September 2022

Interest rate turnaround

A turning point for development finance?

by Bodo Ellmers

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Executive summary

Since the adoption of the 2030 Agenda on Sustainable Development, development finance has operated under conditions of low interest rates and high liquidity in global financial markets. This has changed with the recent turnaround in interest rates. This briefing paper describes the current trends, analyzes the implications for financing sustainable development in the Global South, and formulates policy recommendations on how countries in the Global South and their financing partners in the North can respond to the interest rate increases.

Since March 2022, the US Federal Reserve has been raising key interest rates at a record pace and in large steps. Developing countries in particular have had to follow suit in even larger steps in order to remain attractive as investment locations for volatile capital and to prevent massive capital outflows.

The implications are enormous and multifaceted. Escalating interest costs weigh heavily on developing countries' budgets and absorb scarce resources needed for development and public goods. Capital flight and lack of liquidity in global financial markets mean that developing countries find it difficult to access new capital for investment in economic development and socio-ecological transformation, or only at prohibitively high costs. The number of countries in acute debt crises is threatening to grow rapidly.

BRIEFING

The optimal mix of instruments in development finance changes with the level of interest rates. The turnaround of interest rates is also a gamechanger for development finance. It requires a fundamental policy shift. As interest rates rise, using private financing at market conditions is rational and affordable for fewer countries and for fewer purposes. At the same time, financing channels such as domestic financing from tax revenues or external financing from Official Development Assistance (ODA) grants become more important, as these are not dependent on interest rate levels.

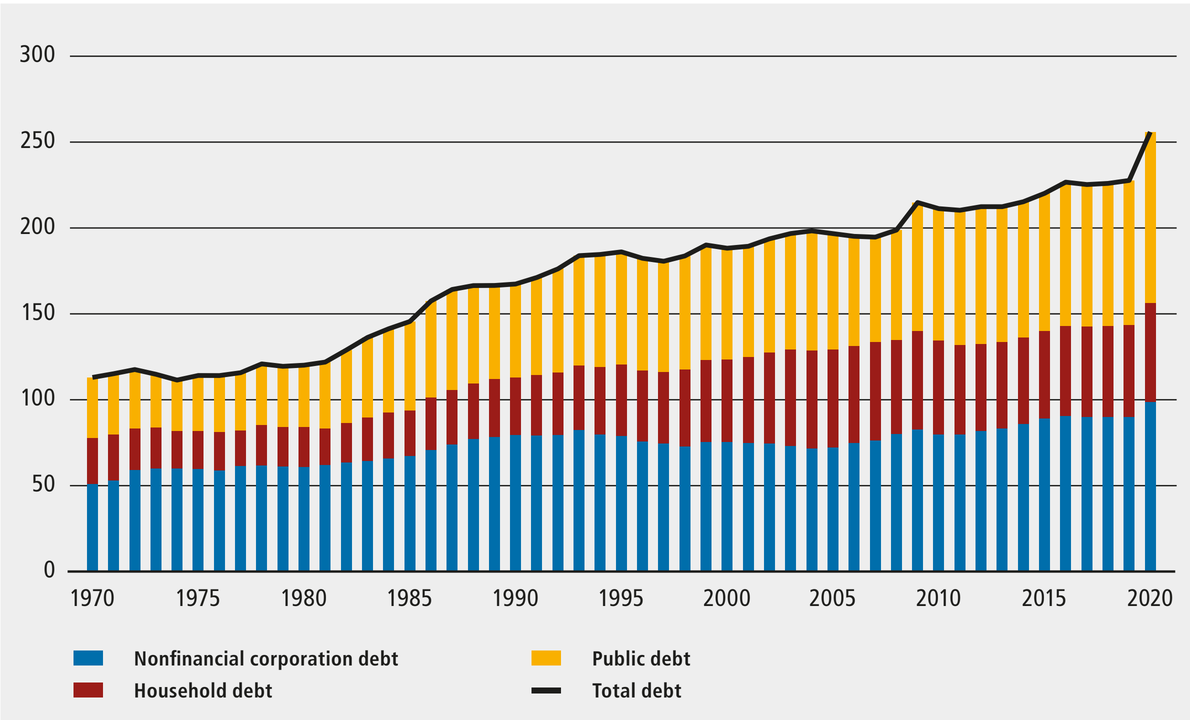
The interest rate turnaround exacerbates the humanitarian emergency in the Global South, where populations have been hit hard by multiple energy, food, climate, and coronavirus crises. In the short term, the international community can provide liquidity to the Global South, for example, through a new issue of International Monetary Fund (IMF) Special Drawing Rights. Relief packages also need to be put in place in developing countries to protect vulnerable groups, and investment in sustainable development still needs to be scaled up under difficult conditions. Fair and effective taxation, debt relief and ODA grants can increase the fiscal space for this.

