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How Can the G20 Support Innovative Mechanisms to Mobilise Financial Resources for LDCs in a Post-Pandemic World?

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ABSTRACT

The covid-19 pandemic has generated severe health, economic and debt crises for the least developed countries (LDCs). On the one hand, they cannot mobilise sufficient financial resources on their own to cope with the effects of the pandemic because their public revenues are too low and external finance is not always available. On the other hand, many LDCs have been highly indebted, even prior to the crisis. Of the 45 LDCs covered by the Debt Sustainability Framework of the World Bank and International Monetary Fund, five were in debt distress and thirteen more were classified at high risk of debt distress. In this context, the G20 members hold a strong responsibility to support and identify innovative mechanisms to mobilise financial resources for the LDCs. The G20 could play a key role in bringing forward a more effective architecture for development finance: blended finance, special drawing rights reallocation and sustainable bonds.

G20 | Finance | Sustainable development

keywords

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How Can the G20 Support Innovative Mechanisms to Mobilise Financial Resources for LDCs in a Post-Pandemic World?

by Kathrin Berensmann*

1. Financial needs in LDCs in the wake of the covid-19 crisis

In least developed countries (LDCs), the covid-19 pandemic has generated severe health, economic and debt crises. On the one hand, LDCs cannot mobilise sufficient financial resources on their own to cope with the effects of the pandemic because their public revenues are too low and increased external finance is not always available. Innovative financing mechanisms can mobilise further financial resources for LDCs, in addition to domestic resources and traditional external financial resources.

Scaling up domestic resources in LDCs and in general in low income countries (LICs) is one main game changer in accelerating financial resources for LDCs.[1] Tax

[1] For the sake of clarity not all LICs can be grouped as LDCs. For the current 2022 fiscal year, low-income economies are defined as those with a GNI per capita, calculated using the World Bank Atlas method, of 1,045 US dollar or less in 2020; lower middle-income economies are those with a GNI per capita between 1,046 US dollar and 4,095 US dollars; upper middle-income economies are those with a GNI per capita between 4,096 US dollars and 12,695 US dollars; high-income economies are those with a GNI per capita of 12,696 US dollars or more. Please cf. World Bank Data: *World Bank Country and Lending Groups*, https://datahelpdesk.worldbank.org/knowledgebase/articles/906519. LDCs instead are "low-income countries confronting severe structural impediments to sustainable development. They are highly vulnerable to economic and environmental shocks and have low levels of human assets. There are currently 46 countries on the list of LDCs which is reviewed every three years by the Committee for Development (CDP). LDCs have exclusive access to certain international support measures in particular in the areas of development assistance and trade." Please cf. UN Department of Economic and Social Affairs (UNDESA) website: *Least Developed Countries (LDCs)*, https://www.

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revenues remained relatively low in 2018, at about 14.2 per cent of GDP, compared to about 34 per cent of GDP in Organisation for Economic Cooperation and Development (OECD) countries.[2] For enhancing domestic revenues, both national and international measures have to be taken. G20 countries should support developing countries in improving their tax policies and administration, revenue collection and statistics by enhancing capacity-building and supporting efforts to reduce illicit financial flows.[3]

In view of increasing current account deficits in LDCs, external financing is very important. The current account deficit of LDCs as a group significantly increased from 3.9 per cent of GDP in 2019 to 5.6 per cent in 2020, during the course of the pandemic. These higher current account deficits have to be financed with increased capital inflows.[4] However, mobilising more traditional external financial resources has become difficult for LDCs in the course of the covid-19 pandemic.

Official Development Assistance (ODA), which has been the largest capital inflow to LDCs (in 2018, bilateral and multilateral public financial resources made up 3.9 per cent and 2.0 per cent of GDP, respectively),[5] is not expected to be significantly increased.[6] Among private sources of external financing, remittances form a crucial part of financial flows to LDCs, accounting for 4.7 per cent of GDP in 2018, albeit their prominence is rather peculiar to some large recipients and to small (often insular) LDCs. According to estimates of the World Bank, remittances to LICs and middle-income countries (MICs) could decline in 2020 by about 20 per cent.[7] Similarly, foreign direct investment (FDI) and portfolio investments to LDCs accounted for 1.8 per cent of GDP and 0.8 per cent of GDP, respectively in 2018.[8] While these different flows represent viable sources of external finance, their distinct nature has a bearing on their intrinsic characteristics, motivations and development footprint.[9]

un.org/development/desa/dpad/least-developed-country-category.html.

[2] Organisation for Economic Co-operation and Development (OECD) and United Nations Capital Development Fund (UNCDF), *Blended Finance in the Least Developed Countries 2020. Supporting a Resilient COVID-19 Recovery*, Paris, OECD Publishing, 2020, https://www.uncdf.org/article/6379; and OECD, *Revenue Statistics 2020*, Paris, OECD Publishing, 2020, https://doi.org/10.1787/8625f8e5-en.

