TASK FORCE ON CLIMATE, DEVELOPMENT AND THE INTERNATIONAL MONETARY FUND

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Designing a Resilience and Sustainability Trust

A DEVELOPMENT-CENTERED APPROACH

VULNERABLE TWENTY GROUP

INTERGOVERNMENTAL GROUP OF TWENTY FOUR G-24

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TASK FORCE ON CLIMATE, DEVELOPMENT
AND THE INTERNATIONAL MONETARY FUND

About the Task Force on Climate, Development and the International Monetary Fund

The Task Force on Climate, Development and the International Monetary Fund is a consortium of experts from around the world utilizing rigorous, empirical research to advance a development-centered approach to climate change at the IMF. The Task Force believes it is imperative that the global community support climate resilience and transitions to a low-carbon economy in a just manner. As the only multilateral, rules-based institution charged with promoting the stability of the international financial and monetary system, the IMF has a vital role to play in supporting a globally coordinated response.

MEMBER ORGANIZATIONS

- Intergovernmental Group of Twenty-Four (G24)
- Vulnerable Group of Twenty (V20) Ministers of Finance
- African Economic Research Consortium
- Boston University Global Development Policy Center
- National School of Development, Peking University
- Centre for Social and Economic Progress
- Financial Futures Center
- United Nations Economic Commission for Latin America and the Caribbean

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EXECUTIVE SUMMARY

In 2021, the International Monetary Fund (IMF) issued a historic allocation of Special Drawing Rights (SDRs) equivalent to $650 billion. These supplementary international reserve assets were allocated to help meet the liquidity bottlenecks facing many countries due to the COVID-19 pandemic. However, because of the IMF's quota-based system, SDRs primarily flowed to more advanced economies, even though they don't face the same economic pressure as developing countries. In response, Group of Seven (G7) nations agreed to re-channel $100 billion in SDRs to the countries that need them, roughly 20 percent of those SDRs allocated to G7 countries (G7 2021). China has pledged to provide $10 billion of its SDRs to Africa, at 25 percent of its allocation (Farand 2021).

As a vehicle to facilitate SDR re-channeling, the IMF announced it was looking to establish a 'Resilience and Sustainability Trust' (RST). In October 2021, the Group of 20 (G20) also called on the IMF to establish such a Trust, with a very clear mandate of providing climate vulnerable nations with access to short-term and long-term financing in face of the climate crisis. The G20 recognized the need for 'affordable long-term financing to help low-income countries, small developing states and vulnerable middle-income countries reduce risks to prospective balance of payment stability, including those stemming from pandemics and climate' in its Rome Leaders' Declaration (G20 2021).

With respect to climate change, this unprecedented and much needed financing instrument could address a glaring gap in the international finance architecture. At this writing, however, the design particulars of the RST would deem this financing unattractive to much of the IMF membership, essentially locking up billions in climate- and pandemic-fighting resources.

What is more, the IMF has also identified addressing the pandemic and digitalization as two other key objectives of the RST. As the resource requirements to tackle climate change alone are significantly greater than the RST's expected capitalization at $30 to 50 billion, it must be designed to play a catalytic role. First, the RST needs to be equipped with substantially more resources, including built-in design features that trigger regular replenishments. Second, the IMF will have to work collaboratively with the World Bank and other multilateral development banks (MDBs) to ensure that the RST's resources have the furthest-reaching impact possible.

The Task Force on Climate, Development and the IMF published an initial policy brief on potential modalities of the RST in October 2021 (Task Force 2021). There, we identified three overarching objectives: the RST should enable countries to respond to climate shocks; catalyze low-cost financing for poorer, climate vulnerable countries; and enhance the ability of emerging market and developing countries to mobilize longer-term financing.

Since then, the IMF has put forth several design iterations, each responding to engagement from member states, outside experts and civil society organizations. While the Fund's thinking has evolved on this issue in the right direction, current RST proposals still fall far short of their promise. This policy brief underscores five design features critical to ensuring the RST can have the transformational impact that developing countries need. The RST should:

- **Have broad eligibility criteria** to ensure that countries vulnerable to physical and transition risks of climate change have access.
- **Offer concessional terms**, short- and long-term financing and access that is not conditional upon having an existing IMF program.
- **Prioritize country ownership and avoid conditionalities**. Onerous conditionalities will dampen demand and undermine the effectiveness of the RST.
- **Ensure collaborative governance** by actively involving the World Bank and other MDBs, as well as outside experts and civil society. MDBs' experience with climate programming and longer-term investments and disaster risk financing will be vital.
- **Build for scale**. The RST should be scaled in a manner commensurate to the needs of member states in building resilient and sustainable economies. This should be based on climate-risk adjustments depending on the temperature trajectory.