Interest rate turnaround: End of an era

The period of low interest rates that has recently come to an end has been exceptional in every respect. During the global financial crisis of 2008, the world's major central banks began cutting interest rates so sharply that the key interest rate in the world's major economies plummeted to zero. In some countries, it was even negative. In the European Union (EU), the European Central Bank (ECB) lowered the key interest rate to zero in July 2011 and left it there for over a decade, until the summer of 2022. For over five years, the interest rate was at negative levels.[1]

The extent and duration of the low interest rates are unprecedented in history. Economists spoke of zero interest rates as the "new normal". Government financing was cheap during this era. In Germany, for example, interest costs for the federal budget fell to just €4 billion per year at the last count. This made it possible to carry out important

Figure 1: Global debt stock: Total public and private debt, 1970 – 2020 (percent of GDP)



Source: IMF World Economic Outlook, April 2022, p. 46

1 https://www.ecb.europa.eu/stats/policy_and_exchange_rates/key_ecb_interest_rates/html/index.de.html

government spending and still report a small budget deficit. Twenty years ago, at the last high interest rate phase, the federal government's interest costs amounted to over €40 billion.[2]

Both governments and private companies in the Global South as well as in the North took advantage of the period of low interest rates and high liquidity on global financial markets to make massive use of debt financing. Consequently, both private and sovereign debt stocks have grown hugely over the past decade. The debt ratio as a share of Gross National Product has also reached new highs (see Figure 1).

The 2030 Agenda for Sustainable Development, adopted in 2015, was first implemented during this low interest rate environment. Policy proposals to implement it were shaped accordingly.

Special attention was paid to the initiative of multilateral development banks to use scarce ODA funds to siphon off the vast sums of private investment capital available in global financial markets and make them available to finance sustainable development. Blended financing instruments that mix public and private capital were to be used to achieve a huge leverage effect. This leverage should turn a few billions into the trillions needed to close the Sustainable Development Goal (SDG) financing gap. But how is SDG financing supposed to work when there is no more cheap money available in global financial markets?

For the Global South, these financing models conceived in the North have always been less suitable. For some time, non-governmental organizations have levelled the criticism that the design of these models primarily met the needs of investors looking for new investment opportunities with an attractive risk-return profile in new markets, at times when traditional forms of investment such as US government bonds or German Bundesanleihen (federal bonds) no longer yielded much return.

The United Nations (UN)'s *Financing for Sustainable Development Report 2022* raised awareness of the "financial divide" – the fact that developing countries had to pay a disproportionately higher interest rate to access money in private capital markets.[3] Investors offered significantly worse financing conditions to the Global South, even during the low-interest-rate phase. Even emerging economies like South Africa had to pay interest rates of well over 10 percent on government bonds, while governments from the North financed themselves at interest rates close to zero (see Figure 2).

What trends are visible?

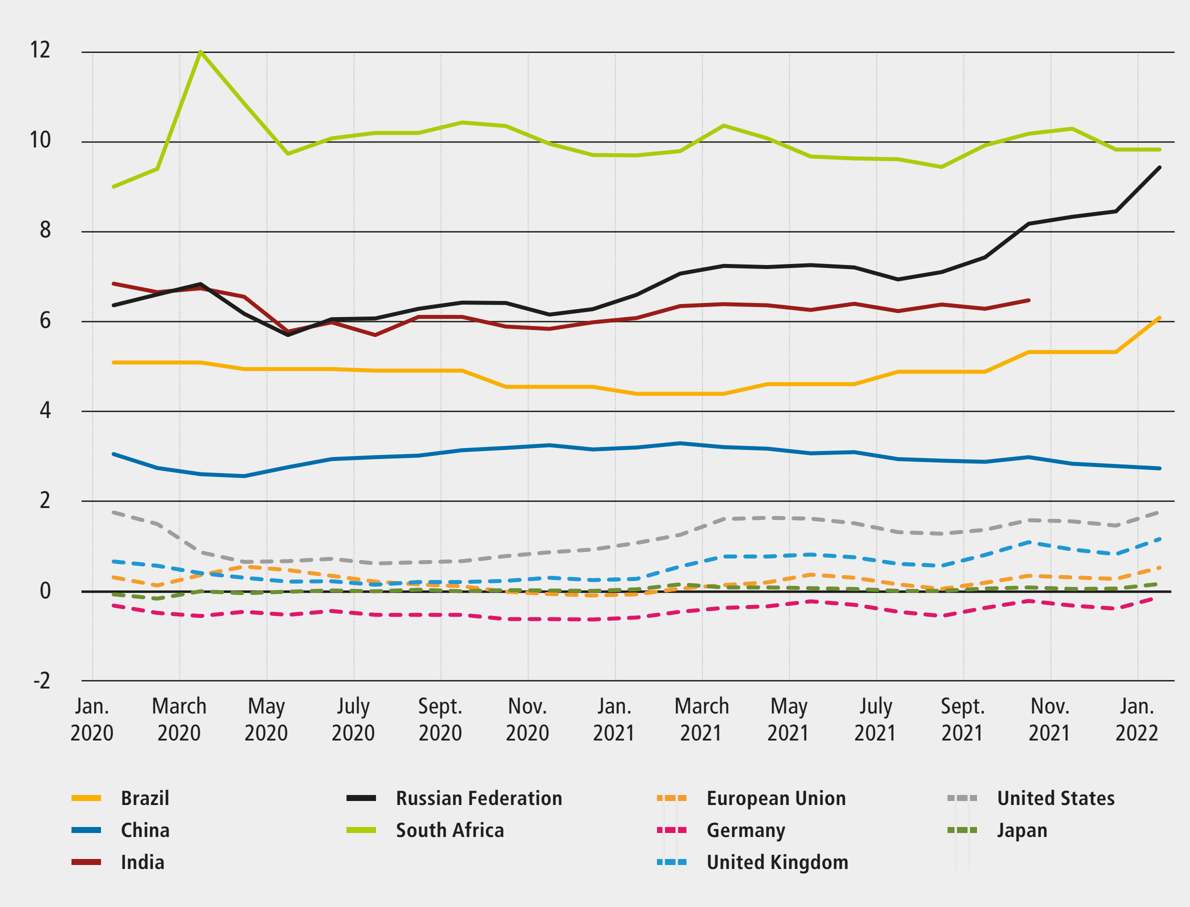
The Federal Open Market Committee (FOMC) meeting of the US Federal Reserve (Fed) on 15–16 March 2022 will go down in history as the meeting that triggered the turnaround in interest rates in the United States. Based on economic data from the US economy, a group of 12 Americans readjusted the financial parameters of the entire world on that day.