[3] Kathrin Berensmann et al., "COVID-19: How Can the G20 Address Debt Distress in SSA?", in *T20 Italy Policy Briefs*, September 2021, https://www.t20italy.org/?p=8226; Christian von Haldenwang and Sabine Laudage, "Financing for Development and Domestic Revenue Mobilisation: More International Reforms Are Needed", in *DIE Briefing Papers*, No. 13/2019, https://doi.org/10.23661/bp13.2019; OECD and UNCDF, *Blended Finance in the Least Developed Countries 2020*, cit.

[4] UNCTAD, *The Least Developed Countries Report 2020*, Geneva, United Nations, 2020, https://unctad.org/webflyer/least-developed-countries-report-2020.

[5] OECD and UNCDF, *Blended Finance in the Least Developed Countries 2020*, cit.

[6] UNCTAD, *The Least Developed Countries Report 2020*, cit.

[7] World Bank, "COVID-19 Crisis Through a Migration Lens", in *Migration and Development Briefs*, No. 32 (2020), http://hdl.handle.net/10986/33634.

[8] OECD and UNCDF, *Blended Finance in the Least Developed Countries 2020*, cit.

[9] UNCTAD, *The Least Developed Countries Report 2019*, Geneva, United Nations, 2019, https://unctad.org/webflyer/least-developed-countries-report-2019.

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Many LDCs have been highly indebted, even prior to the crisis. Of the 45 LDCs covered by the Debt Sustainability Framework of the World Bank and International Monetary Fund (IMF), five were in debt distress and thirteen more were classified at high risk of debt distress.[10] Along with those with debt vulnerabilities, other LDCs had to carry high debt service burdens, and simultaneously had to increase their social expenditures to cushion the social effect of the pandemic.[11]

Against this background, the G20 has implemented two important initiatives to improve the debt situation in 73 eligible low- and lower middle-income countries (including the majority of LDCs) in the wake of the covid-19 crisis. First, the G20 Debt Service Suspension Initiative (DSSI) has been established to address short-term liquidity constraints. However, this does not cancel debt, but only shifts its payment into the future. In addition, the G20 put in place the Common Framework for Debt Treatments beyond the DSSI to restructure and, if necessary, cancel debt.[12] Since even concessional financing would further worsen the debt situation in these countries, timely implementation of the Common Framework is necessary. Debt restructuring and debt relief should be linked to the implementation of the United Nations Sustainable Development Goals (SDGs). To effectively implement these two instruments, all loan agreements should be disclosed and that private creditors should participate in the two initiatives on an equal basis. These are two important preconditions to prevent collective action problems among creditors.[13] Moreover, LDCs have to cope with pre-existing challenges, including the climate risks.

2. The role of the G20 in promoting innovative finance in LDCs

A major global policy coordination forum, the G20 has a key function in carrying out the 2030 Agenda in terms of achieving the 17 Sustainable Development Goals (SDGs) and meeting the requirements of the Addis Ababa Action Agenda (AAAA).[14]

With regard to development finance, the role of the G20 is to promote international policy co-operation and co-ordination; design and implement an appropriate

[10] Ibid.

[11] UNCTAD, *The Least Developed Countries Report 2020*, cit.; International Monetary Fund (IMF), "Macroeconomic Developments and Prospects in Low-Income Countries–2021", in *IMF Policy Papers*, No. 2021/020 (March 2021), https://www.imf.org/en/Publications/Policy-Papers/Issues/2021/03/30/Macroeconomic-Developments-and-Prospects-In-Low-Income-Countries-2021-50312; UNCTAD, *External Debt Sustainability and Development* (A/75/281), 30 July 2020, https://undocs.org/A/75/281.

[12] G20 and Paris Club, *Common Framework for Debt Treatments beyond the DSSI*, Annex to the *Statement of the Extraordinary G20 Finance Ministers and Central Bank Governors' Meeting*, 13 November 2020, https://www.imf.org/-/media/Files/News/news-articles/english-extraordinary-g20-fmcbg-statement-november-13.ashx.

[13] Kathrin Berensmann et al., "COVID-19: How Can the G20 Address Debt Distress in SSA?", cit.; UNCTAD, *The Least Developed Countries Report 2020*, cit.

[14] Kathrin Berensmann, "G20 support for SDGs", in *D+C e-Papers*, December 2016, p. 21-23, https://www.dandc.eu/en/node/2860.

