Remarks by Under Secretary for International Affairs Jay Shambaugh on the U.S. Vision for Global Debt and Development Finance

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As Prepared for Delivery

Thank you, Peter, for the kind introduction. And thank you to Adam Posen and the Peterson Institute for International Economics for hosting me.

In September last year, I laid out the U.S. Treasury Department's views on how the IMF should respond to the macroeconomic and long-term challenges faced by low- and middle-income economies.

Today I want to widen the aperture and talk about our vision for how the international financial system as a whole can and should be doing more to address these challenges, particularly given this high-stakes moment for sustainable development.

LIQUIDITY AND DEVELOPMENT CHALLENGES

I want to start with how the system ought to work: low- and middle-income countries committed to ambitious development and sustainability goals – and pursuing sound macroeconomic and sectoral policies – should be able to access financing for productive investments without facing debt distress. We want such countries to develop domestic resources and capital markets over time. Meanwhile, they should be able to invest in their sustainable development at a pace faster than current domestic resources allow by drawing net financing flows from the rest of the world. Their low current levels of capital and potential for higher growth rates presents opportunities for global finance if fundamental policies and governance are in line. This is especially critical given the scale of investments needed to address cross-border challenges like climate change, pandemics and global health, and fragility and conflict that can undermine and reverse hard fought development gains even in the best-managed economies.

But too often, we are seeing financial flows on net out of low- and middle-income countries, with the burden of debt repayments exceeding new financing. Such net outflows from low-

and middle-income countries, particularly to official bilateral and private sources, are at multi-decade highs. Per the World Bank, over 50 low-and middle-income countries experienced net outflows[1] of public debt to official bilateral lenders over 2021 and 2022 – the largest such group in nearly 20 years. These outflows are to emerging official lenders, even while Paris Club financing has held steady in aggregate. Adding to this, nearly 70 low- and middle-income countries experienced debt outflows to private creditors in 2022, the largest-ever group in recorded data. Though IFI financing has surged to fill in the gaps, the net result is that almost 40 countries experienced external public debt outflows in 2022, including 14 from Africa. These flows likely worsened in 2023, with for example no bond market access for Sub-Saharan African countries last year. They could also continue to deteriorate over the next two to three years – particularly given scheduled principal repayments to all creditors as a share of GDP more than doubling for low-income countries in 2024 and 2025 relative to the average level over 2010-2019, per IMF data.

It is not just that net flows are negative for some subset of countries. Overall flows to low- and middle-income countries have declined, something incongruous with the evident and urgent needs to meet development and climate needs. Over the last two years, net debt flows to developing countries fell by over 50 percent, to their lowest level in over a decade. For the poorest countries that rely on official development assistance, net debt inflows in 2022 were almost 80 percent lower than their 2014 peak, close to their lowest recorded level.

This is not simply an issue of less money flowing in; more money is also flowing out of these countries. As shares of both exports and revenues, external debt service has risen to levels not seen in nearly two decades. This is despite the current level of outstanding sovereign debt stock being well below prior peak levels. Public external debt service as a share of revenue is now 14 percent for the median low-income country, over two and a half times higher than a decade ago, and typically exceeds spending on health, education, and other social programs by a substantial margin. This fiscal pressure is especially daunting against the backdrop of the hundreds of billions in additional public financing needed to help low-income countries make progress toward sustainable development goals over the coming years.

This is not to say that all low- and middle-income countries face that fact pattern. Some countries have emerged from COVID shocks without a rise in debt distress and continue to enjoy robust financing from both external and domestic sources. Others lack the governance, reform commitments, or sustainable-development objectives to achieve progress. Nevertheless, many countries operating in good faith are caught in these conditions with

significant official bilateral and market debt and facing alarming tradeoffs due to falling flows and rising debt service.

VISION FOR COORDINATED ACTION

This sobering and disturbing reality for developing countries is a generational challenge. And like prior generational challenges in debt and development, it calls for the international community to step up and take decisive, coordinated actions. We have the tools to meet the moment, but we must strengthen and use them much more effectively.