Because of the continued dominance of the dollar in global financial markets, the Fed's interest rates are the benchmarks that central bankers around the world must follow if they want to ensure the attractiveness of their countries as investment locations and prevent massive capital outflows. Between March and July 2022, the Fed raised key interest rates in four steps from 0.25%–0.50% to 2.25%–2.50%.[4] This is an unprecedented pace.

The European Central Bank (ECB) held out for a few weeks, refusing to follow suit, in part because it was aware of the fragility of the European economy and the debt sustainability in some heavily indebted Eurozone member states. But as interest rate differentials between the US and Europe have risen, the Euro has steadily depreciated against the dollar, falling more than 12 percent between March and mid-July alone. This further fuelled inflation in Europe, as many imported products are priced in US dollars, especially energy and other commodities. On 27 July 2022, the ECB's Board also raised key interest rates by 0.5 percent, the first increase since 2011, and announced further rate hikes. Central banks almost everywhere in the Global North followed the lead of the Fed and the ECB. Only Japan has so far (as of August 2022) remained faithful to its low interest rate policy.[5]

2 https://www.bundesfinanzministerium.de/Content/DE/Downloads/Broschueren_Bestellservice/kreditaufnahmebericht-2021.html
3 https://developmentfinance.un.org/fsdr2022
4 https://www.federalreserve.gov/monetarypolicy/openmarket.htm
5 https://www.bis.org/statistics/cbpol.htm

Figure 2: Current yields on 10-year government bonds in selected countries (by percent)



Source: UN Financing for Sustainable Development Report 2022, p. 7

The effects were even more problematic for the Global South than for Europe. Many developing countries are extremely dependent on external financing from abroad. They attract investment by paying investors an interest rate premium over what is offered in the US. If US interest rates rise, this means developing countries have to offer even higher premiums. The consequences have been drastic, especially in Latin America, which is closely linked to the US economy. In Brazil, key interest rates rose by seven percentage points within a year, and in Chile, rates rose by as much as 8.5 percent. Central banks in Africa and Asia also raised interest rates, albeit to a lesser extent.[6]

As a result, the long period of low and zero interest rates that had lasted for more than a decade has come to an end worldwide.

Is the turnaround in interest rates inevitable?

Central banks primarily cite the current high inflation rates as a justification for interest rate hikes, which are to be brought under control by making money and credit "more expensive". In the economic mainstream, the general causality is that interest rate rises reduce inflation. Since most central banks are tasked with keeping inflation within a certain target (in the Eurozone, this is 2 percent), they use money supply management tools – the most prominent of which is the adjustment of policy interest rates – to steer inflation toward the inflation target.

However, many economists doubt that the current galloping inflation is caused by money supply. They point to the massive supply chain problems seen since the global economy restarted after the Covid-19 lockdowns, which have tightened the supply of goods. In addition, the war in Eastern Europe has made energy

6 Ibid.

and food prices in particular more expensive, as Russia and Ukraine are major producers. Speculation on commodity futures markets has also contributed to price increases. In many cases, price increases also seem to be caused by the fact that companies with pricing power want to make higher profits and therefore set higher prices. If inflation has such causes, combating it through central bank interest rate policies is not very effective.

