or the specific economic and geo-strategic interest of the individual creditors in the debtor country), the mistakes of the past will continue to repeat themselves and debt cancellations will be too little and too late. So, the Vulnerable Twentyare right: we need a meaningful overhaul of the international financial architecture in favour of fair and transparent rules-based sovereign insolvency procedures. Whether these expectations will be met at this year's IMF and World Bank annual meeting in Marrakesh remains to be seen.



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