In response to that imperative, I would like to lay out today a vision for international finance where all stakeholders are incentivized to sustain net positive flows to IMF- and MDB-supported countries who are doing the right things, pursuing responsible macroeconomic policies, and prioritizing ambitious sustainable development goals.

This vision has three facets.

First, we need a pledge from official bilateral creditors to act in coordination to sustain high quality, net positive flows to such countries. When the IMF and MDBs support countries' reforms and investment plans, Fund shareholders should not be withdrawing their own financing. This does not necessitate haircuts for solvent countries, but rather a basic expectation of refinancings or reprofilings, absent new liquid financing, increased grant flows, or haircuts being applied. We should be enforcing and incentivizing these norms, including through changes in IMF policy around lending into official arrears and financing assurances, as I will discuss further.

Second, we need a way to help developing countries with significant external market debt sustain private flows at affordable terms and over longer time horizons. Private outflows should not be netting against IFI support. It's time to implement market incentives and mechanisms at scale to mobilize lower-cost, longer-term, and shock-resistant private flows to low- and middle-income sovereign borrowers with sound policy frameworks. We need this both for traditional project finance and budgeted public investments.

Third, we need coordinated packages of support for countries that use newly expanded IFI resources to sustain cross-IFI flows for debt sustainability and sustainable development in smarter, integrated, and additive ways. This should be IFI-led and country-owned and use new resources from facilities at the IMF, from the balance sheet optimization at the MDBs, and from better use of existing pools of concessional finance, new Development Finance

Institution (DFI) tools, and even philanthropic pools. It is important to pair flows with scaled-up technical assistance in priorities like domestic resource mobilization and strengthening investment climates.

I will discuss each of the key areas I mentioned – official bilateral sources, private sources, and IFIs financing – in turn.

Before that, I want to note up front that realizing this vision depends on an IMF that is seen as a credible steward of country programs – and of well-functioning restructurings for borrowers that need it. Fund resources and policy must incentivize strong macroeconomic and sectoral reforms that put countries on a viable path and unleash private flows, such as in the recent case of Egypt. If programs are not rigorous and credible, countries can find themselves worse off despite IFI inflows, and programs will not draw in private finance. By the same token, while my focus today is on helping countries well before restructurings are needed, we must also acknowledge that the sovereign debt architecture needs to be delivering deeper and more timely restructurings – and doing so more consistently – than it has been for many countries. We have seen progress on some country cases, and that is important, but we must improve the Common Framework so we can more expeditiously deliver debt treatment to countries in crisis.

NET POSITIVE FLOWS FROM OFFICIAL BILATERAL SOURCES

Official bilateral financing should reflect a norm that creditors coordinate multilaterally to sustain financial flows to borrower countries that are steadfastly pursuing IMF- and MDB-supported reforms and investments. Historically, major creditors followed this norm. And yet, we are seeing some emerging G20 creditors that do not follow this norm, with consequences for global debt distress and sustainable development. For over 40 low- and middle-income countries, cumulative net debt flows from Chinese creditors since 2019 are now negative.[2] Almost all of these have had recent IMF programs.

All official bilateral creditors, particularly major IMF and World Bank shareholder creditor countries, should pledge to act responsibly, providing durable financing that further incentivizes and is commensurate with reform efforts by borrowers. No individual creditors should be free-riding by pulling funds out of a country while it is implementing IMF- and MDB-supported reforms and other bilateral and multilateral creditors are refinancing or rolling over funds, or injecting new resources.

To be clear, reverting to low-quality official flows of recent years from some emerging creditors is not the answer. Financing from official creditors, including that which IMF brings in to fill program financing gaps, must be credible, transparent, and aligned with program goals. Ultimately countries need strong macroeconomic fundamentals, hospitable business environments, and sound practices in transparency and governance to unlock stable and affordable flows of financing, including private capital and domestic resources, and all official financing needs to be aligned with that direction. This includes bilateral project finance, which should also be transparent; opaque, extractive project finance and trade credits that help lenders promote their own exports are not credible program support.