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development finance architecture that mobilises sufficient financial resources for attaining the 2030 Agenda; and ensure financial stability. An agenda-setting role for an appropriate development finance architecture is associated with this task. For incentivising non-G20 countries to support developing countries, the G20 assumes a frontrunner role, i.e. leading by example. A corollary of this is the need to acknowledge (and possibly contribute to a shared solution of) the deep-seated asymmetries between developed and developing countries – notably LDCs – in terms of access to international liquidity and long-term development finance.

To promote and implement an adequate global governance policy framework, G20 members should use their economic and financial weight to financially and technically support developing countries. The recent communiqué of the G20 Finance Ministers and Central Bank Governors meeting underscored the need to increase their financial support to developing countries.[15] The G20 countries provide a substantial amount of official and private financial resources to developing countries, including ODA, private investments and remittances.

Moreover, the G20 takes on a crucial role in supporting developing countries with carrying out measures and reforms of the development finance architecture, as well as in providing capacity support to developing countries, and promoting knowledge sharing with non-G20 members. Development finance has been one priority area under the Saudi and Italian presidencies.[16] Innovative financing for development could contribute to generating new funds for sustainable development and leveraging existing scarce public concessional resources (ODA).[17] Innovative financing mechanisms represent crucial resources beyond ODA.

Currently, there is no internationally agreed definition of innovative financing for development. According to the Leading Group on Innovative Financing for Development, it includes those sources and mechanisms that are not covered by traditional aid flows such as ODA. Two sub-categories of innovative financing have been distinguished: (i) innovative financing sources generating new funds for sustainable development, and (ii) innovative financing mechanisms contributing to enhance the efficiency, impact and leverage of existing resources (public, private or under the form of a public-private partnerships).[18]

[15] G20, *Second G20 Finance Ministers and Central Bank Governors Meeting. Annex II: Update of the G20 Action Plan*, April 2021, https://www.g20.utoronto.ca/2021/Annex-II-Update-of-the-G20-Action-Plan-April-2021.pdf; G20, *Third G20 Finance Ministers and Central Bank Governors Meeting. G20 Communiqué*, Venice, 9-10 July 2021, https://www.g20.utoronto.ca/2021/210710-finance.html.

[16] G20, *G20 Finance Ministers and Central Bank Governors. G20 Communiqué*, 15 April 2020, http://www.g20.utoronto.ca/2020/2020-g20-finance-0415.html; G20, *Second G20 Finance Ministers and Central Bank Governors Meeting. Annex II: Update of the G20 Action Plan*, cit.; G20, *Third G20 Finance Ministers and Central Bank Governors Meeting. G20 Communiqué*, cit.

[17] United Nations Inter-agency Task Force on Financing for Development (IATF), *Financing for Sustainable Development Report 2021*, New York, United Nations, 2021, https://developmentfinance.un.org/fsdr2021.

[18] Global Development Incubator, Innovative Financing for Development: *Scalable Business Models That Produce Economic, Social, and Environmental Outcomes*, September 2014, https://www.

The role of the G20 has a role in promoting innovative financing instruments, namely blended finance, sustainable bonds and the redistributive allocation of Special Drawing Rights (SDRs), which are specifically important for LDCs. Blended finance can leverage private funds with concessional financing. The redistributive allocation of SDRs could unlock a comparatively large amount of financial resources from the IMF in the short-run. Sustainable bonds can mobilise money directly geared to support SDGs and to finance specific purposes; all of which could have a significant impact in countries whose financial sector is small-sized and relatively underdeveloped. For these reasons, these three innovative instruments are currently under discussion at the G20 to mobilise financing for achieving the SDGs. Further innovative financing instruments include taxes (carbon or financial transaction taxes) special purpose climate funds, an air-ticket levy, emission trading systems, national lotteries or crowdfunding, etc.

2.1 Blended finance

Given LDCs' daunting sustainable investment needs, mobilising private financial flows is an inevitably key step to scale up sustainable development financing. LDCs face a number of challenges in this respect, ranging from perceived higher risk to weak institutional frameworks, which so far have dampened their capacity to adequately scale up private investments for sustainable development.[19] Blended finance is one option to use ODA in combination with private finance, and thereby leveraging scarce concessional public funds. One applicable definition of blended finance is provided by the OECD: "Blended finance is the strategic use of development finance for the mobilisation of additional finance towards the SDGs in developing countries."[20] "Blended finance is an innovative approach to financing sustainable development that aims to attract commercial capital towards projects that benefit society while also providing financial returns to investors."[21]

In principle, the benefits of blended finance are: first, scale up concessional with private financing resources, thus supporting the mobilisation of additional funding; second, reduce risks for private investors to attract private finance for investments in SDGs; third, take on a frontrunner role for further private financing; and fourth, contribute to enhance developmental impacts by linking financing to the SDGs.

globaldevincubator.org/wp-content/uploads/2016/02/Innovative-Financing-for-Development.pdf. For other definitions of innovative financing, see Elisabeth Sandor, "Mapping Innovative Finance for Development Mechanisms", in *OECD Journal: General Papers*, No.1/2010, p. 77-97, http://dx.doi.org/10.1787/gen_papers-2010-5kgc6cl2x95d.

