



POLICY BRIEF

ALIGNING SOVEREIGN DEBT FINANCING WITH CLIMATE ACTION IN THE ASIA-PACIFIC REGION

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MANUEL F. MONTES

ABSTRACT

The Asia-Pacific Region (APR) has experienced prolonged economic growth in the past decades. However, these growth trends have come with great environmental costs, mainly through manufacturing activities, consumption, and urbanization. Global climate change poses a risk to the APR's continued development. This Policy Brief explores how individual nations and the region must address these environmental concerns to avert an economic stall. The ongoing COVID-19 pandemic has highlighted the degree of interdependence among APR economies through its network of global value chains; thus, climate change presents a clear threat to the region's entire economic model. The dominant features of the international financial system severely hamper climate finance options. Developing economies in the APR must contend with high financing costs for their physical climate investments. This Policy Brief investigates how nations can reorient investment decisions and mobilize necessary finances to sustain growth. It is also essential that the APR develop the social and political resolve to upgrade the social provisioning and care sectors (upon which APR economies depend) in tandem with economic growth and in the context of global climate change. Remedies would not only be appropriate for financing climate action; they would also prove necessary for the long-term sustainability and efficiency of international financial markets.

TABLE OF CONTENTS

Abstract	3
Acknowledgements	4
Introduction	5
Climate Challenges in the Asia-Pacific Region	6
Escalating human and physical impacts	6
Economic impacts already borne	7
Financing needs for international commitments on mitigation	10
Limitations and Vulnerabilities in the International Financial System	10
Not fit for purpose	11
International finance’s differentiated welcome mat	11
Financing climate action in an unfavorable financial setting	12
ESG standards and finance	14
Recommendations	15
Domestic fiscal and monetary actions	15
Rethinking capital account openness	15
Reforming regulatory approaches to elicit climate finance	16
Strengthening national tax systems	16
Tapping external sources of finance	16
Borrowing from international sources	16
Green bonds and SDG bonds	17
Debt restructuring for climate finance	17
Debt-for-nature swaps	17
Voluntary debt buybacks	18
Special drawing rights-facilitated climate finance	18
New issues of SDRs	18
SDR facilities to bolster climate financing could increase soon	19
Political Economy Considerations	20
List of Tables	21
References	21
About the Author	24

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INTRODUCTION

**“All my life, though some
have changed,
Some forever, not for better”**

**John Lennon and Paul McCartney (1965)
“In My Life”**

A 2011 study projected that if the Asia-Pacific Region (APR) continues its upward trajectory, by 2050 it could account for more than half of global gross domestic product (GDP), trade and investment (ADB 2011). One could see this as a kind of ‘Great Re-emergence’, since the territories in the APR had accounted for this same proportion of the global economy before industrial development began in the West. Whole swaths of the APR have undergone permanent change, accompanied by corresponding disruptions and widespread adjustments in social and political arrangements.

These permanent transformations have been enabled by decades of vigorous economic growth, and these growth trends have, themselves, spawned an accelerating pattern of environmental costs, many induced by enlarged manufacturing activities, increased incomes that have in turn spurred expanded consumption baskets, and urbanization. Global climate change, interacting with the APR’s achieved economic successes, threatens to increase the steepness of the climb toward development. Without the necessary course corrections in its current growth path, which has relied heavily on installing the fossil-based technology of the West’s industrial dominance, development in the APR may stall sometime in this century.

This paper argues that acting now, both as individual nations and on a regional basis, can both avert this stall and mitigate the human and economic costs of the action itself. In fact, if climate change marks out a path of technological, social, and economic development, the question becomes one not of reducing costs but instead of accelerating investment in pursuit of development ambitions (UN, 2011; UN, 2015; Stern, 2015).

The ongoing COVID-19 pandemic offers a window into the developmental and climate action issues facing countries in the APR. First, the pandemic highlights

the heightened degree of interdependence among economies in the APR arising from commerce, travel, financial flows, and shared geography. With its network of global value chains, the APR has more intense economic integration than other regions of the world (Baldwin, 2016). With increasing urbanization and the region’s dependence on ports for trade and on food production from coastal and river-basin areas, climate change presents a clear threat to the economic model.