At the Paris Peace Forum in November 2021, IMF Managing Director Kristalina Georgieva said the design of the RST would be ready for IMF Board approval by the 2022 IMF and World Bank Spring Meetings, with the goal of making the RST operational by the Annual Meetings in the fall (Georgieva 2021). There is still time to improve the design of the RST to make it an important, transformational instrument for resilience and sustainability in the world economy.

INTRODUCTION

In 2021, the International Monetary Fund (IMF) issued a historic allocation of Special Drawing Rights (SDRs) equivalent to $650 billion. These supplementary international reserve assets were allocated to help meet the liquidity bottlenecks facing many countries due to the COVID-19 pandemic. However, because of the IMF's quota-based system, SDRs primarily flowed to more advanced economies, even though they don't face the same economic pressure as developing countries. In response, Group of Seven (G7) nations agreed to re-channel $100 billion in SDRs to the countries that need them, roughly 20 percent of those SDRs allocated to G7 countries (G7 2021). China has pledged to provide $10 billion of its SDRs to Africa, at 25 percent of its allocation (Farand 2021).

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Since then, the IMF has put forth several design iterations, each responding to engagement from member states, outside experts and civil society organizations. While the Fund's thinking has evolved on this issue in the right direction, current RST proposals still fall far short of their promise. This policy brief analyzes the RST modalities currently in play and offers five design features that will make the RST an important, transformational part of the global financial architecture.

BROADEN ELIGIBILITY AND SCOPE

The G20 called on the IMF to establish an RST that allows access to low-income and climate vulnerable middle-income countries (G20 2021). As climate vulnerability is a multidimensional concept, income-based metrics alone should not be used to determine eligibility to the RST (Runfola et al. 2017).

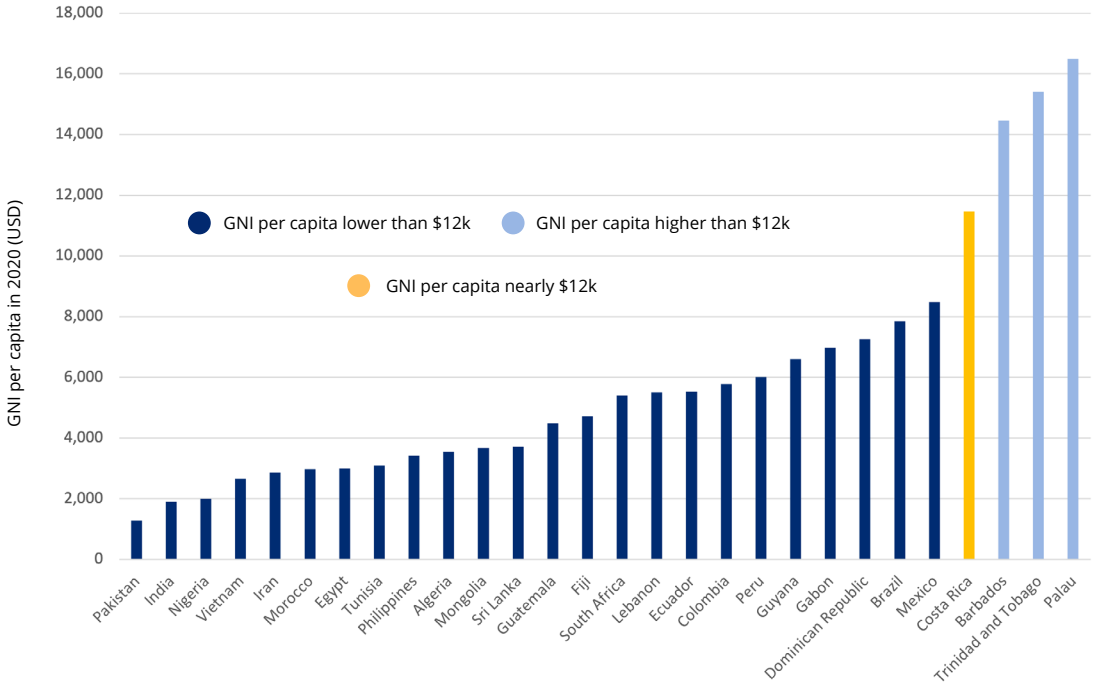
Furthermore, income-based measures do not do justice to the acute exposure to climate risks that many higher-income climate vulnerable nations face, especially small island developing states; climate impacts may amount to a major share gross domestic product (GDP) of climate vulnerable nations. For example, Dominica—classified by the IMF as an upper middle-income country—suffered damages amounting to 90 percent of its GDP due to Tropical Storm Erika in 2015. Just two years later, in 2017, Hurricane Maria resulted in damages amounting to 226 percent of Dominica's GDP (Waithe 2019). In other words, even though countries may have higher per capita incomes, the sheer scale of climate impacts will mean that they need access to instruments like the RST.