[19] UNCTAD, *The Least Developed Countries Report 2019*, cit.

[20] OECD, *OECD DAC Blended Finance Principles for Unlocking Commercial Finance for the Sustainable Development Goals*, Paris, OECD Publishing, 2018, p. 3, https://www.oecd.org/dac/financing-sustainable-development/development-finance-topics/OECD-Blended-Finance-Principles.pdf.

[21] OECD, *The OECD DAC Blended Finance Guidance*, Paris, OECD Publishing, 2021, p. 2, https://doi.org/10.1787/ded656b4-en.

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Whether or not these benefits materialize (and whether this is the most effective use of public finance) will depend on numerous context-specific factors, ranging from the development rationale pursued (and the alternative opportunity costs for using other development finance instruments) to the achieved additionality and effectiveness of the partnerships built.

Due to a number of socio-economic and political constraints, private investors often classify investments in developing countries as riskier than investments in industrialised and emerging ones. First, macroeconomic fundamentals in LDCs are often perceived as riskier than in emerging markets or industrialised countries, due to high inflation rates, erratic growth rates, volatile exchange rates and capital flows. Second, weak institutions and regulatory risks represent barriers for private investments in LDCs. Third, political instability is often an additional risk factor in LDCs. In addition, there have been several risks at the project level, comprised of operational and contract risks, costly project preparation, relatively high transaction costs due to low volumes, untested business models, as well as a lack of relevant data.[22] Moreover, blended finance may exacerbate the debt situation of LDCs, in so far as blended finance deals create contingent liabilities or increase the overall debt level of these countries.

These difficulties mainly explain the relatively low volume of blended finance used in LDC. Between 2012–2018, only 6 per cent of the total private finance mobilised by ODA went to LDCs.[23] Multilateral development banks (MDBs), such as the World Bank Group and the African Development Bank, mobilised on average in 2017–2018 the largest volume of private finance.[24] According to the OECD/UNCDF reports, development finance institutions and MDBs assume an important role in promoting blended finance, a as well as in developing and/or expanding innovative financial mechanisms to support blended finance.

In order to provide similar understanding and agreement among actors on a good practice and an effective way of using blended finance to support sustainable development in 2017, the OECD developed, in cooperation with the private sector, civil society and governments, the OECD DAC Blended Finance Principles.[25] In addition, in 2020, the OECD established the OECD DAC Blended Finance Guidance to facilitate implementation of these principles.[26] These principles (Box 1) represent a good instrument to outline and carry out effective and transparent blended finance programmes that mobilise financial resources with additional commercial capital. These Principles address actors offering development finance, including

[22] UNCTAD, *The Least Developed Countries Report 2019*, cit., United Nations IATF, *Financing for Sustainable Development Report 2021*, cit.; UNCDF, *Blended Finance in the Least Developed Countries 2018*, New York, UNCDF, 2018, https://www.uncdf.org/en/article/4220.

[23] OECD and UNCDF, *Blended Finance in the Least Developed Countries 2020*, cit.

[24] Ibid.

[25] Ibid.

[26] OECD, *The OECD DAC Blended Finance Guidance*, cit.

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bilateral and multilateral donors, private philanthropies and other providers of development finance stakeholders.

Box 1 | OECD DAC blended finance principles

The OECD DAC Blended Finance Principles comprise five principles:
Principle 1: Anchor blended finance use to a development rationale;
Principle 2: Design blended finance to increase the mobilisation of commercial finance;
Principle 3: Tailor blended finance to local context;
Principle 4: Focus on effective partnering for blended finance;
Principle 5: Monitor blended finance for transparency and results.

Source: OECD, *OECD DAC Blended Finance Principles*..., cit., p. 5.

One main challenge of blended finance initiatives is that the approaches and instruments deployed differ significantly, including concessional loans or guarantees with different risks levels. In the same vein, some governments have conducted blended finance initiatives for a long time and others are relatively unexperienced in using blended finance approaches.

These principles have become one element of the international development architecture, and have been accepted and implemented by countries, donors, organisations and other actors deploying blended finance instruments. Similarly, the G20 and G7 have committed to implement or at least recognise the importance of these Principles under the past two G20 and G7 presidencies. In addition to implementing these Principles, many LDCs lack sufficient institutional capacity to carry out blended finance. For this reason, the G20 should support LDCs in developing institutional capacity in order to effectively implement blended finance approaches and minimize associated risks.