How can societies reorient their investment decisions (and mobilize the necessary finances) to sustain growth and the degree of interdependence among the APR’s nations? Second, the pandemic reveals that economies in the APR depend upon their social provisioning and care sectors, the capabilities of which may either hinder or stimulate their development successes. Will societies in the APR summon the social and political resolve to steadily upgrade these sectors in tandem with their economic growth to keep their populations safe and thriving in a climate-warming world? Third, the pandemic exposes the human limits of technological capabilities needed to respond to natural events. Will capabilities in the APR advance rapidly enough in all societies to access, adapt, and innovate with the technologies required for climate change?

This paper examines how the APR might reorient investment and its financing as forms of climate action, focusing on economic restructuring, a strengthened care economy and technological development as key problems. It warns that the hazardous features of the international financial system may frustrate the climate actions needed to keep the APR on its development trajectory. As discussed below, these hazards would pose problems even in a non-warming climate and demonstrate the need for thoroughgoing reforms in global finance. The first section surveys the climate challenges confronting the APR and their corresponding economic costs. The second section examines the limitations of the current financial system in generating the kind of finance required for climate action. The third section offers recommendations for further unpacking the question of climate-action investment and financing in the APR.

CLIMATE CHALLENGES IN THE ASIA-PACIFIC REGION

Asian-Pacific countries find themselves confronting escalating development costs because of three forces: natural disasters; domestic pressures, such as those arising from public health concerns and the need to reverse environmental degradation; and the combination of national requirements and international obligations, such as commitments in the United Nations Framework Convention on Climate Change (UNFCCC), to reduce their greenhouse-gas emissions. Global climate change trajectories dominate the first and third cost sources; thus, the countries in the APR do not fully control the costs confronting them. The second source arises from rapid economic growth and human habitation expansion interacting with a natural environment not given enough time to regenerate itself. All of these costs would hinder the APR's current development models unless they evolve rapidly enough to undertake the appropriate physical investments.

Could the APR simply continue current development paths without the extensive and expensive alternative investments? Recent events suggest that the answer is 'No', and that the business-as-usual option may be no more feasible than desirable. Most climate assessments issue a warning, exhorting governments and societies to do more and sooner to keep warming to well below 2 degrees Celsius at most. This section assumes probable delays in the emergence of an effective global response. Policy actions should reflect an extrapolation from the most recent costs and allow for their acceleration in the near term, although the scale of future acceleration remains uncertain.

ESCALATING HUMAN AND PHYSICAL IMPACTS

First of all, based on the recent record, Asia-Pacific nations cannot evade the human and physical impacts of globally driven climate change. With its diverse geography, including the Tibetan plateau, the APR has witnessed a variety of both long-term trends (also called 'slow onset' events) and extreme weather events, with climate change driving the duration and frequency of both.

One emblematic case of an ongoing climate change trend is the melting of the Himalayan glaciers. In 2017, around 1.9 billion people lived in the ten river basins with headwaters located in the Hindu Kush region, including 240 million people in the region itself (Wester et al., 2019). These populations face the prospect of widespread livelihood dislocation, vulnerability to flooding events and increasing outmigration pressures.

In the last two decades, the APR has suffered more from extreme weather events than other world regions. Between 2000 and 2018, 82 percent of natural disasters in Asia came from extreme weather events (ADB, 2019). In the same period, developing countries in Asia accounted for 84 percent of the 206 million people affected by disasters on the average each year. At an estimated annual average of almost 38,000 fatalities in the same period, the APR accounted for 55 percent of the 60,000 global disaster fatalities (ADB, 2019). As elsewhere in the world, the poor, the rural, the marginalized, and the isolated absorb most of the costs of these disasters. Isolated Pacific Island nations, with limited economic diversification, are particularly vulnerable to extreme weather events.

Under the current global climate trajectory, countries in the APR must find a way to absorb these kinds of costs, even once an effective global regime begins to deflect the path of emissions and warming. Most countries will experience an increasing number of warm days and decreasing number of cold days. Water demand will also increase, exacerbated by poor water management policies.

In the case of the second cost source – reversing environmental degradation – the more rapidly growing economies in the APR have already absorbed significant costs in terms of human health and economic production. For example, in China, smog-inducing ozone and fine particles cause an estimated 1.1 million premature deaths annually, while destroying 20 million tons of rice, wheat, maize and soybeans (Gu et al., 2018). Despite the locally generated character of pollution and its principally domestic impact, domestic efforts to mitigate pollution nevertheless would also advance global objectives to reduce greenhouse emissions.