A focus on vulnerability will require the IMF to include at-risk middle-income countries in RST eligibility. Using a threshold of per capita gross national income (GNI) below $12,000, ten times the International Development Association (IDA) operational cut-off, countries such as Barbados, Palau and Trinidad and Tobago would be excluded. Figure 1 identifies the per capita GNI of the Group of 24 (G24) and Vulnerable Group of 20 (V20) members that are not qualified as low-income and are ineligible for the IMF's Poverty Reduction and Growth Trust (PRGT) against this operational cut-off. The figure illustrates how important it is for the IMF to consider climate vulnerability. Barbados and Trinidad and Tobago have been identified as countries that are threatened by cyclone risks and earthquakes (IMF 2019). Similarly, an IMF policy paper identified Costa Rica and Palau as being at risk of major natural disasters (IMF 2019). Expanding eligibility to countries classified as small developing states would qualify Barbados, Trinidad and Tobago and Palau to access the RST. However, Costa Rica, despite its

recognized climate vulnerability, barely qualifies under an operational cut-off of $12,000 per capita GNI and risks being excluded in the near future.

A broad approach to eligibility is also warranted given the characteristics of climate scenarios, as well as the commonly used macroeconomic models. These two components lead to an underestimation of climate impacts. On the one hand, with regards to climate change sce-

FIGURE 1 RST eligibility with IDA cutoff illustrated by G24 and V20 members not eligible for the PRGT



Source: Lara Merling, Boston University Global Development Policy Center (2022). **Data source:** IMF

narios, the scenarios developed by the Network for Greening the Financial System (NGFS) and used by financial authorities for climate stress tests focus on chronic climate risks (NGFS 2021). Thus, large economic impacts are visible only after a few decades (Ranger et al. 2022). On the other hand, aggregated Integrated Assessment Models (IAM), such as the Dynamic Integrated Climate Change Model (DICE), adopt a positive and rather larger discount factor, thereby underestimating future impacts while overestimating the costs of climate policies. Moreover, these models do not distinguish between low-carbon and carbon-intensive sectors' contribution to growth and consider shocks at the global, average level, thereby shedding inadequate light on national and region-specific impacts (Monasterolo 2020). In addition, because such models neglect the role of finance and investors' expectations, which are expected to play a major role in mobilizing capital for a low-carbon transition, the feasibility of the different climate mitigation scenarios is distorted (Battiston et al. 2021). This problem is particularly aggravated by the emphasis on the short- and near-term in macroeconomic models. By underestimating shocks in the short- and medium-term, these models do not offer an accurate picture of climate vulnerability on the ground (Dunz et al. 2021).

These modeling shortcomings underscore the importance of incorporating loss and damage into the scope of the RST and closing the financial protection gap facing climate vulnerable countries. In particular, climate vulnerable countries require affordable and accessible insurance products and measures to help avoid and manage non-insurable impacts (Hirsch et al. 2019).

