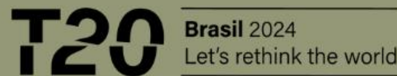
T20 Policy Brief



Task Force 03
REFORMING THE INTERNATIONAL FINANCIAL ARCHITECTURE

Mobilizing Innovative Sources of Finance: Lessons from the Resilience and Sustainability Trust (RST)

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Abstract

In April 2022, the International Monetary Fund (IMF) established the Resilience and Sustainability Trust (RST), its first new lending facility to provide longer-term concessional financing to low- and middle-income countries in order to help them tackle key structural challenges such as climate change and pandemic preparedness. The RST is resourced through voluntary rechanneling by G20 countries as part of their 2021 historic allocation of Special Drawing Rights (SDRs).Costa Rica, Barbados, Rwanda, Bangladesh, and Jamaica were the first five countries to access the Resilience and Sustainability Fund (RSF), the instrument under which RST loans are made. RSF programs have been in demand, with the number of RSF programs reaching 18 by the end of March 2024.

As the IMF has concluded an interim review of the RST and intends to undertake a more comprehensive review in 2026, the G20 has an opportunity to provide policy direction to the Fund to make the RST an important, transformational part of the global financial architecture. This policy brief makes three specific recommendations on the Resilience and Sustainability Facility to the G20. First, the G20 should call on the IMF to: (i) remove the qualifying requirement that countries must have a concurrent Fund program in place to access RST concessional funding.; (ii) programmatically have the RSF play a much stronger catalytic role in mobilizing private finance support by focusing on a few ambitious, high-depth reforms; and (iii) deploy RSF resources to help create fiscal space for climate action through debt relief solutions that are timely, fair and effective. Given the demand and pace of existing commitments, G20 members should commit more resources to the RSF. In addition to these RSF reforms, the G20 should also help countries address liquidity challenges by issuing a new round of SDRs, encourage the IMF to fully integrate climate investment needs and shocks into its debt sustainability

assessment methodologies, and commit to increasing the supply of concessional finance to enable countries scale up investments for climate-positive development.

Keywords: Concessional finance, Resilience and Sustainability Trust (RST), Resilience and Sustainability Fund (RSF), catalytic finance, conditionality

Diagnosis of the Issue

Developing countries require considerable capital investment to finance their climate mitigation and adaptation actions by 2030. Estimates of external finance needs converge around $1 trillion per year by 2030 (Songwe et al. 2022), which is well beyond the fiscal capacities of many developing countries, especially those that are also struggling with high and rising debt. These countries require substantial innovative and mostly concessional financing to be unlocked and mobilized with urgency.

In response to the need to create more fiscal space in developing countries, the IMF established the Resilience and Sustainability Trust (RST) in April 2022 and the Trust became operational in October 2022. The RST is the IMF's first new lending facility designed to provide longer-term concessional financing to low- and middle-income countries in order to help them tackle key structural challenges such as climate change and pandemic preparedness while contributing to strengthening their prospective balance of payments stability (IMF, 2022). The RST is funded through voluntary rechanneling by the G20 countries as part of their 2021 historic allocation of Special Drawing Rights (SDRs). The G20 played a pivotal role in generating the political consensus to issue SDRs as a part of the global liquidity response to the COVID-19 pandemic and called for the creation of the RST.

Costa Rica, Barbados, Rwanda, Bangladesh, and Jamaica were the first five pilot countries to access the Resilience and Sustainability Fund (RSF), the instrument under which RST loans are made. At the end of March 2024, the number of RSF programs had grown to 18, with all of these arrangements focusing exclusively on climate change, not pandemic preparedness.

While the RST has been promoted as a key innovation in the international financial architecture, its current design features may not have the intended transformational impact on developing countries. In 2021, the Task Force on Climate, Development and the IMF published an initial policy brief on the potential modalities of the RST (Task Force, 2021). There, the Task Force identified three overarching objectives for a climate resilient and just transition: 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 for climate transitions. The Task Force published a second policy brief in 2022 and offered five design features to make the RST an important, transformational part of the global financial architecture, which were reinforced in another policy brief capturing early lessons from implementing countries (Task Force, 2022; Task Force, 2024). These are that: the RST should have broad eligibility criteria; provide concessional terms with no requirement of existing IMF programs; prioritize country ownership and avoid conditionalities; ensure collaborative governance; and build for scale with self-replenishment mechanisms.