ECONOMIC IMPACTS ALREADY BORNE

Second, the economic impacts of climate-related events indicate that the affected countries already bear the costs and will continue to do so regardless of policy. While responses cannot produce instantaneous results, in the long run, countries would benefit from investments that reduce these cumulative costs.

In the 11 years between 1989 and 2018, countries in the APR absorbed US\$687.6 billion in physical damage from weather-related¹ causes, affecting 5.2 billion people (ADB, 2020b). In 2014, India bore \$16 billion in physical damage from flooding in September. In 2017, floods in June and July and a storm in July caused \$6 billion and \$3.5 billion, respectively, in physical damages in China (ADB, 2020b).

A widely cited 2015 model covering most² countries estimated 13.6 percent to be the average (among countries) of the amount taken off per capita GDP production capacity by mid-century (defined as the span of years 2040-2059) by climate change (Burke, Hsiang and Miguel, 2015). These estimates are considered on the high side because of an assumption that gives cumulative negative impacts for higher temperatures (Aufhammer, 2019). This estimate of climate impacts suggests that the average country could afford to invest 13.6 of their per capita output over the 44 years between 2015 and 2059 – much less than one percent per capita annually – to evade or mitigate its harmful impacts on production capacity.

However, assessing the affordability of climate investments requires at least four caveats. First, climate investments and related spending, compared to other investments, tend to require high upfront costs, with a declining cost or positive benefits afterward. Second, climate costs entail cumulative processes, as implied in the cost methodology cited above, although early action to obtain financing for upfront costs can arrest the pattern. Third, national climate efforts must contend with the fact that the action, inaction, or inadequate action of other nations determines the scale of national action. If, for example, certain countries maintain higher fossil-fuel subsidies over an extended period, then the costs become shared among other countries. This underlines the indispensability of international cooperation and the essential practice of common but differentiated responsibilities in climate action (Montes and Williams, 2017). The mitigation efforts of large countries in the APR - China, India, Indonesia, Japan, and the Republic of Korea – have profound global impact. Regional authorities must actively engage in global climate rule making and evolution.

“The all-inclusive SDG framework poses a challenge for each Asia-Pacific society in aligning its social progress, industrialization and poverty eradication ambitions with the framework's urgent call to combat climate change and its impacts”

These large countries can also contribute immensely as global innovators in technological development and the economic and social aspects of climate action. Fourth, countries experience a widely unequal distribution of negative impacts on production capacity. Projections for mid-century give impacts from climate change alone on per capita GDP a range from -40 percent (Pakistan) to +88 percent (Mongolia) (Aufhammer, 2019). This wide range of impacts will require major efforts in multilateral cooperation and sharing in investment resources, despite the earlier observation that the investment requirement would be about one percent of per capita GDP for the average country.

Table 1 provides a window into the variety of climate change impacts among the countries in the APR. The data in Table 1 affirm the starting point of the International Finance Corporation (IFC) (2020) analysis that identifies South Asia as home to three of the five countries most vulnerable to climate change. For Bangladesh, India, Nepal and Pakistan, the loss in GDP per capita by mid-century may exceed 30 percent. The maritime-exposed countries of Southeast Asia also risk losses of the same order. China's estimated loss is below 10 percent

¹ Excluding earthquakes, landslides, and dry-mass earth movements.

² Countries not included did not have enough of the data needed to apply the methodology.

Table 1: Range of climate change impacts on Asia-Pacific country GDP to mid-century, 2040-2059

Country	Change in per capita GDP
Afghanistan	-4.78
Armenia	19.28
Australia	-12.60
Azerbaijan	-2.53
Bangladesh	-36.49
Brunei Darussalam	-34.16
Bhutan	-1.17
Cambodia	-38.94
People's Republic of China	-7.51
Fiji	-23.63
Georgia	5.52
Indonesia	-31.44
India	-38.78
Japan	-5.97
Kazakhstan	32.17
Korea, Republic of	3.09
Kyrgyz Republic	29.53
Lao People's Democratic Republic	-32.21
Malaysia	-33.53
Mongolia	87.81
Nepal	-31.08
New Zealand	-0.41
Papua New Guinea	-24.30
Pakistan	-39.54
Philippines	-30.61
Samoa	-27.87
Solomon Islands	-39.54
Tajikistan	-31.35
Thailand	-37.81
Turkmenistan	-14.10
Uzbekistan	-8.45
Vanuatu	-26.14
Viet Nam	-33.60

Source: Auffhammer (2019); Burke, Hsiang and Miguel (2015)

We must recognize that the countries facing the global climate threat are at different stages of development; not all have shared the rate of success in recent decades that has given the APR its reputation for economic growth.