OFFER CONCESSIONAL TERMS AND ACCESSIBILITY

An accessible RST would be attractive to developing countries because many lack the fiscal space necessary for a mobilization of resources commensurate with the demands posed by climate change. However, if the rates charged by the IMF are too high and the access terms are too restrictive, countries will be deterred from using the RST at all. Accessibility has two elements: (1) rates and terms and (2) linkages with existing IMF programs.

Rates and terms

The RST should offer concessional rates because tackling climate change shouldn't overburden developing countries with more debt. These countries are already dealing with large debt burdens, as well as high debt servicing costs and will need more concessional financing. The call from the G20 to focus on low-income and climate vulnerable countries also further underscores the need for concessional finance. Given the major fiscal ramifications of a low-carbon transition, concessional rates should not be restricted to countries susceptible to physical climate risks alone but also countries facing transition risks. Table 1 below captures the recommended rates and tenors against existing proposals.

TABLE 1 Financing terms

	Existing Proposal*	Recommended
Rates	SDR interest rate plus a margin of up to 100 basis points	Zero, or SDRs should become perpetual allocations to countries with 0.05% interest payment without having to repay the SDRs
Maturity	20 years	20 years or more
Access limits	150% of quota or less than the SDR equivalent of $1 billion	No limits

*The information in this column primarily relies on Pazarbasioglu and Ramakrishnan (2022).
Source: Compiled by authors.

The RST could offer terms similar to those available via the PRGT. The PRGT offers concessional terms with zero interest. The PRGT's terms are provided in Table 2 below. However, unlike the PRGT, the maturity periods for RST resources should have a longer lifespan of 20 years. The longer maturity is warranted for three reasons: (1) risk financing and long-term adaptation needs, (2) the transition away from fossil fuels will require sustained efforts and (3) climate impacts are not simply one-off extreme weather events but cumulative in nature, including slow onset impacts. Akin to the PRGT, the RST could also have a subsidy account, enabling it to offer a wide range of instruments with highly concessional features. A subsidy account would improve accessibility and could also allow RST borrowers confronting climate shocks to cover payments to the IMF similar to how the Catastrophe Containment and Relief Trust allowed PRGT countries to cover payments.