Since development banks and development finance institutions assume a crucial role in providing blended finance,[27] two selected blending facilities established or proposed by international fiscal institutions (IFIs) are briefly outlined: (i) IDA blending facility in Box 2,[28] and (ii) the Liquidity and Sustainability Facility (LSF) proposed by UNECA and the Pacific Investment Management Company (PIMCO) in Box 3.[29] Further innovative blending instruments supported by IFIs include the UNCDF proposal for development of pipeline, investable Small and medium-

[27] Ibid.

[28] See Clemence Landers, "IDA-20: Donors Must Go Big, and IDA Must Too", in *CGD Notes*, April 2021, https://www.cgdev.org/node/3129593.

[29] United Nations Economic Commission for Africa (UNECA), *Building Forward Together. Financing a Sustainable Recovery for the Future of All*, Addis Ababa, UNECA, 2020, https://hdl.handle.net/10855/43829.

sized enterprises or a blended social bond to support microfinance institutions. In addition to these instruments, there is a wide array of blended finance tools adopted by Development Finance Institutions.[30]

Box 2 | IDA blending facility

To supplement its other sources of finance, including donor grants and internal reflows from loans, the IDA introduced in 2017 "a hybrid financing model by issuing debt in commercial bond markets against its equity (i.e., outstanding loans)". Accordingly, IDA could mobilise additional concessional loans through blending instruments. IDA could further enhance their market bonds. In spring 2021, IDA's debt outstanding in the capital market (16 billion US dollars) accounted for only less than 10 per cent of its equity base – 175 billion US dollars in concessional loans. This ratio is quite low compared to the International Bank for Reconstruction and Development (IBRD), whose market debt outstanding amounts to 250 billion US dollars or six times of its equity base. The main reasons have been that the IBRD has access to callable capital from its shareholders and that this institution has at its disposal a higher credit quality loan portfolio than IDA.

Source: Clemence Landers, "IDA-20: Donors Must Go Big, and IDA Must Too", cit., p. 2.

Box 3 | The Liquidity and Sustainability Facility

In order to improve access to global financial markets for developing countries, the United Nations Economic Commission for Africa (UNECA) – in cooperation with the asset management firm PIMCO – has proposed to establish the so-called Liquidity and Sustainability Facility (LSF). This facility would subsidise private sector investments in government bonds from countries that have had some access to international financial markets, and that had a solid macroeconomic performance prior to the covid-19 crisis. As such, this facility would be a blending facility that combines public and private money to leverage private investments in developing countries. The MDBs and/or the central banks of OECD members, as well as ODA, should finance the LSF.

[30] Anja-Nadine König, Chris Clubb and Andrew Apampa, *Innovative Development Finance Toolbox*, Frankfurt am Main, KfW Development Bank, October 2020, https://www.kfw-entwicklungsbank.de/PDF/Download-Center/PDF-Dokumente-Brosch%C3%BCren/2020_Innovative_Development_Finance_Toolbox.pdf; Daniela Gabor, *The Liquidity and Sustainability Facility for African Sovereign Bonds: Who Benefits?*, Brussels, Eurodad / Berlin, Heinrich Böll Foundation / Nairobi, NAWI, 2020, https://www.boell.de/en/node/69139; United Nations, *Financing for Development in the Era of COVID-19 and Beyond. Menu of Options for the Consideration of Heads of State and Government, Part II*, New York, United Nations, September 2020, https://www.un.org/sites/un2.un.org/files/financing_for_development_covid19_part_ii_hosg.pdf.

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Box 3 (continued)

Under this facility, private investors could pledge assets as collateral against the facility in order to receive financing that can be used to purchase bonds from eligible countries. Investors would sell their bonds to the LSF and promise to repurchase (repo) it in the future. On the one side, investors would be the economic owners of the bonds taking on price risks and incurring returns. On the other side, the LSF would be the legal owner of the bonds and could sell bonds in case investors default and do not repurchase them. Insofar, the LSF would take on the collateral liquidity risk. In addition, the risks of further indebtedness and unsustainable debt increases in debtor countries. The main advantage for developing countries is that interest rates will be lower, enabling them to issue bonds on more favourable conditions, and thereby enhancing their opportunities to issue a larger volume of sovereign bonds. The use of the proceeds could be linked to the SDGs. In this framework, new SDG bonds could also be issued, for example, based on the Social or Sustainability Bonds Principles established by the International Capital Markets Association. In addition, more favourable lending conditions could be included to provide more incentives for such bonds.

Source: UNECA, *Building Forward Together*, cit.; Daniela Gabor, *The Liquidity and Sustainability Facility for African Sovereign Bonds: Who Benefits?*, cit.; United Nations, *Financing for Development in the Era of COVID-19 and Beyond*, cit.