Five developing economies, two already industrialized, and five fast-growing middle-income converging economies – India, Indonesia, Japan, Malaysia, People’s Republic of China, Republic of Korea, and Thailand - have led the others in an economic model that relied on linkages to export markets beyond the APR. Climate change imperils the sustainability of such production chains. For example, catastrophic flooding in Thailand in 2011 severely disrupted production activities far beyond its borders (Haraguchi and Lall, 2015). Therefore, these leading countries have important roles in global value chains that require safeguarding against climate change.

The APR also has important commodity exporters, many among the less-diversified (least-developed) countries (LDCs). These countries have not been immune to extreme weather events, such as the devastating 2019 floods in Myanmar. They share an important characteristic in their vulnerability to external financing difficulties; Lao PDR, in fact, appears as a country facing high probability of debt distress in the International Monetary Fund’s (IMF) annual debt sustainability framework for 2019 (World Bank and IMF, 2019).

All APR countries will be compelled by their circumstances, national and international requirements, and their development ambitions to undertake all three of the standard categories of climate action: loss-and damage, adaptation, and mitigation.

Loss-and-damage applies to the negative effects of climate variability and climate change that overwhelm people’s capacities to cope or adapt. National governments already bear the costs of damage arising from extreme weather events. Investments in insurance pools, at the national and international level, could mitigate the sudden call on public resources in such contingencies (Warner et al., 2012). A significant proportion of the losses from climate events fall upon the populations directly affected; risk-sharing mechanisms with unaffected populations will fall far short of requirements in such cases (Warner, van der Geest and Kreft, 2012). Through regulatory policies, private insurance could also play an important part in risk-sharing. The ADB (2020b) estimate of weather-related damage costing \$687.60 billion indicates an annual requirement of about \$63 billion, which could be pooled across the region. Such a pool will not have

to disburse this amount every year and could require more in specific years; different countries would also draw upon it at different times.

Adaptation actions to climate-proof infrastructure, telecommunications, transportation, farms, manufacturing operations, offices and residences represent an important portion of the climate investment requirements. Questions about investment financing immediately arise in adaptation because it entails installation or erection of new facilities that produce returns over the life of the investment. Financing to pay for the immediate costs of installations is required at the start and must be paid back over the life of new facilities. Estimates from a recent IFC study (2020) on climate investment opportunities in South Asia illustrate the following adaptation-associated sectors and the corresponding estimates of investment potential for the period 2018 to 2030: green buildings \$1.53 trillion, transport infrastructure \$0.3 trillion, municipal solid waste \$0.02 trillion, climate smart urban water \$0.1 trillion and climate smart agriculture \$0.2 trillion. These by no means exhaust the list of adaptation requirements; it only names those that might offer private investors reasonable returns. Such returns would be possible once inadequate facilities are remedied through investment and the resulting savings get redirected to investors from the present publicly borne costs.

For mitigation, investment requirements are strongly shaped, in part, by international commitments – the Nationally Determined Contributions (NDCs) of countries under the Paris Agreement. Investment requirements are even more strongly shaped by the most significant of these costs: human health and premature deaths in urban areas. The national studies for China have consistently shown that the costs of pollution exceed the costs of investments to avoid harmful effects. For example, air pollution in China costs an estimated 6.5 percent of GDP per annum (Crane and Mao, 2015).

³ These countries also fall into Poverty Reduction and Growth Trust fund (PRGT) eligible grouping of the IMF.

⁴ The UNFCCC has not agreed on an official definition and this formulation is from Warner et al. (2012). For more information, see Durand and Huq (2013).

⁵ Financing innovations through options pricing or contingent bonds to cover exposure to catastrophic natural event remain in an ‘experimental’ stage.

⁶ In the IFC (2020) list, it is difficult to differentiate mitigation from adaptation investments, but the analysis here treats headings with greater adaptation content as adaptation projects.

⁷ The countries included in the estimates were Bangladesh, Bhutan, India, Maldives, Nepal, and Sri Lanka.