The first countries have therefore introduced alternative policies to combat inflation. These include subsidized public transport tickets and a reduction in fuel taxes in Germany. During the crisis, numerous European countries such as Italy, Romania and Greece introduced so-called excess profits taxes, which are used to skim off excessive profits from companies in the energy sector in order to be able to use these revenues for price subsidies. Spain has also extended excess profit taxes to the financial sector to skim bank profits from rising interest income.[7]

It is also questionable whether a rigid inflation target should really be the main guiding principle for central banks. Some more critical development economists argue that the US central bank should already be cutting interest rates again if its mandate were primarily to promote growth and employment. After all, the US has been in a technical recession for two quarters, struggling with sharply declining economic growth, and the entire global economy is in danger of slipping into recession too.[8] The massive collateral damage of the interest rate turnaround could reignite the debate that the mandates of central banks and their instruments also need to be realigned in the interests of sustainable development.

What are the implications of the interest rate turnaround?

Rising interest costs

A key consequence of the interest rate turnaround is rising interest costs for everyone who has or will incur debt in the future. This is hitting the global economy at a time when debt stocks have reached historic highs, both in the North and the South, among both government debt and that of the private sector. These mountains of debt were not a problem as long as they cost nothing or little. Now that is changing.

In Germany, Finance Minister Christian Lindner warned in July 2022 that interest costs from the federal budget could rise from €4 billion to as much as €30 billion in just one year. Lindner garnished his warning at the same time with austerity policy suggestions as to where spending could be cut, citing ideas such as subsidies for electric cars.[9]

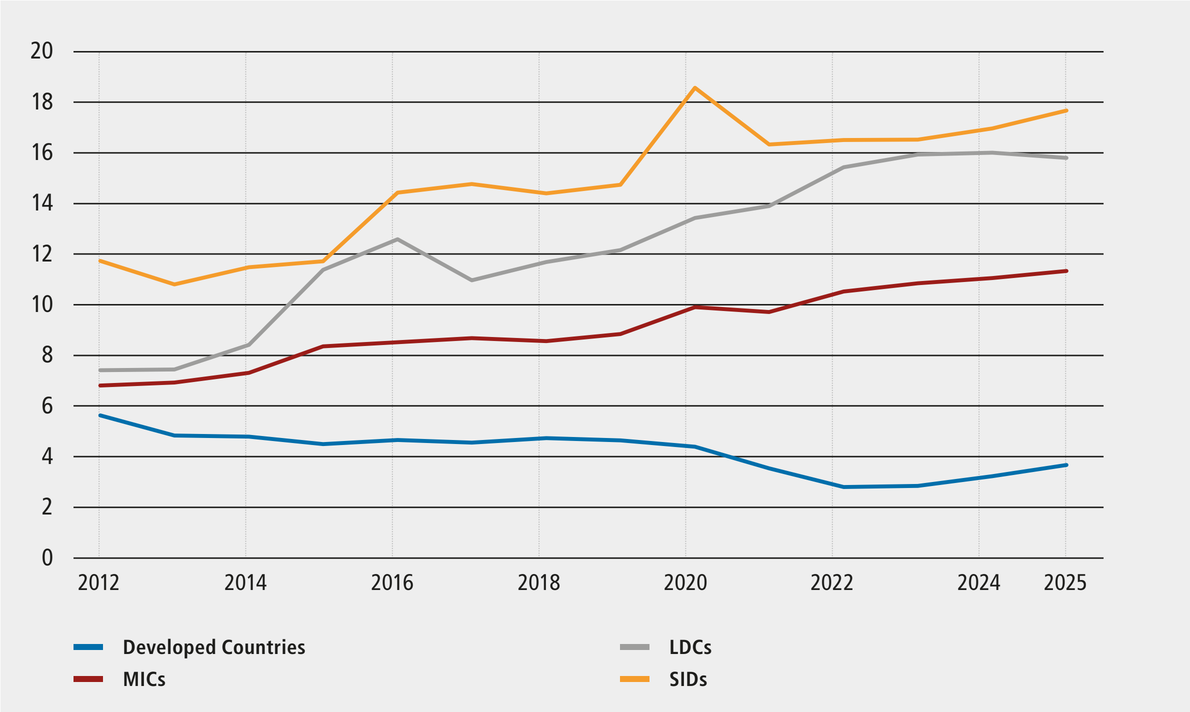
This anecdote goes to the heart of the problem: Every Euro that governments spend on debt servicing is a Euro that does not flow into socio-ecological transformation in the sense of the 2030 Agenda and other SDG-relevant government spending. Germany's development budget will also be cut by nearly 10 percent, or €1.27 billion, according to the federal government's draft for 2023.[10] If Lindner's estimate is correct, even this cut would only cover 5 percent of the additional interest costs.