2.2 Redistributive new allocation of Special Drawing Rights

A further option to increase external financial resources to LDCs is to use a part of the new SDR allocation, approved by the IMF in August 2021, to LDCs beyond their quota. In their communiqués, the G20 already called for a general allocation of SDRs amounting to 650 billion US dollars; this measure became effective on 23 August 2021.[31] SDR allocation being proportional to the countries' existing quotas in the Fund implied that LDCs received only SDR 9.8 billion, or 2.1 per cent of the total allocation.[32] In light of this foreseeable constraint, the G20 proposed that the IMF investigates options to voluntarily allocate a part of these "new" SDRs to vulnerable countries. A further option would be to redistribute existing unused SDRs.[33]

[31] IMF, "Guidance Note for Fund Staff on the Treatment and Use of SDR Allocations", in *IMF Policy Papers*, No. 2021/59 (August 2021), https://www.imf.org/en/Publications/Policy-Papers/Issues/2021/08/19/Guidance-Note-for-Fund-Staff-on-the-Treatment-and-Use-of-SDR-Allocations-464319; IMF, "Allocation of Special Drawing Rights for the Eleventh Basic Period", in *IMF Policy Papers*, No. 2021/50 (July 2021), https://www.imf.org/en/Publications/Policy-Papers/Issues/2021/07/12/Allocation-of-Special-Drawing-Rights-For-The-Eleventh-Basic-Period-461912.

[32] Computation based on IMF website: *2021 General SDR Allocation*, https://www.imf.org/en/Topics/special-drawing-right/2021-SDR-Allocation.

[33] United Nations, *Financing for Development in the Era of COVID-19 and Beyond*, cit.

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The G20 assumes a crucial role in designing a proposal for allocating the newly issued SDRs and for assigning SDRs to LICs exceeding their quota. This suggestion should include a proposal on the volume of these additional SDRs apportioned to LICs and how to allocate these among developing countries.

Even though LICs only account for 3.2 per cent of newly allocated SDRs, the volume – 21 billion US dollars – is comparatively large, considering that it is about twice as high as the IMF lending to LICs in 2020.[34] Accordingly, even a small reallocation to LICs would be relatively effective.

There are some proposals available to ensure an effective re-allocation of SDRs. One proposal is to provide the additional SDRs through the IMF's Poverty Reduction and Growth Trust (PRGT) by donating or lending the SDRs. The funds would be allocated according to the rules of the PRGT managed by the IMF or by allocating the funds through the Catastrophe Containment and Relief Trust (CCRT).[35] Another option could be to set up a new fund such as the above mentioned LSF with the aim to "either leverage or on-lend a pool of SDRs". Although a new fund has been advocated by some studies, as a way to ensure a stronger ownership by African and LDCs,[36] the first option seems to be the easiest path to follow,[37] as the IMF's Executive Board has already allowed the donation or lending of SDRs among IMF members. In the past, some countries already lent a part of their SDRs to the PRGT[38] that used separate subsidised resources to lend it to LICs.[39]

A further option is that members donate SDRs to other members. The volume of donations should be decided by each member country. In both cases, the question of how to distribute these SDRs among developing countries arises. One way is to distribute the SDRs in relation to their quota, based on the existing system – the PRGT. On the one hand, assets of the lending/donating country would be protected by the IMF's safeguards of the PRGT.[40] On the other hand, recipient countries

[34] David Andrews, "How Might an SDR Allocation Be Better Tailored to Support Low-Income Countries?", in *CGD Notes*, February 2021, https://www.cgdev.org/node/3129460; Mark Plant and David Andrews, "What is the Best Way to Allocate New SDRs?", in *CGD Blog*, 4 February 2021, https://www.cgdev.org/node/3129459.

[35] Kevin Gallagher, José Antonio Ocampo and Ulrich Volz, "Special Drawing Rights: International Monetary Support for Developing Countries in Times of the COVID-19 Crisis", in *The Economists' Voice*, Vol. 17, No. 1 (December 2020), Article 20200012, https://doi.org/10.1515/ev-2020-0012.

[36] Sameera Al Tuwaijri, Basma Maziad Al Tuwaijri and Rym Ayadi, "Debt Relief for Sustainable Recovery in Low- and Middle Income Countries: Proposal for New Funding Mechanisms to Complement the DSSI Problem-Solving and Learning-by-Doing Practices Towards the 2030 Agenda", in *T20 Italy Policy Briefs*, September 2021, https://www.t20italy.org/?p=9452.

[37] David Andrews, "How Might an SDR Allocation Be Better Tailored to Support Low-Income Countries?", cit.