FINANCING NEEDS FOR INTERNATIONAL COMMITMENTS ON MITIGATION

Countries in all the major Asia-Pacific subregions have made time-bound commitments to reduce greenhouse gas (GHG) emissions under the Paris Agreement. International journals are rife with analyses of these NDCs; a recent study of South Asian NDCs raises doubts about how strongly these plans have elicited stakeholder support (Haque et al., 2019). The APR has an extraordinarily strong climate mitigation potential, not only given the low level of clean energy sources currently installed, but also in terms of sources of wind and insolation⁸ power (Climate Analytics, 2019). For any country, meeting their NDC commitment raises the question of financing the investment and installing the supporting regulatory and market frameworks for transitioning to clean energy generation and transport.

Presuming an extension of their high-growth record, Southeast Asian countries have committed to ambitious mitigation targets in the future under their NDCs. NDC plans involve transitions to cleaner sources of primary and indirect energy, including increased dependence on gas and biofuel. One should note that the increased biofuels may create a potential impact on food security, especially if climate change impairs agricultural productivity. The commitments also propose significant conversions in the transport sector, including public transport. Among Southeast Asian countries, the Philippines offer the most ambitious emission cuts, which include a 50 percent reduction in CO₂ emissions below 1990 level. The implied target of per capita CO₂ emissions below 1 ton would be one of the lowest in the world (Fulton et al., 2017). Fulton et al. (2017) underscore that Southeast Asian NDC commitments are highly contingent on flows of external finance. This amounts to 70 percent in the Philippines, 41 percent in Indonesia, 45 percent in Malaysia, and 25 percent in both Thailand and Vietnam.

LIMITATIONS AND VULNERABILITIES IN THE INTERNATIONAL FINANCIAL SYSTEM

The cost of finance for the most credit-worthy borrowers has remained near zero since the onset of the 2008 subprime financial crisis. Logically, this situation presents an exceptional opportunity for governments and private investors to mobilize finance for climate investment. In this section, we seek to explain a crucial part of the anomalous situation, one that has seen enormous growth in financial investment, as opposed to investment in the physical, long-term requirements for climate action. Addressing the inadequacies of finance in this area will prove critical to the APR's development prospects and climate action success.

One should also recognize that the financial system itself has responded to an economic environment where the price of carbon is 'too low' from fuel subsidies along with other policies that, in effect, do not internalize the cost of air pollution (Coady et al., 2019; IEA, 2020). The cost of borrowing has stood at historically low levels due to the quantitative easing policies chosen by advanced economies (the European Union, Japan, and the United States) to forestall a financial

markets collapse following the 2007-2008 financial crisis. This strategy reduced the cost of borrowing to near zero and provided abundant global liquidity in exchange for unprecedented expansions of central-bank balance sheets.

Many central banks in industrialized countries reverted to quantitative easing policies with the onset of the COVID-19 crisis in February 2020. As in the previous episode, global liquidity has expanded enormously. In this instance, the US Federal Reserve System has engaged in generous purchases of high-risk ('junk') private bonds. The resulting liquidity in private companies may either go to purchases of equipment or increased hiring (the Federal Reserve's preferred channel), or to investments in other financial assets.

As of December 2020, the main debt propellants for developing countries are the fiscal demands arising from responses to the COVID-19 pandemic. Develop-

⁸ Exposure to the sun's rays.

ing country debt balances have dramatically worsened because of the pandemic, coming on the heels of already proliferating debt difficulties in 2019. The pandemic has thrown a harsh light on the limitations and vulnerabilities of the international development financing system.

NOT FIT FOR PURPOSE

Structurally, the international financial system mobilizes too little financing for physical investments required for the ‘dirty’ business-as-usual (BAU) economy. Thus, it is also unable to finance investment in newer, more technologically appropriate ‘green’ activities in production and consumption. Climate action also requires securing long-term financing. For the global community to have any chance of mobilizing adequate financing for climate action, thoroughgoing changes in the international financial system will be required (UNEP 2015). Asian-Pacific developing countries, most with open capital accounts, must manage their macroeconomies to fend off surges of inflows to avoid unwanted exchange rate appreciation and avoid sudden capital outflows in the short-term (Montes, 2013b). The great bulk of investment by private actors lies in other financial assets, with an eye to capital gains within a short period of time. In the starkest terms, UNEP (2015) characterized the system as ‘not fit-for-purpose’ and the “stability and effectiveness of key parts of the financial system, for example, remain at risk from short-termism and excessive leverage.”