The consequences for developing countries are even more dire. Even before the current interest rate shock, debt service was the largest expenditure item in the national budget for many developing countries. Least Developed Countries (LDCs) and Small Island Developing States (SIDS) in particular already have to spend many times more on this than rich countries (see Figure 3). In extreme cases (such as in Djibouti), they gobble up more than half of government revenues, according to the non-governmental organization network Eurodad.[11]

This means that the bulk of these countries' tax payments are not translated into public goods, social protection, or development projects, but are transferred to their wealthy creditors, and often flow to richer foreign countries. The interest rate increase exacerbates this situation: according to calculations by the British NGO Debt Justice UK, every percentage point by which interest rates are increased adds US$ 35 billion to the annual interest costs of

7 https://www.netzwerk-steuergerechtigkeit.de/neue-studie-zu-uebergewinnsteuer-fuer-energieunternehmen/
8 https://www.ipsnews.net/2022/08/april-fools-inflation-medicine-threatens-progress/
9 https://www.handelsblatt.com/politik/deutschland/finanzpolitik-finanzminister-lindner-staatliche-zinskosten-koennten-2023-30-milliarden-euro-erreichen/28435710.html
10 https://www.bundestag.de/presse/hib/kurzmeldungen-905818
11 https://www.eurodad.org/outofservice, p. 25.

Figure 3: Interest costs as a percentage of government revenues in various country groups



Source: UN Financing for Sustainable Development Report 2022, p. 123

countries in the Global South on their external public debt. Debt Justice UK also warned that there is a link between high debt service and cuts in education and health spending.[12] Rising interest costs also threaten the achievement of the 2030 Agenda's other development goals beyond education and health.

Capital outflows from the Global South

Although many central banks in the Global South responded to the guidance from the US with massive interest rate hikes of their own, it has not been possible to prevent constant capital outflows from developing and emerging countries since March 2022 – i.e., private capital being withdrawn and flowing back to safe havens in the Global North, primarily the US. That this is happening over such a long period is unusual. Even in the Covid-19 crash of early 2020, developing countries suffered net outflows for only one month before they turned positive again.

From March to July 2022, more than US$30 billion of private capital was cumulatively withdrawn from the Global South. This is a historic trend reversal. Periods of net capital outflows from developing countries are statistically rare. This is because, according to economic logic, developing countries with their growing populations and comparatively fast-growing economies should attract foreign capital.

In development economics, many approaches to development finance are based on the hypothesis that developing countries can achieve additional investment, additional growth, and faster development if they supplement their domestic savings with capital imports from abroad. The deregulation and liberalization of cross-border capital movements – which has made the Global South more vulnerable to financial crises and, precisely, interest rate developments abroad – has been justified by the International Monetary Fund (IMF) and World Bank primarily on the basis of the need to create favourable conditions for capital imports by foreign investors.

Almost all policy recommendations since the beginning of the 2030 Agenda have been based on the hope that private capital would fill the SDG financing gap, if only the institutional frameworks were improved. This is what Germany has tried to do, for example, since its G20 presidency in 2017 with the Compact with Africa.

12 https://debtjustice.org.uk/press-release/countries-in-debt-crisis-cut-public-spending-in-face-of-soaring-prices

Net capital flows in developing and emerging economies (in billion US$)

	Total	Of which: equity	Of which: debt
2021 monthly average	22.0	4.7	17.3
January 2022	1.1	−3.4	4.5
February	17.6	10.1	7.7
March	−9.8	−6.7	−3.1
April	−4.0	−9.5	5.5
May	−4.9	−3.4	−1.5
June	−4.0	−10.5	6.6
July	−9.8	−1.0	−8.8

Source: IIF Capital Flows Tracker; various editions, https://www.iif.com/Research/Capital-Flows-and-Debt/Capital-Flows-Tracker

Instead, private capital has been flowing out of the Global South since the interest rate turnaround began.

Liquidity bottlenecks and new debt crises

A closely related problem is the declining liquidity in global financial markets, coupled with decreasing risk appetite among investors. Over the past decade, there has been a boom in bond markets in the Global South. Even poorer countries such as Benin, Ghana, Mozambique, and Zambia have begun to finance themselves through international financial markets by issuing government bonds, mostly denominated in US dollars. The IMF called this group of newcomers "first-time issuers"; in investor jargon, they are considered "frontier markets".