[38] In 2015, 15 countries lent money to the PRGT, and five loans were in terms of SDRs. In the same vein, a further fund-raising activity in 2020 included five agreements based on SDRs. See ibid.

[39] Ibid.

[40] Mark Plant and David Andrews, "What is the Best Way to Allocate New SDRs?", cit.

need to comply with the conditions of the PRGT. A further option for using these additional SDRs would be to finance the IMF's Catastrophe Containment and Relief Trust (CCRT) that offers debt relief on debt services for LICs.[41] Since most of the LDCs are highly indebted, donations of at least a part of the SDRs would be more appropriate than only lending these SDRs to LDCs.

Another proposal is to establish a special purpose fund that would at least to some extent be financed by SDR allocation such as a Green Fund or a global health fund for LDCs. In case the fund is located at the IMF it would be necessary to approve this fund as a prescribed holder that is entitled to get SDRs. In general, the Articles of the IMF would allow using the money for a fund, as long as these are in line with the functioning of the Articles and working of the SDR department. However, a legal assessment would be needed.[42] The IMF Managing Director, Kristalina Georgieva, mentioned in a *Financial Times* article that the IMF is discussing with its member countries a new Resilience and Sustainability Trust for poor and vulnerable countries.[43]

2.3 Sustainable bonds

Sustainable bonds and other bonds related to promote sustainable development, including the newly issued covid-19 bonds,[44] have a large potential to mobilise a substantial volume of financial resources for achieving the SDGs. In 2020, the green, social, sustainability and sustainability-linked (GSSS) bond market has significantly increased. The issuances of GSSS nearly doubled from 326 billion US dollars in 2019 to about 600 billion in 2020.[45]

In principle, sustainable bonds have a number of benefits. First, they facilitate long-term investments linked to sustainability objectives, as underpinned in the criteria for project eligibility. Second, sustainable bonds contribute to develop more efficient financial markets, as they provide transparency on the use of proceeds. Third, sustainable bonds contribute to enhance issuers' reputation because of the commitment to invest in "sustainable" financial products. Fourth, sustainability bond can contribute to creating a deeper and more sophisticated financial market,

[41] Bodo Ellmers, "Financing Sustainable Development in the Era of COVID-19 and Beyond. An Analysis and Assessment of Innovative Policy Options", in *GPF Briefings*, December 2020, https://www.globalpolicy.org/en/node/2139.

[42] David Andrews, "How Might an SDR Allocation Be Better Tailored to Support Low-Income Countries?", cit.; Mark Plant and David Andrews, "What is the Best Way to Allocate New SDRs?", cit.; United Nations, *Financing for Development in the Era of COVID-19 and Beyond*, cit.

[43] Kristalina Georgieva, "How the World Can Make the Most of New Special Drawing Rights", in *Financial Times*, 23 August 2021, https://www.imf.org/en/News/Articles/2021/08/23/how-the-world-can-make-the-most-of-new-special-drawing-rights.

[44] Covid-19 bonds for about 150 billion US dollars were issued in 2020. See Anna Hirtenstein, "Investors Channel Over $150 Billion Into Coronavirus Bonds", in *The Wall Street Journal*, 3 June 2020.

[45] Environmental Finance, *Sustainable Bonds Insight 2021*, February 2021, https://www.environmental-finance.com/assets/files/research/sustainable-bonds-insight-2021.pdf.

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since a large range of private and public actors can be involved as issuers and investors (development finance institutions, governmental authorities at the national and sub-national levels, private finance financial actors, etc.).[46]

On the other hand, the value proposition of sustainable bonds ultimately hinges on the effectiveness, transparency, comparability and credibility of the related institutional framework. While the sustainable bond market has significantly increased, one main challenge of its further development is a fragmented architecture for sustainable bond standards because different definitions and standards exist.[47] Different standards have been established for sustainable bonds at different levels – international, regional, national and even the subnational level.

The green bond standards represent an illustrative example for a proliferation of standards on various levels.[48] One international standard, the Green Bond Principles (GBP) have mainly been used as a guideline for other standards[49] and the climate bond standards put in place by the Climate Bonds Initiative that has often been adopted for climate bonds.[50] However, the GBP are not detailed enough. This is one main reason that various green bond standards at the regional and national levels have been established, including the European Union Green Bond Standard and the ASEAN Green Bond Standards.[51] At the national level, several countries have established their national green bond standards, such as China, which put in place the Green Bond Catalogue in 2017. Even at the national level, various national green bonds standards have been set up as in the case of China, where different standards have been established for sovereign green bonds and corporate

[46] Kathrin Berensmann, Florence Dafe and Nannette Lindenberg, "Demystifying Green Bonds", in Sabri Boubaker, Douglas Cumming and Duc Khuong Nguyen (eds), *Research Handbook of Investing in the Triple Bottom Line*, Cheltenham/Northampton, Edward Elgar, 2018, p. 333-354; OECD, "Mobilising Bond Markets for a Low-Carbon Transition", in *Green Finance and Investment*, 2017, https://doi.org/10.1787/9789264272323-en.