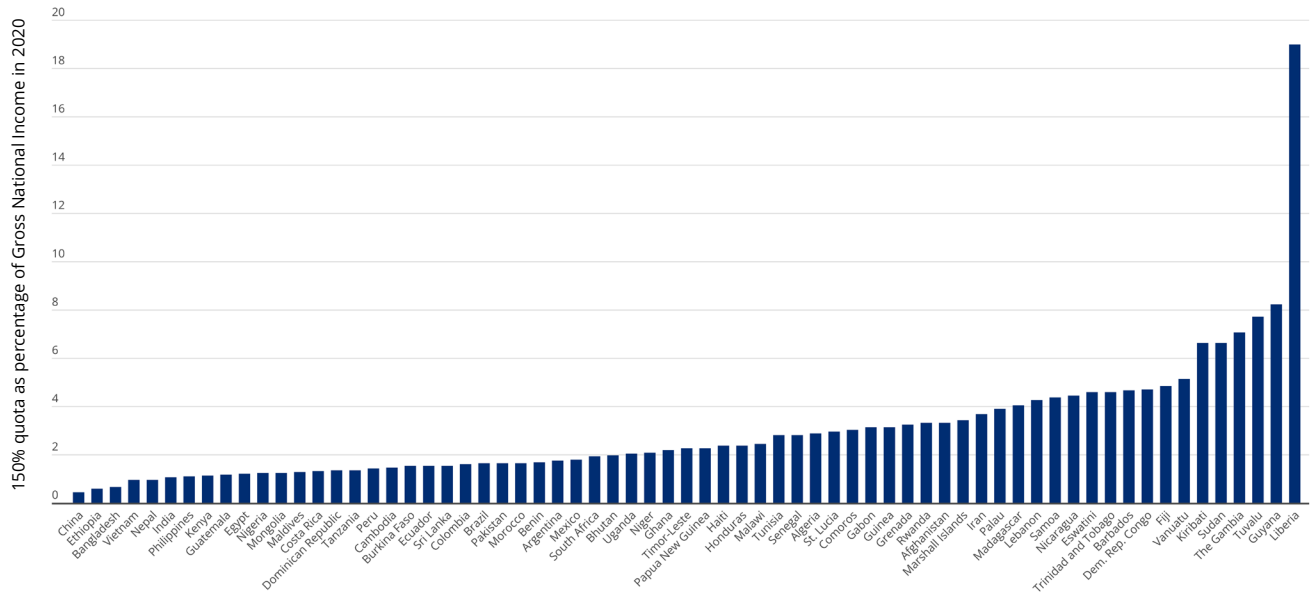
TABLE 2 PRGT Terms

	Poverty Reduction Growth Trust		
	Extended Credit Facility	**Standby Credit Facility**	**Rapid Credit Facility**
Rate	0%	0%	0%
Maturity (grace)	10 (5.5)	8 (4)	10 (5.5)
Access limits	145% of quota per year, total outstanding concessional credit to 435%[1]	145% of quota per year, total outstanding concessional credit to 435%[2]	Cumulative 100%, 133.33% for large natural disasters[3]

Source: International Monetary Fund.

The IMF has also proposed to restrict access to financing to 150 percent of IMF quota, or SDR 1 billion, with the lower figure being the ceiling. On average, this figure is around 3 percent of GNI for eligible countries (Figure 2). When spread out over a 10-year program, the actual finance available on a yearly basis will be minor compared to actual needs.

FIGURE 2 Access limit as a share of GNI



Source: Luma Ramos, Boston University Global Development Policy Center (2022). **Data Source:** IMF and World Bank Databases

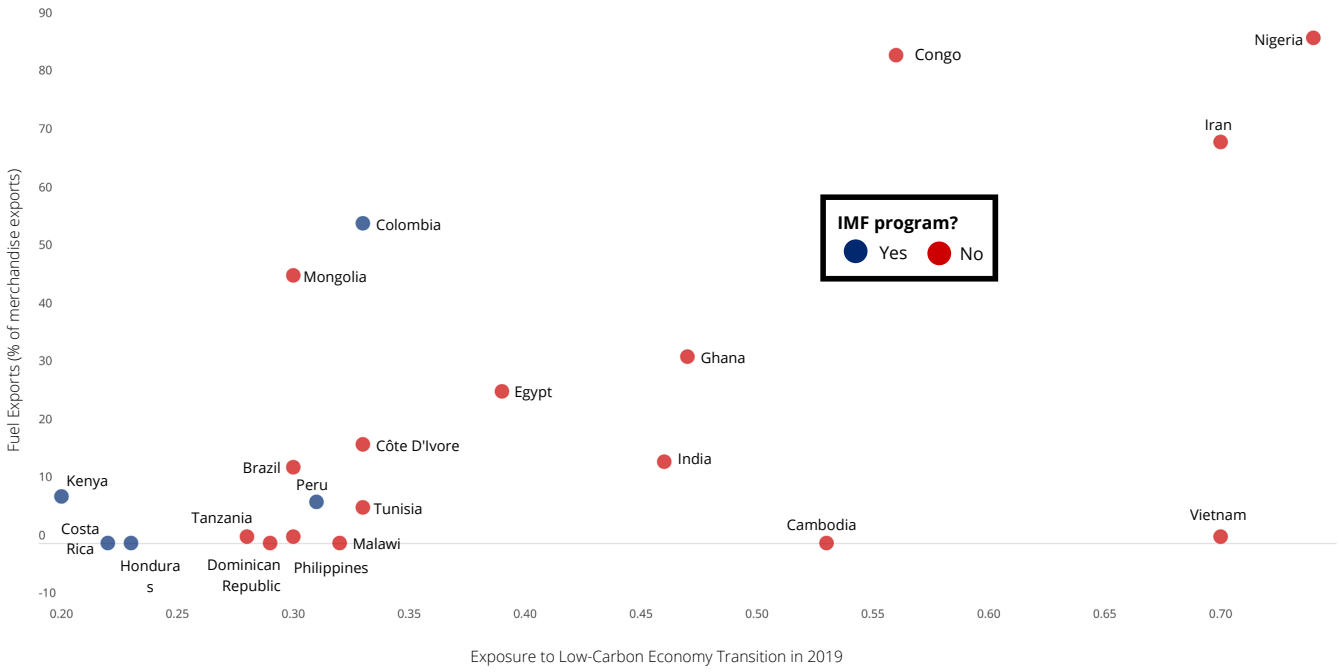
[1] If PRGT exceptional access criteria are met, limits can be exceeded.
[2] If PRGT exceptional access criteria are met, limits can be exceeded.
[3] Regular window access limit is 50 percent of quota per year. For the large natural disaster window, countries have an annual access limit of 80 percent of quota per year. Access limits have been raised to 150% of quota for the exogenous shock window and 183.33 percent of quota for the large natural disaster window.