In the same vein, for many lower-income countries needing support, official bilateral flows should more often entail direct budget support, new grants, and concessional financing rather than non-concessional loans in order to protect debt sustainability and free up public balance sheets. For this reason, the United States, along with many other creditors, significantly reduced loan exposures to developing countries following a wave of debt treatments in the 1980s and 1990s and has since transitioned to be a leading provider of grants to these borrower countries. It would help if more emerging creditors made this shift. For example, The United States has disbursed nearly $70 billion in aid to Sub-Saharan African countries over the past five years – nearly seven times the net debt flows from all Chinese creditors and more than half of the $130 billion in total net debt flows to sovereigns in the region. If the United States had provided this financing as loans instead of grants, the U.S. would be the largest bilateral creditor to the region by a substantial margin, and these countries would face even higher debt servicing costs.

The international community should be prepared to enforce and incentivize norms around official debt flows, including through IMF policy and comparability of treatment in restructurings. In that spirit, I want to highlight IMF Board approval of the Fund's proposed policy adjustments to its Lending into Official Arrears Policy and to its financing assurances reviews. These changes will not only allow the IMF to move faster with program financing to debt-distressed countries – they are also a step toward aligning incentives for all official bilateral creditors to participate responsibly with restructurings, reschedulings, or new liquid finance to borrowing countries. Multilateral guidelines should likewise codify norms around transparent, high quality official flows that are aligned with overall debt sustainability objectives – such as the OECD's Sustainable Lending Practices and Officially Supported Export Credits guidelines, to which the United States, including EXIM, is an adherent but key G20 emerging creditors are not.

NET POSITIVE FLOWS FROM PRIVATE CAPITAL

For developing countries with strong macro frameworks and development policy ambition– specifically those with significant market debt – external private funds should not be flowing out as IFI funds flow in. Spikes in debt service costs also draw public resources away from immediate development priorities. MDBs and bilateral institutions have for many years facilitated market financing for developing countries with the long tenors and stable outlook needed for successful project finance. It's time we do so at greater scale and also for publicly budgeted sustainable-development investments. This means incentivizing external private funds to “stay in” at attractive terms and provide immediate relief for sovereign borrowers facing debt distress from sharp adjustments in external financing costs and availability.

We can help preserve market access with two underutilized features of sovereign debt and development finance: credit enhancements and borrower protections. These features are complementary to one another – and they are likewise complemented by ongoing private capital mobilization initiatives for project finance, such as securitization and originate to share approaches, that free up MDB balance sheets.

First, well-structured credit enhancements from MDBs and DFIs, such as loan guarantees, can help flatten out the spikes in public debt service costs we've seen over the past two years. They can also help procure longer-tenor financing and shift creditor composition to more stable sources for long term development – both for public project finance and budgeted investments. While they must be applied judiciously, given resource constraints and other considerations, we can scale these in a targeted way for borrowers around debt amortization walls without curtailing traditional concessional finance. While MIGA is already active in this space with its non-honoring sovereign financial guarantee product, it has the balance sheet space to do significantly more – including by using more inclusive credit-rating thresholds for developing countries aligned with an IMF program and by increasing guarantee limits. The IDB has been an innovator in this space by piloting a top-up in its volume of financial support for sovereigns that pursue guarantees rather than loans, but more needs to be done, including instilling the right incentives around opportunity-cost accounting and for staff to prioritize deployment in their country engagement. All of this builds on momentum around scaled-up guarantees for project finance from the launch of the World Bank Group Guarantee Platform this summer.

Bilateral guarantees should also be aligned with and amplify these efforts for sovereign borrowing around sustainable objectives, both for general public borrowing and publicly

guaranteed project finance. When used in the right context and where funding is available, bilateral guarantees can fill in the gaps left by exposure limits on MDB guarantees, free-up lending for global challenges, and be deployed flexibly. For instance, bilaterally guaranteeing risk held on MDBs' balance sheets, such as through sectoral initiatives at the ADB and IBRD[3] around energy-transition lending, could achieve outsize leverage via MDB headroom. The United States is actively exploring these tools as well as others from DFC, and we encourage others to do so. I also want to highlight ongoing work by the U.S. DFC and MCC, to improve and scale-up the use of credit enhancements to support issuance of debt-for-nature swaps and sustainability-linked bonds in the Technical Taskforce established after COP28 and other forums.