While it appears that the IMF took into account some of the suggestions of the Task Force on the design of the RST, two critical recommendations were not considered. The first Task Force recommendation that the IMF did not consider was for the IMF to provide concessional RSF financing without requiring a member country to have an existing Fund program. Currently, to qualify for an RSF arrangement, eligible countries would need, among other things, to have a concurrent on-track financing or non-financing IMF supported program with "upper credit tranche" quality policies and at least 18 months remaining in the program at the time of approval of the RSF arrangement. The second recommendation from the Task Force that was not considered by the IMF was to refrain

from linking SDR re-channeling to policy conditionality, partly in order to maintain the conditionality-free characteristic of SDRs. However, this conditionality-free principle has been violated in RST arrangements. Conditionality is intrinsic to RSF lending programs and is linked to specific "green" policy reform measures that countries are required to implement over the program period, rather than have these countries address their climate goals voluntarily in line with their national plans.

RSF programs have been in demand, with the 18 RSF programs at the end of March 2024 all exclusively focusing on climate change; the IMF's Executive Board has yet to approve RSF programs focused on pandemic preparedness (Gupta and Brown, 2023). The Fund estimates that there could be an average of 33 active RSF programs a year (IMF, 2022). As the IMF has concluded an interim review of the RST in May 2024 and intends to undertake a more comprehensive review in 2026, the G20 has an opportunity

To provide policy direction to the Fund in order to make the RST an important, transformational part of the global financial architecture.

While the climate module will be a necessary part of the debt sustainability assessment process for RSF candidate countries, the climate module and the DSA methodology need to be upgraded. The IMF/World Bank's review of the Low Income Country Debt Sustainability Framework provides a welcome opportunity to integrate the full range of climate shocks into the methodology alongside climate investment needed for a resilient and green transition.

Recommendations

In light of the foregoing, we put forward three specific and actionable recommendations to the G20 so that it can help to make the RST an important, transformational part of the global financial architecture. These recommendations require that the G20 call on the IMF to:

(i) Remove the qualifying requirement that countries must have a concurrent Fund program in place to access RST concessional funding. This requirement is restricting access to the RST and reducing the overall effectiveness of the push to re-channel SDRs.

(ii) Programmatically, the RSF has played a much stronger catalytic role in mobilizing private finance support through a focus on a few ambitious, high-depth reforms. These high-depth reforms lead to permanent institutional changes, such as legislative changes to support 'green' procurement, or conditions with long-lasting impact, such as incentivizing investment in renewables through fiscal measures. A key expectation of the IMF's RSF arrangements is the overwhelming reliance on the Fund's catalytic effect to unlock external financing, even though there is no empirical evidence to justify this catalytic effect and demonstrated by over optimistic projections of substantial private climate flows (Bird et al., 2001; Mody and Saravia, 2003; Diaz-Cassou et al., 2006). The potential of private finance to help close the climate financing gap by investing in areas such as renewable energy and sustainable infrastructure is compelling, but the RSF's catalytic character in making this happen is still unproven. Early RSF country experiences demonstrate that the signaling effect of RSF climate policy reforms

to spur large-scale private climate investments faces strong headwinds. At the end of 2023, both Barbados and Jamaica had not attracted any private climate finance flows, despite having an RSF arrangement for 12 months and nine months, respectively. Bangladesh received a marginal amount of private climate financing. In addition, countries should focus on a few ambitious, high-depth RSF reform measures that stand a reasonable prospect of successfully generating transformational change or having a long-lasting impact. This may play a stronger catalytic role in encouraging the private sector to come to the table.