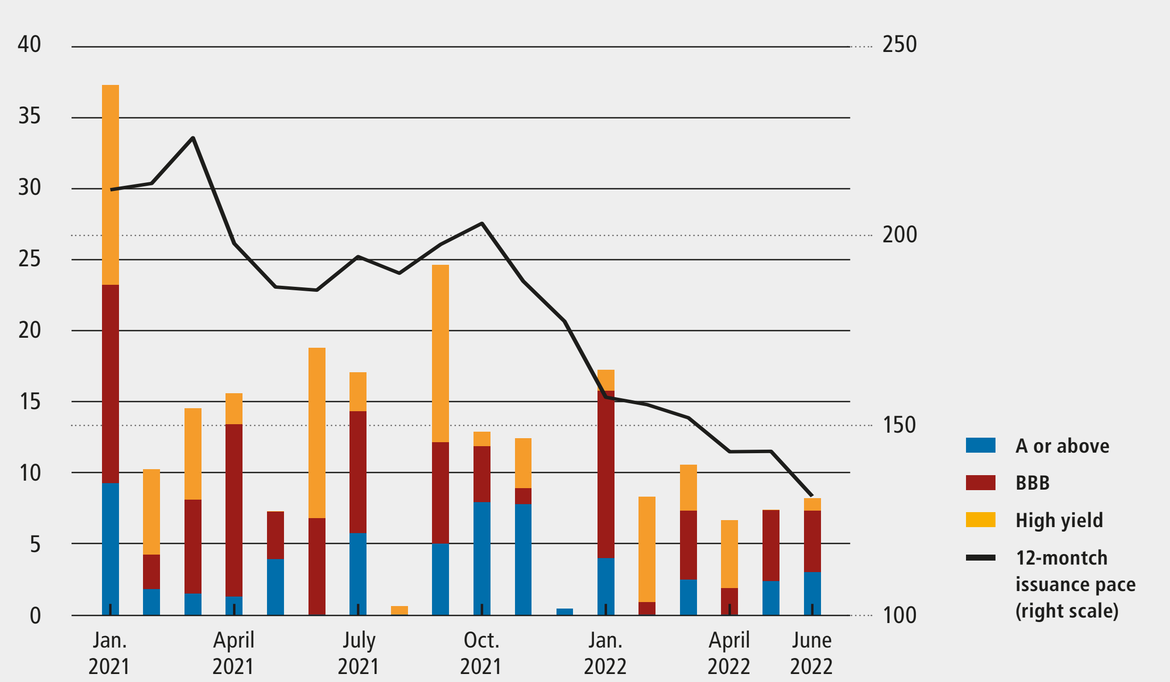
The financing method was always controversial. Because of the high interest premiums that the first-time issuers had to pay, the bonds in some cases incurred interest costs of 10 percent or more, payable in foreign currency. This made them an extremely lucrative business for investors, while issuing countries had to use scarce foreign currency to service their debt. Now that the interest rate turnaround has made investing in US or German government bonds attractive again, it is increasingly questionable whether the government bonds of the frontier markets will find buyers at all. The volume of new issues has already plummeted. In the first months of 2022, it was 40 percent below the level of 2021. In particular, countries with poor credit ratings – these are usually the less developed and poorer countries, which at the same time need capital most urgently – have been de facto excluded from access to international capital markets since the beginning of the interest rate turnaround (see Figure 4).

The problem here is that countries can often only repay the capital when old bonds reach maturity by raising new capital through new bond issues. This "rollover" of bonds only works as long as fresh money continues to flow in. If this is no longer the case, there is a threat of default and thus a debt crisis.

The fact that bonds issued by developing countries are no longer in demand can already be seen from current stock market quotations. In a study for the latest World Economic Outlook, the IMF warned that both the interest premiums of emerging market bonds over those from the Global North and the absolute current yields have risen rapidly. The latter indicates what interest rate the country in question would have to pay if it issued new bonds now. In the meantime, more than a third of the countries are paying interest rates of more than 10 percent on foreign currency loans, and the trend is rising rapidly. In practice, there are very few economic activities that yield such high returns to make it profitable for the issuer to finance it at that cost.

This eliminates foreign currency bonds as an instrument of development finance. At the time of the interest rate turnaround, they are only a problem for the debt sustainability of those countries that have relied on them in the past. The interest rate

Figure 4: New issues of government bonds in developing countries by rating group, January 2021 – June 2022 (in billion US$)



Source: IMF World Economic Outlook, July 2022 Update, p. 18

increase threatens to exacerbate the systemic debt crisis in the Global South.[13] Debt crises in which a large portion of the debt stock consists of bonds are extremely difficult to resolve. This is because there is no legal obligation for creditors to participate in restructurings. Some hedge funds, so-called vulture funds, even specialize in buying up the bonds of bankrupt states, and suing the debtor for full repayment. This is done at the expense of the country and all other creditors who are willing to make partial forgiveness.[14]

In particular, the case of Zambia has shown how difficult it is to get private bondholders to resolve debt crises constructively.[15] The interest rate turnaround increases the likelihood that Zambia will not remain an isolated case. The IMF has classified more than half of low-income countries as at high risk of default. As interest rates rise, more countries will fall into this category, even if their debt stock remains constant, because the interest rate is a key determinant of debt sustainability.

Rising investment costs

For SDG finance, the implications of the interest rate turnaround are critical. As recently as last year, policy recommendations in the UN's *Financing for Sustainable Development Report* were based primarily on exploiting low interest rates. The experts argued: "Given that interest rates are likely to stay low for a long time in many countries, the next decade provides a window for governments to borrow and invest in the transition toward climate-neutral economies".[16] And further: "A sustainable and resilient infrastructure push, along with investment in human capital, is entirely feasible in most developed countries, in part due to extraordinarily low interest rates that enable access to cheap finance".[17] In short, the experts believed that the 2030 Agenda could still be saved because money was cheap. The turnaround in interest rates has changed that.