Access

The IMF has identified three qualifying elements: existing IMF programs (financing or non-financing), sustainable debt and the ability to repay, and policies that support the RST's goals (Pazarbasioglu and Ramakrishnan 2022).

The expansion of eligibility to include countries with financing, as well as non-financing programs, is welcome; however, it is not enough. As Figures 3 and 4 below demonstrate, many climate vulnerable countries do not have existing IMF programs. In other words, if accessing the RST is pre-conditioned on having an IMF program, most of the vulnerable countries will be left out, whether or not the IMF uses metrics beyond income for eligibility. The inclusion of non-financing programs does not significantly change this picture. In the last 12 years, only nine countries have used the Policy Coordination Instrument (PCI) or the Policy Support Instrument (IMF 2022). In other words, the requirement to have a concurrent program is very likely to dampen demand.

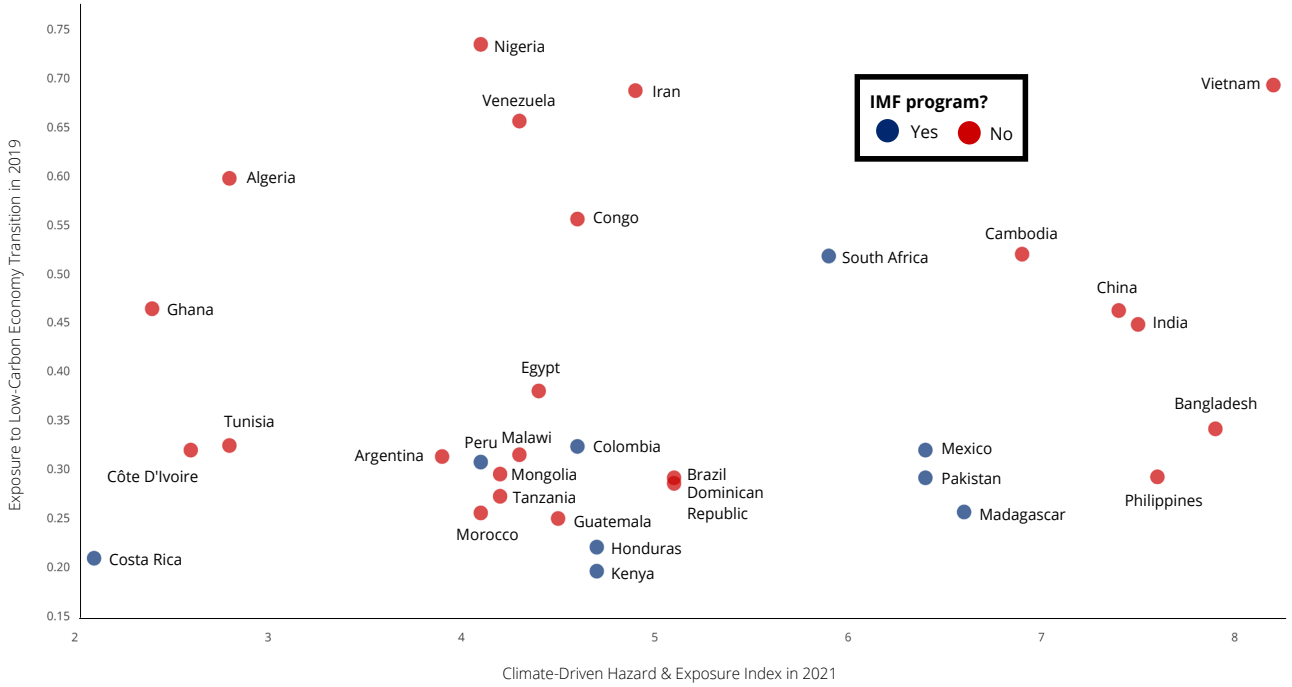
FIGURE 3 Do countries facing high transition risks have IMF programs?