[47] Kathrin Berensmann, "Upscaling Sustainable Bond Markets: The Need for Harmonised Green Bond Standards", in *DIE Briefing Papers*, No. 12/2017, https://www.die-gdi.de/en/briefing-paper/article/upscaling-green-bond-markets-the-need-for-harmonised-green-bond-standards; OECD, "Mobilising Bond Markets for a Low-Carbon Transition", cit.

[48] Kathrin Berensmann, "Upscaling Sustainable Bond Markets", cit.; Torsten Ehlers and Frank Packer, "Green Bond Finance and Certification", in *BIS Quarterly Review*, September 2017, p. 89-104, https://www.bis.org/publ/qtrpdf/r_qt1709h.htm; European Investment Bank and Green Finance Committee, *The Need for a Common Language in Green Finance, Phase I Report*, 11 November 2017, https://www.eib.org/attachments/press/white-paper-green-finance-common-language-eib-and-green-finance-committee.pdf.

[49] International Capital Markets Association (ICMA), *Green Bond Principles. Voluntary Process Guidelines for Issuing Green Bonds*, Paris, ICMA, June 2021, https://www.icmagroup.org/sustainable-finance/the-principles-guidelines-and-handbooks/green-bond-principles-gbp.

[50] Climate Bonds Initiative, *Climate Resilience Principles. A Framework for Assessing Climate Resilience Investments*, September 2019, https://www.climatebonds.net/node/39518.

[51] Asian Capital Markets Forum (ACMF), *ASEAN Green Bond Standards*, October 2018, https://www.theacmf.org/initiatives/sustainable-finance/asean-green-bond-standards; European Union Technical Expert Group (TEG), *Report on the EU Green Bond Standard*, June 2019, https://ec.europa.eu/info/files/190618-sustainable-finance-teg-report-green-bond-standard_en.

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bonds.[52] It might be possible that one widely used green bond standard, such as the European Union Green Bond Standard, could become a model for other national and regional green bond standards, and could prevail also in other countries and regions.

A further challenge is to elaborate and establish appropriate standards for different types of countries – industrialised countries, emerging markets and developing countries – because the country specific circumstances often need to be considered.

Aligned standards are needed to improve the effectiveness and efficiency of sustainable bonds and to prevent "SDG-washing". However, some flexibility is needed to consider different types of sustainable bonds and their purposes, as well as country specific circumstances. In case of diverse standards, these differences need to be transparent to financial market participants. Since developing countries often do not have the expertise to adopt these standards, capacity building is crucial, including through peer-learning and experience-sharing platforms, such as the Sustainable Stock Exchange Initiative and the United Nations Global Sustainable Finance Observatory that has been launched at UNCTAD's World Investment Forum in October 2021.

3. Conclusion and policy recommendations for the G20

Innovative financing for development can contribute to closing the financial gap by mobilising new funds for sustainable development and leveraging existing scarce public concessional resources (ODA). In addition to domestic resources and traditional external financial resources, innovative financing mechanisms can mobilise further financial resources for LDCs.

In view of the LDCs' enormous sustainable investment needs, mobilising private financial resources is both crucial and inescapable. Blended finance represents an important instrument to combine ODA with private finance, thereby leveraging scarce concessional public financial resources. The G20 should consider promoting the adoption and implementation of the OECD Blended Finance Principles in LICs to enhance blended finance in these countries. As many LDCs do not have sufficient institutional capacity. To adopt blended finance instruments the G20 should support LDC in developing institutional capacity to effectively implement blended finance tools and to lower risks associated with blended finance.

An additional instrument to enhance external financial resources to LDCs is to allocate the recently approved new SDR allocation to LDCs exceeding LDCs quota. The G20 should take on a leading by example/frontrunner role and donate as well

[52] Kathrin Berensmann, "Upscaling Sustainable Bond Markets", cit.

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as lend a percentage of their allocations, discuss establishing a special purpose fund (i.e. a green or health fund), support allocating a large amount of SDRs to LDCs exceeding their quota and discuss proposals how to allocate them among LICs and discuss how these financial instruments can be used to ensure a sustainable and inclusive recovery from the covid-19 crisis.

As the fragmented architecture of sustainable bond standards represent one main challenge in mobilising financial resources for attaining the SDGs by issuing sustainable bonds the G20 should discuss and promote harmonisation of sustainable bond standards. Moreover, the G20 countries should provide capacity building for LDCs for developing the sustainable bond market in these countries.

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