It should be noted that the experts from the UN-coordinated Inter-agency Task Force on Financing for Development were already of the opinion that

13 https://www.reuters.com/markets/us/imfs-georgieva-warns-against-complacency-global-debt-problems-2022-07-11/
14 https://www.globalpolicy.org/en/publication/new-debt-crisis-and-what-do-about-it
15 https://erlassjahr.de/laenderinfos/sambia/
16 https://developmentfinance.un.org/fsdr2021, p. 10.
17 https://developmentfinance.un.org/fsdr2021, p. XIV.

developing countries cannot rely on capital markets and debt financing to the same extent, because of the higher interest rates there. This shows the impact of interest rates on financing options for development. The recommendation for the Global South was therefore that multilateral development banks (MDBs) should play a supporting role. They could raise capital at low interest rates, and on that basis, provide low-interest loans to developing countries. Even this becomes problematic, because while the relative interest rate advantage of MDBs over countries in the Global South is preserved, their financing terms are also affected by the rise in absolute interest rates during the interest rate turnaround.

What are the benefits of different development finance instruments in the new high interest rate environment?

In general, the interest rate turnaround is changing the relative attractiveness of interest-bearing instruments versus those that are interest-free or at least, those that are lent at fixed rates. In the zero and low interest rate environment of recent years, it was attractive and economically rational to finance many measures by borrowing. However, the number and proportion of measures for which debt financing is economically rational reduces with every interest rate rise.

With the turnaround in interest rates, financing methods from so-called cash flow are becoming more attractive again. These are, in particular, domestic financing from current tax revenues, but also external financing through grants from ODA. The problem here, however, is that reforms in the areas of "tax policy" and "official development assistance" have been criminally neglected since the beginning of the 2030 Agenda.

Most of the discussion has been about how to turn the masses of cheap money circulating in global financial markets into sustainable finance. Policy recommendations aimed to package (formerly) public goods into "bankable projects" to offer to investment funds in global financial markets. Taxonomies were developed to show investors which investment products invest sustainably, including substantial greenwashing.[18] Entire new asset classes emerged, such as green bonds, blue bonds, SDG bonds, and even gender bonds and child bonds.[19] In recent years, innovative development finance has primarily meant developing blended finance that can leverage private investment and steer it toward the SDGs. Now, the turnaround in interest rates is drying up the flows of cheap money. The UN Global Crisis Response Group on Food, Energy and Finance points out in its August 2022 briefing that, while developing and emerging economies can still show modest growth in sustainable finance, the global volume of new sustainable bond issuance in the first quarter of 2022 has already plummeted 28 percent year-on-year.[20]

In contrast, too little has happened in international tax policy. In low-income countries in particular, the tax ratio as a share of Gross Domestic Product (GDP) is too low to finance development and public goods. Tentative steps have been taken, to increase tax transparency and information exchange. Profit shifting by transnational corporations to tax havens was also on the agenda.[21] In practical terms, however, these steps that had been taken mainly within the Organisation for Economic Co-operation and Development (OECD) framework have been too timid and not sufficiently tailored to the needs of the Global South to stop tax evasion, tax avoidance, and harmful tax competition between countries.

There is also a lot wrong with external financing. The ODA ratio of donor countries has remained fairly constant at just over 0.3 percent of their GDP for 15 years.[22] This means they are contributing less than half of the internationally set 0.7 percent target. Of the US$ 178.9 billion in ODA that donors collectively provide, only a portion reaches the Global South. The draft for Germany's 2023 federal budget, which cuts a good 10 percent in the

18 In Europe, the EU's decision to classify investments in gas and nuclear energy as sustainable has discredited the taxonomy.

19 https://www.unicef.cn/en/stories/innovative-finance-children-and-young-people

20 https://news.un.org/pages/wp-content/uploads/2022/08/GCRG_3rd-Brief_Aug3_2022_FINAL.pdf, p. 28. The fact that many fossil fuel providers have seen huge profit increases during the crisis, can show higher stock market valuations and pay out high dividends to their investors creates problematic incentives. For years, sustainable investments were also considered economically rational because they were sustainable. Investments in fossil fuels were considered stranded assets, and investments in them had a high risk of depreciation or even total loss. State intervention through excess profit taxes would also have the effect of reducing the relative attractiveness of investments in fossil fuels again and directing capital – which has become scarcer with the increase in interest rates – back into more sustainable sectors.

21 https://developmentfinance.un.org/fsdr2022, p. 28–54.

22 https://www.oecd.org/dac/financing-sustainable-development/development-finance-standards/official-development-assistance.htm

development budget, has disproportionately cut those items where money flows out of Germany.[23] The effective use of scarce funds is also being undermined by the fact that development cooperation is increasingly being put at the service of geopolitics. A clear example is the EU's new Global Gateway Infrastructure Initiative, which aims to secure Europe's influence in the Global South by offering partner countries an alternative to China's Belt and Road Initiative.