Source: Luma Ramos, Boston University Global Development Policy Center (2021). **Data source:** IMF and World Bank.

When RST resources are coupled with existing financing programs, two considerations need attention. First, existing IMF programs were not designed with the goal of helping countries tackle climate change. Adding RST resources to programs that have fundamentally different objectives, regardless of their merit, will reduce the ability of the RST to help countries address the climate crisis in a meaningful way. Second, if the RST resources are simply used as a 'sweetener' to make the terms more appealing to member states with existing IMF programs, the RST may lose its potential for transformational impact. There will be no guarantee that these extra resources, minimal as they may be, would have contributed any additional impact on existing climate efforts.

FIGURE 4 Do climate-exposed countries have IMF programs?



Source: Luma Ramos, Boston University Global Development Policy Center (2021). **Data source:** Chen et al. 2015 and IMF.

Non-financing programs, such as the PCI, require countries to be subject to the same Upper Credit Tranche (UCT) standard as that for financing programs. For example, the PCI requires monitoring a range of indicators, such as quantitative targets of variables deemed to be of critical importance to the program goal (for example, net international reserves and fiscal balances), reform targets and prior actions that countries adopt before the PCI is even approved.

It is conceivable that countries would want to meet the UCT standard to access concessional resources from the RST. However, the criteria countries need to meet should support country-owned climate plans and should facilitate, rather than undermine, long-term investments in green, climate resilient growth.

PRIORITIZE COUNTRY OWNERSHIP AND AVOID CONDITIONALITIES

Country ownership needs to be the organizing principle for RST support. Countries have already submitted rounds of nationally determined contributions (NDCs) under the Paris Agreement, and they are the clearest articulations of how countries intend to tackle climate change. However, a critical unanswered element is identifying how to mobilize the investment required for each country to achieve its climate objectives. As such, these country-owned documents should form the basis of RST support. The IMF needs to actively work with countries to help them put in place country programs that facilitate the mobilization of resources,

while also playing a leadership role in global policy coordination and capacity building to help countries prepare for climate shocks.

Pazarbasioglu and Ramakrishnan note the need for countries to have 'high-quality policy measures consistent with the RST's purpose' (Pazarbasioglu and Ramakrishnan 2022). The IMF can play a role in helping countries elaborate their NDCs in a manner that is compatible with their climate and development aspirations. As discussed further below, the IMF will need to work in coordination with MDBs, like the World Bank and regional development banks, to facilitate resource mobilization and investment in climate resilience.

The IMF may need to re-think and re-orient existing programs, so these shorter-term programs do not run counter to the longer-term objectives of climate resilient, low-carbon development that is so central to the RST. For example, IMF conditionalities often include fiscal consolidation, while climate change requires a stepwise increase in investment. IMF programs emphasizing fiscal consolidation as an objective may not be congruent with the need to build climate resilience and steer countries towards low-carbon economies.

Climate change also tests one of the key premises for why conditionalities are needed in the first place. The most vulnerable countries are exposed to climate risks irrespective of the quality of economic programs that they have put in place. In other words, conditionalities that are designed to improve economic management may not actually achieve that goal, let alone allow countries to reduce their vulnerability to climate impacts.

IMF conditionalities have deterred borrowing countries from approaching the IMF, in part, because conditionalities often do not achieve their intended social or economic outcomes. The limited effectiveness of conditionalities is evident from the IMF's own research and other scholarly literature (IMF 2007; Stubbs et al. 2021). Furthermore, fiscal consolidation may often not yield the economic outcomes expected (IMF 2018), and such requirements can directly run counter to the imperative to invest in low-carbon growth. In 2021, Pakistan passed a supplementary budget that taxes previously exempt clean energy technologies to enhance revenue as a part of IMF reforms (Reuters 2021).

In summary, broadening the eligibility perimeter is not enough. To ensure that a wide range of countries have access to the RST, the IMF will need to actively help countries implement their NDCs in a manner that builds on the strengths and expertise of the MDBs and related institutions.