Second, we should create safe harbors for countries seeking proactive relief from private debt distress on a voluntary, market-aligned basis. Borrower countries should be able to proactively sustain private flows through consensual, largely net present value neutral debt treatments – including standstills, buybacks, and exchanges, where appropriate – without suffering from rating downgrades and losing market access. To that end, the IMF, much like as with collective-action clauses over recent decades, should play a leading role on developing and promulgating contractual mechanisms like state-contingent standstill clauses to shield sovereign borrowers collectively – without stigmatizing any individual borrower – from global or regional changes in external private finance.

Efforts underway at the World Bank, AfDB, EBRD, EIB, and IDB to incorporate climate-resilient debt clauses into loan agreements are a starting point and should be paralleled in the private loan and bond markets where possible – as well as in bilateral development finance and export credit. IMF research indicates that collective-action clauses have benign effects for sovereign bond yields; the same could ultimately hold for well-structured state-contingent clauses.

For buybacks and exchanges, I likewise urge the IMF’s and World Bank’s Global Sovereign Debt Roundtable to further engage credit rating agencies to address borrower countries’ concerns about adverse impacts that disincentivize these transactions. “Debt-for-X” swaps or similar transactions cannot substitute for comprehensive debt restructurings or other forms of relief, but they can provide material private flows where conditions align, and the international community should incentivize them being used more often and more effectively. In addition, in key financial jurisdictions for sovereign debt, narrow, targeted updates that avoid market disruptions – such indexing prejudgment interest rates to prevailing market rates – could help further align incentives for net private flows.

NET POSITIVE FLOWS FROM IFIS

I now want to turn to the opportunity we have to use the significantly expanded – and still expanding – IFI resources to sustain IFI flows in a way that advances countries' development and sustainability ambitions. Today's financing challenges would have likely been much worse absent the extraordinary financing support that IFIs extended since the onset of the pandemic. From 2020 to 2022, this collective support accounted for nearly 60 percent of the total net debt inflows to developing countries. With the hundreds of billions in new IFI capacity we've achieved through recent efforts from MDB Evolution and the implementation of the G20 Capital Adequacy Framework report, we must work to have these resources come together strategically and maximize impact.

It is difficult to overstate the scale of the opportunity with these additional IFI resources. Take the IMF. The United States was a strong supporter of the 50% expansion in quota resources that the IMF board approved last year. The Biden Administration is pleased that Congress authorized the United States to lend $21 billion to support low-income countries through concessional financing from the Poverty Reduction and Growth Trust (PRGT). Building on that momentum, I would echo the call I made last fall for IMF members to further support the PRGT by using future lending income to meet its subsidy needs. In addition, the IMF's new Resilience and Sustainability Facility (RSF) now has up to $40 billion of new lending firepower focused on long-term financing for sustainability. The IMF Executive Board has approved commitments so far of $8 billion to 18 countries, the majority of which is on track to be disbursed by the end of the year. Formalizing the IMF's collaboration with the World Bank and WHO so that RSF tackles risks associated with pandemics would deepen its impact.

The MDBs are likewise seeing historic expansions in financing resources, as a result of MDB Evolution. We have made great progress on this front, particularly through implementation of the G20 MDB Capital Adequacy Framework Review recommendations that are enabling $200 billion in additional financing capacity over the next ten years.

However, there is space to go even further, particularly around boosting concessional finance, and we are seeing countries take action to this end. President Biden's FY25 budget request includes funds for a U.S. guarantee that would enable an additional $36 billion in World Bank lending for addressing global challenges and a large U.S. contribution to trust funds and financial intermediary funds. More broadly, the MDB Evolution initiative seeks to not only expand the ability to lend by these institutions, but to make that lending more agile, more effective, and better channeled to solving cross-border challenges like climate, pandemics and

global health, and fragility and conflict. Reforms around incentive structures and operational approaches will make the enhanced lending capability even more impactful. The United States has also been supportive of capital increases where capital is the binding constraint on lending, for example at the EBRD and IDB Invest. MDB boards should periodically evaluate the need for such investments by shareholders.