(iii) Deploy RSF resources to help create fiscal space for climate action through debt relief solutions that are timely, fair and effective. The G20 should tackle this directly by issuing a new round of SDRs to help countries cope with liquidity challenges and increasing the supply of concessional finance. By taking on more debt to fight climate change, many developing countries have been caught in a vicious debt-climate change trap. Rising debt repayments are increasingly diverting the resources their governments need to invest in fighting climate change, while their borrowing costs are rising partly due to climate-related vulnerabilities, leading to more debt. Future RSF arrangements in highly indebted climate vulnerable countries should consider linking debt relief options such as pause clauses, debt restructuring and reprofiling, and debt swaps to investments in green resilience policies aligned to their national climate and development plans. Quite interestingly, the IMF put forward a new working paper on lessons and implications for how the Brady Plan delivered on debt relief and this may rekindle interest in a Brady Plan-style mechanism to facilitate debt restructurings when countries face acute solvency challenges (Shenai et al. 2023). Both Rambarran (2022) and Ramos et al. (2023) have developed sovereign debt and climate justice proposals which partly draw on the

principles of the Brady Plan and other global policy frameworks (Rambarran 2023; Ramos et al. 2023). More recently, the Finance for Development Lab has proposed a “bridging program” to climate action that seeks to unlock net positive flows for debt distressed countries facing liquidity constraints (Diwan et al., 2023). The IMF can use these proposals as templates for incorporating high-depth reform measures in RSF-supported programs that expand fiscal space for climate action through timely, fair and effective debt restructurings.

Scenarios of outcomes

Scenario 1: New allocation of SDRs

The G20 could invite the IMF to pursue a new round of SDR allocations, following the 2021 SDR allocation that was made to tackle the global liquidity crisis during the COVID-19 pandemic. The new allocation of SDRs would immediately inject liquidity into the system and thereby allow countries that are facing tight liquidity constraints to cope with ongoing imbalances. In terms of re-channeling, the new round of SDRs would enable G20 members to once again pledge to re-channel their SDRs. With the G20's commitment to re-channel SDRs amounting to $100 billion having been achieved, the G20 could show renewed leadership by taking on a new target. The new SDR allocation would mitigate a risk achieved by relaxing the requirement to have a concurrent IMF program to access the RST as mentioned above and elaborated in Scenario 2.

Scenario 2: Relaxing the requirement for a concurrent IMF program

The G20 could encourage the IMF to remove the requirement for borrowing countries to have an active IMF program to access the RSF. This is likely to increase the demand for RSF arrangements. What is more, the IMF is already facing a high demand and will need to ensure the continued availability of resources to support pipeline countries even if it expects a drawdown by 2030. A new allocation of SDRs would provide further cushion to the IMF to remove the requirement for a concurrent program. With more rechanneling,the IMF will be able to increase its buffers to account for any perceived risks of not requiring concurrent IMF programs.

Scenario 3: Debt solutions advanced with the support of RSF arrangements

The G20 Common Framework represents an advancement of the existing sovereign debt architecture but requires significant reform to be fit for purpose. In particular, the Common Framework needs to be equipped with adequate incentives to gain the participation of all of the relevant creditors so that the solutions advanced are meaningful and durable and capable of providing countries with the fiscal space to make the necessary investments towards their development and climate change goals. The G20 could make a specific call to the IMF to encourage the use of the RST to back Brady-type bonds as a part of a solution to a package of debt relief solutions. On the one hand, the Common Framework would directly benefit from having incentives to offer private creditors. On the other hand, given the limited resources in the RST, there will be trade-offs between those who have access to the RSF arrangements – countries that are in acute distress or ones seeking to build resilience to the prospective balance of payment crises.

The trade-offs can be mitigated through a sequential approach. For example, in 2024, the G20 could review the experience of the 2021 allocation, with the possibility of inviting the IMF board to make another allocation in 2025. Armed with these early lessons on RSF arrangements, the G20 could increase the use of SDR rechanneling by multilateral development banks for scaling up climate investments. Second, the G20 could encourage the close engagement of multilateral development banks and regional development banks in country platforms that could be undergirded by RSF arrangements. In light of the ongoing review of the RST, the G20 could invite the IMF to relax the concurrent program requirement while encouraging the RST resources to support Brady bond-type instruments. Furthermore, considering the review of the IMF/WB Low Income Country Debt Sustainability Framework, the G20 could recommend the IMF to incorporate climate change and development needs into account.

Overall, the RST's design is limiting its transformational impact. The G20 has the opportunity to encourage design reforms, equip the trust with more resources, and use the RST as leverage to encourage timely and meaningful debt relief solutions. A new round of SDRs would help to address the immediate liquidity challenges while also increasing the capitalization of funds that need urgent scaling up.

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