ENSURE COLLABORATIVE GOVERNANCE

Along with the IMF, MDBs also need to be engaged in the RST's governance. MDBs, including regional development banks, will allow countries to leverage greater resources and tap into MDB and regional development bank expertise in climate programming. At a fundamental level, countries will need a mix of financing instruments to mobilize finance at the necessary scale. Therefore, IMF financing via the RST will have to be viewed considering other financing available through MDBs as well.

The RST should be equipped with both short-term and long-term instruments so countries can tackle immediate or prospective climate-induced liquidity crises, of which pre-arranged financing or capitalization of insurance pools or products is an important contribution to the

climate and disaster risk architecture. This must happen while also investing in the longer-term structural transformation required to put their economies on a trajectory of green, climate resilient growth. MDBs need to support this overarching purpose of the RST. Furthermore, these investments should also support domestic resource mobilization efforts and enable longer-run green transformations (Task Force 2021).

Furthermore, the RST could be used as collateral to leverage additional resources, especially from the MDBs. Coalitions such as the V20 have also suggested the RST play a role in helping to reduce indebtedness and increase the space available for investing in climate change, including through guarantees. Similarly, a capital neutral approach that allows finance to be used as equity would be particularly catalytic.

As mentioned above, the RST, at most, should only include conditionalities on implementing NDCs and long-term strategies. The IMF will need to work together with MDBs to ascertain the policy programs that can best help countries achieve their climate targets. As the IMF issued a draft climate strategy only in August 2021, the IMF will need to learn from, build on and leverage MDB expertise, as well as civil society and research institutions working on climate change.

BUILD TO SCALE

The scale of resource mobilization needed to support low-carbon, climate resilient pathways for developing countries is immense. Developing countries will need to spend an additional 2 percent of their GDP on an annual basis up to 2030 to address climate change (Bhattacharya et al. 2019). This estimate does not include the finance required to equip economies to withstand the negative cross-border spillover effects of policies implemented by other countries.

The estimates of demand for the RST's resources need to be informed by these financing needs. Constraining the size of the RST to demand based on quotas of IMF members will not reflect the actual capital requirements needed for the RST to have transformational impact.

IMF Managing Director Georgieva said the RST initially would be capitalized at $30 billion and would grow to $50 billion. This estimate falls short of the call made by the V20 to capitalize the RST with $100 billion as the floor (V20 2021). At the 2021 United Nations Climate Change Conference (COP26), Barbados Prime Minister Mia Mottley called for an annual allocation of $500 billion in SDRs for the next 20 years to finance sustainability and resilience.

The RST will need built-in triggers to replenish its resources and ensure sustainability of its funding stream. Regular allocations of SDRs will be vital, with significant portions of those allocations re-channeled to the RST. Grant resources will also help the RST maintain maximum flexibility and ensure concessional terms moving forward.

CONCLUSION

The IMF has made bold and unprecedented action during the COVID-19 crisis in providing a fresh allocation of SDRs and articulating the need for re-channeling efforts that can tackle the macro-critical aspects of both short-term and long-term challenges posed by climate change in the areas of adaptation, low-carbon pathways, and climate and disaster risk financing and insurance. The design of the RST is of crucial importance, however. If the RST is not equipped

with the design details, flexibility and policy space to generate interest from developing countries, the IMF will not be able to achieve the full impact of the historic SDR allocation it made in August 2021.

Climate change calls for re-thinking the eligibility criteria on accessing IMF funds. Coupling RST access together with existing IMF programs will dampen demand from countries and undermine its stated goals. Similarly, the rates and terms must be attractive and not have terms that place additional burdens on countries already struggling with high debt burdens and debt servicing costs.

In the immediate aftermath of the pandemic, the IMF mobilized rapidly with financial support through emergency programs that carried no conditionality. This design made these programs an attractive source of finance, with a record number of countries turning to the IMF for funds that were crucial in supporting health-related and social protection spending as part of their pandemic response. This should serve as a precedent for the RST, which must allow countries to access funds without having to accept burdensome conditionalities that generally fail to achieve their stated goals.

The difference in impact of a poorly or well-designed RST will be significant. The IMF can either develop a responsive, sustainable tool that countries can make use of to pursue their climate and development aspirations, or they can design a Trust that is hard to access and may actually undermine the climate goals the IMF is seeking to promote. This policy brief outlines a path for the IMF to lead on resilience and sustainability for decades to come.

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