This is the moment to integrate these expanded IFI balance sheets with technical assistance and cross-stakeholder leadership to make progress on debt sustainability and sustainable development. This includes by unlocking new and high-demand concessional funding pools in the climate-finance architecture, including the Climate Investment Funds, the Global Environment Facility, and the Green Climate Fund. One opportunity will be in the recommendations from the forthcoming G20 climate finance architecture independent review. Other important sources of finance include the Pandemic Fund and Global Concessional Financing Facility.

Another important opportunity to update the system is in the ongoing joint IMF and World Bank comprehensive review of the Low-Income Countries' Debt Sustainability Framework, which should incorporate borrowers' sustainable finance considerations, including risk adaptation and mitigation costs. This would build on enhancements that have been made for the IMF's framework for Market Access Countries. But updating these tools is only impactful if they are used effectively. Consistent with my earlier call for credible IMF programs and restructurings, I am calling on the Fund to ensure that debt relief envelopes and program financing are commensurate with what countries need to pursue ambitious development and sustainability goals.

Ultimately IFI flows should be aligned with country priorities, strategies, and plans that help cultivate domestic resources and capital markets – the most durable flows for sustainable development. Too often, countries borrow externally and take on financing risks to cover fiscal deficits that wouldn't exist if they collected domestic financial resources at the same rates as developed economies. Domestic resource mobilization reforms can also bring in much needed foreign currency, relieving balance of payments pressures with hard currency borrowing. The U.S. Treasury, through our Office of Technical Assistance, dispatches public financial management experts to help governments around the world strengthen their ability to better raise and manage domestic resources through improved revenue, budget, and debt management. One such project in Angola generated fiscal flows of $125 million each year by successfully helping to lower costs, reduce risk, and more efficiently manage sovereign debt.[4]

In the same spirit, last year the World Bank dramatically expanded its support for domestic resource mobilization reforms that will create fiscal space through both revenue policy and administration measures, and addressing spending inefficiencies and harmful subsidies. We would like to see other MDBs, in coordination with the World Bank, move in a similar direction.

A CALL TO ACTION

The international community has made significant progress in recent years with strengthening tools across the IMF, the MDBs, multilateral trust funds, and DFIs to help prevent debt distress from impeding developing countries investing ambitiously and productively in sustainable development. If we use these tools in coordination across stakeholders, and think expansively about their application, they can add up to something much greater than the sum of their individual parts.

With such a process, a country committed to sound macro policy and sectoral policy ambition for sustainable development would have the ability to responsibly invest in its needs. The IMF and World Bank would re-establish a credible policy anchor and development path. Official creditors would pledge grants and concessional finance over the path, alongside funds from other MDBs, maximizing the impact of IFI flows. Private funds would likewise stay in, in some cases due to MDB and other credit enhancements, so that IFI funds would not merely refinance private debts. High quality project finance from MDBs, DFIs, trust funds, and export-credit agencies would complement general-budget flows by funding public projects and private balance sheets. Financing conditionality would be tied to technical assistance to drive reforms that mobilize domestic resources. The goal would be to maximize external and domestic resources to help lift up countries making productive, ambitious investments.

There are a number of countries who are doing the right things with their macro and development policies – including doing their part to address in ambitious ways the climate, pandemic and global health, and fragility and conflict challenges I've alluded to today – but are facing significant debt amortizations in the next 24 months. The international community must make sure that the international financial system is there for these countries.

All stakeholders will find the United States an enthusiastic partner and leader in realizing this vision. Thank you.

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[1] Disbursements net of principal repayments.

[2] Aggregates official bilateral and private creditors from China.

[3] Innovative Finance for Climate in Asia Pacific and Just Energy Transition Partnership guarantees, respectively.

[4] Projected through life of the bonds issued in 2022 under improved liability management.