



Italian G20 Presidency

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Annex II G20 Recommendations for the Use of Policy-Based Lending

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Annex II: G20 Recommendations for the Use of Policy-Based Lending

Context

Multilateral Development Banks (MDBs) play an important role in helping countries to meet their financing requirements during periods of macroeconomic vulnerability. In 2017, the G20 International Financial Architecture (IFA) Working Group developed the *G20 Principles for effective coordination between the IMF and MDBs in case of countries requesting financing while facing macroeconomic vulnerabilities* (the *G20 Principles*)¹. These principles were aimed at encouraging the International Monetary Fund (IMF) and MDBs to engage in a regular dialogue and ensure effective coordination when MDBs consider providing financing to countries facing macroeconomic difficulties and when Policy-Based Lending (PBL) is envisaged. It was recognized that lack of coordination between the IMF and the MDBs may undermine the effectiveness of budget support, with negative impacts on the economic growth and stability of recipient countries, and a potentially wasteful use of scarce MDB resources.

In 2018, the IMF and the MDBs jointly reported back on the approach they adopted to implement the *G20 Principles*. The IMF and MDBs have shown to have deepened their coordination, both formally and informally, including by establishing first points of contact to ensure smooth communication and formalizing the upstream dialogue between senior managers. In addition, according to the Report, MDBs have enhanced their capacity to support borrowers in confronting economic turbulence, while an updated guidance note on IMF's assessment letters and statements has clarified the modalities and circumstances of its intervention. Overall, the *G20 Principles* have achieved their objectives.

An update on the implementation of the *G20 Principles* was discussed at the G20 IFA Working Group at the June 16, 2021 meeting. The 2017 *G20 Principles* remain relevant and useful. As part of this update, a broader exchange took place on how to monitor and maximize the development impact and quality of PBL², in line with the different mandates and comparative advantages of the IMF and MDBs given existing capital constraints and credit ratings of the concerned institutions. This seemed particularly timely, as COVID-19 response packages are channelling substantive resources in the form of budget support to help address fiscal pressures arising from lower revenues and higher expenditure requirements. In the aftermath of the pandemic, there has been an exponential increase in the emergency financing by the MDBs and IMF. Collecting and comparing the data on financing provided by these institutions to different countries during the pandemic could help to objectively evaluate the efficacy of coordination.

¹ <https://www.imf.org/external/np/g20/pdf/2018/082918.pdf>.

² Irrespective of the financial terms and conditions applied, including grant financing.



The G20 has discussed a set of non-binding recommendations on the use of PBL, on top of those formulated in 2017, particularly in the aftermath of the COVID-19 crisis to strengthen resilience and support a strong, sustainable, balanced and inclusive recovery. The starting point of the recommendations is that PBL operations should be country-led, aligned and responsive to the needs of recipient countries. At the same time, PBL should postulate maximum quality and development impact. Some of the recommendations for PBL may apply to Results-Based Financing (RBF), a newer tool for the MDBs which can have some important macroeconomic impacts, where relevant. Broad guidance on PBL is not intended to preempt the role of the Boards of the different institutions. Each institution is responsible for its lending decisions.

G20 recommendations

- The development of PBL should be country-led, aligned and responsive to the needs of recipient countries.
- PBL is designed with governments to support development programs. Its use should be weighed against the use of project loans in terms of development effectiveness. Within MDB mandates, PBLs should be examined for opportunities to support reforms conducive to sustainable and inclusive development, taking into account specific country circumstances.
- MDBs and the government should consider clear, measurable outcome and output indicators for PBL operations, as well as 'prior actions' to implement before loan approval or disbursement. Any indicators should be the product of consensus reached between the MDB and the government. It is important that overarching measures (i.e. legislation or policy frameworks ratified or adopted) are accompanied by proper action plans.
- MDB staff should be incentivised for quality of output, design, management and supervision, and for tracking, measuring and reporting reform outcomes and development results against MDB relevant and transparent indicators, including after completion, where appropriate.
- Consistent with their respective mandates, MDBs should furthermore provide effective complementary capacity development and technical assistance to enable PBL-related reforms, where appropriate.
- The use of PBL in emergency situations should be re-examined to strengthen efficiency, transparency and accountability, also drawing lessons from the COVID-19 experience. This review should include a particular focus on the extent to which PBLs are used to assist clients by supporting social protection systems and reach the poorest.
- PBL's purpose has been exceptionally broadened during this unprecedented crisis. The increase in the PBL ceiling set across different MDBs during the crisis is to be considered temporary. If a country faces a liquidity emergency resulting from balance of payment needs, it should consider the advantages of pursuing an IMF-supported program.

Coordination with the IMF

- MDBs' expertise in structural and sectoral issues should complement the IMF's capacity to assess macroeconomic conditions and advise countries on the appropriate actions to



restore macroeconomic stability. The MDBs' provision of PBL should be transparently communicated and hence predictable over the medium term, consistent with the agreed policy requirements. In cases where an IMF-supported program is in place, PBL should bring out synergies and complementarities during design, programming, implementation and post-implementation, and ensure that interventions are mutually reinforcing. PBL proposals should discuss the value added of MDB's financing, including, where relevant, how it complements IMF support.

- In turn, IMF policy recommendations should take into account the overall objective of PBL contributing to closing a country's financing gap. Where feasible, any structural benchmark under an IMF-supported program that falls under a PBL should be discussed with the relevant MDB. The IMF and MDBs should alert each other when difficulties arise in the implementation and disbursement of a PBL or when an IMF program risks going off track, respectively.
- To the extent possible, governments should be presented with a uniform, simplified policy matrix to implement.
- Capacity development support and technical assistance should also be coordinated across International Financial Institutions (IFIs) and development partners when designing a financing package.

Coordination across MDBs and other development partners

- PBL should be deployed to support sectoral reforms according to each MDB's core areas of expertise, comparative advantage and strategic priorities.
- Effective coordination among MDBs and with other development partners on PBL should take place throughout the full program cycle, to avoid duplications and overlapping and to ensure that interventions are complementary and mutually reinforcing. Each PBL proposal should illustrate how coordination was accomplished and where the concerned MDB fits in. When appropriate, consideration should be given for PBL operations to be jointly developed by the IMF/World Bank and Regional Development Banks under the coordination of the government.
- MDBs' country offices should ensure smooth relationships and continuous dialogue linked to PBL, involving country managers, economists, and program and sector staff.
- Country-owned and country-led platforms³ can be a useful tool through which MDBs align their country programs with the authorities' priorities and ensure coordination among themselves on the ground.
- Institutional incentives to share knowledge should be strengthened. Timely and effective information sharing is critical to ensure full coordination both at headquarter and country-level. MDBs should improve and integrate repositories of their own country operations and commit to a more systematic exchange of information with sister institutions, starting with specific country cases and pilots in selected areas.
- The MDBs' primary role is to support long-term development interventions and build institutional capacity for crisis prevention and management. MDBs should act in close

³ G20 Reference Framework for Effective Country Platforms - 23 February 2020, Riyadh, Saudi Arabia.



coordination with the concerned United Nations agencies, where relevant, bridging the divide between emergency and development assistance, dealing with the socio-economic impact of crises in support of the poorest and with countries' social protection systems.

IFIs should outline the approach they plan to adopt to follow up on the above recommendations and report back to the G20 IFA Working Group in early 2022.