Innovative public financing instrument initiatives have largely been shelved in the decade of low interest rates. Apart from the increasing use of carbon taxes, which as consumption taxes tend to be regressive and therefore ill-suited to poverty reduction and inequality reduction, too little progress has been made in recent years. The priority now would be to advance effective measures against tax evasion and harmful tax competition and to pursue globally coordinated approaches to promote progressive tax systems through the use of financial transaction taxes, wealth taxes, digital taxes, minimum rates for corporate taxes, or even excess profits taxes.

In addition to the use of interest-free instruments, the use of low-interest instruments is also gaining importance. Bilateral and multilateral development banks, as well as the IMF, have numerous facilities that provide loans at low and often fixed interest rates. These have become more important since market interest rates have risen. Here, too, there is much room for improvement. A recent G20 study found that, given their capital bases, MDBs could disburse significantly more credit so that member states would be less likely to have to resort to expensive market borrowing.[24] In its new briefing, the UN Crisis Response Group also criticizes MDBs for disbursing too little and too slowly. In addition, too small a share has gone into the expansion of renewable energies, which is why developing countries are now suffering from the price increases of raw fossil materials.[25]

A reallocation of IMF Special Drawing Rights (SDRs) is now being discussed again as an effective means of creating liquidity in the short term and thus alleviating the crisis. Since SDRs can be used like foreign exchange, developing countries would be empowered to import food and energy commodities and would not lose out again in the increasing distribution struggles, as happened with Coronavirus vaccines. However, the SDR interest rate has also been affected by the interest rate turnaround. For example, since the August 2021 large SDR allocation, the SDR interest rate has risen from 0.05 percent to 1.63 percent.[26] However, this is less than the US$ key interest rate, which has risen by 2.5 percent over the same period. The fact that the SDR interest rate is based on the key interest rates of a basket of currencies and that the central banks of China and Japan in particular – and to a lesser extent the ECB – are not (yet) following the rapid interest rate increases in the US is having a positive impact here.

What needs to be done? Policy recommendations

1. Reduce debt burden

Governments and the IMF should recalculate debt sustainability under the new framework conditions. Experience has shown that governments are reluctant to recognize insolvency. In doing so, however, they service too much debt for too long, deprive their country and its population of scarce resources, and are ultimately unable to prevent the inevitable default.

2. Introduce sovereign debt workout regimes

Resolving debt crises quickly, fairly and sustainably requires better institutions. Sovereign debt is the only form of debt that is not regulated by any insolvency law or insolvency court. The introduction of a sovereign debt workout regime has been discussed for decades. The German government has also spoken out in favour of it in its coalition agreement. Because of the high proportion of bonds in the new debt crises, this would be more important than ever.

23 https://www.bundestag.de/presse/hib/kurzmeldungen-905818
24 https://g20.org/indonesia-g20-presidency-publishes-the-g20-independent-review-of-multilateral-development-banks-capital-adequacy-frameworks/
25 https://bit.ly/GCRG-BRIEF-03, p.22-25.
26 https://www.imf.org/external/np/fin/data/sdr_ir.aspx; as of 4 September 2022.

3. Regulate capital movements

Sovereign states must have the right and the instruments to regulate the movement of capital in and out of their country in order to achieve greater resilience to shocks and financial crises. Adequately designed capital controls are an effective means to this end and should be able to be used flexibly. In some cases, a reform of bilateral investment treaties is necessary for this purpose.

4. Redistribution through excess profits taxes

Excess profit taxes can achieve key policy goals in one instrument. They generate important government revenues. They can reduce inflation if the revenues from skimmed profits are used to subsidize the prices of particularly affected products and are thus a policy alternative to key interest rate hikes. They contribute to social justice and cohesion if they create a balance between profiteers and those affected in crisis situations. It is for that reason that many countries have already introduced them. More countries should follow.

5. Protect vulnerable people against price shocks

While governments in rich countries have begun to put together relief packages to protect their populations, there is again a lack of fiscal space to do so in the Global South. Better financing of social protection systems is important. Instruments of external financing, such as a Global Social Security Fund, can fill financing gaps and should be financed by additional ODA funds.

6. Bring development finance up to speed

In the future, development finance can no longer rely on cheap money and high liquidity in global financial markets. As a substitute for financial market-driven and debt-financed development, other financing methods must be expanded, especially domestic resource mobilization and external financing through ODA grants. Export revenues also have a role to play here. New issuance of SDRs by the IMF could help to bridge liquidity shocks for the Global South.

The interest rate turnaround poses enormous challenges for sustainable finance. The international community must respond to this new situation with a policy shift at the highest level of ambition in order to implement the 2030 Agenda with all its economic, social and environmental goals in the new environment. This turning point in development financing is essential.

Imprint

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