The dominance of capital-gains-seeking investments follows from reforms in regulations (such as the 1980s reforms that weakened prohibitions against corporations⁹ buying back their own shares) and in accounting and tax treatments (such as lowering tax rates on capital gains). The structure of international finance caters to profitability through elevated financial returns without necessarily stimulating real (physical) investment. With market outcomes dominated by short-term considerations, climate-vulnerable countries and sectors will be unable to finance investments (Mackenzie 2021).

Under a capital-gains dynamic, profit from portfolio investments arises from changes in the price of a financial asset between the time of its purchase and the time of resale. This means that profits are also available on a portfolio position, called a ‘short,’ based on a contract to sell an asset at a future date, after the asset price has fallen. Investors do not have to make a judgment about whether a project will succeed in the long run; they can make money on positions that an asset

price will fall. For example, a position based on the judgment that a project will fail, or a particular country’s exchange rate will fall, can become enormously profitable within a short time frame. Shorts exacerbate the short-term bias of financial markets. In contrast, the returns on physical investments are only recovered in the long term, in fractional annual amounts.

INTERNATIONAL FINANCE’S DIFFERENTIATED WELCOME MAT

Economists have scrambled to explain why US interest rates and inflation expectations have remained low despite the massive injections of liquidity since 2008. These liquidity injections have spilled over internationally, leading to debt increases in developing countries. This unexpected pattern arises from the relentless trend in growing income and wealth inequality (both internally and internationally); if this explanation is correct, it makes the question of mobilizing climate finance even more complex.

Persistent trends in income and wealth inequality feed accumulations of financial asset pools in advanced economies that, in turn, generate a strong demand for so-called ‘safe assets’,¹⁰ defined as assets that keep their face value in the event of a systemic crisis. The supply of safe assets falls short of the demand, and fuels short-term placements in developing countries impelled by the ‘hunt for yield.’ This mechanism, as explained in Caballero and Farhi (2017), creates a self-feeding ‘safety trap.’ In advanced economies, the flagging capabilities of labour to secure its share of social output and the low consumption demand from the top 20 percent have slain the inflation dragon and pinned down interest rates to around zero (Mian et al., 2020). Labour’s flagging capacity to protect its share of value added had been greatly abetted by the collapse of the Soviet Union and China’s entry into world markets; both greatly augmented the global labour force and drove the consequent reduction in consum-

⁹ This rule, instituted in the 1930s to obviate stock market speculation in company shares, was weakened in the United States’ Reagan administration to encourage savings and financial investment. Along with the Friedmansque (1970) admonition that the sole social responsibility of private companies is to increase profits, and the tying of management compensation to the company’s share price, the rule change fostered management obsession with manoeuvres, such as stock buybacks and mergers and acquisitions involving substantial job cuts. As a result, companies have redirected profits towards supporting share prices without increasing physical capital investments by the enterprise (Lazonick, 2014).

¹⁰ For more information, see Caballero, Farhi and Gourinchas (2008).

“To achieve the SDGs, domestic resources would need a ramping-up. Developing countries in the APR would do well to expand their participation in efforts to change international standards of allocating taxing rights among jurisdictions”

er goods prices as mobile capital moved production to lower-wage areas (Goodhart and Pradhan, 2020).

Weak macroeconomic demand sustained by inequality ensconces a trend toward lower secular growth and lower fixed capital investment in advanced countries. Because the safe-asset trap arises from income inequality (or wealth inequality), and because reversing income inequality cannot happen instantaneously, the differences in financing costs between advanced and developing countries can hold sway for quite some time. Among countries, a stark gap has arisen in the cost of accessing funds from the same international pools. While borrowing rates remain near zero in advanced economies, developing countries borrow at rates of about 5 percent and higher.¹¹

Global governance mechanisms lack a process for sovereign debt resolution: a non-arbitrary (rule-based), comprehensive, predictable, and equitable method. International creditor committees currently manage such matters with little or no oversight – notably the Paris Club, properly called a club with the cachet of exclusivity, and one that violates common notions of good governance. In debt restructuring episodes, the debtor country barely sees¹² the so-called ‘bailout’ resources, which pass through the debtor to the creditor claimants in exchange for an increased level of indebtedness. Moreover, with the default risk transferred away from creditors by the debt regime, restructuring has triggered the vigorous restart of lending to debt-distressed countries, as we see in the enthusiastic private resumption of lending to Latin American countries.

The outbreak of developing country debt difficulties triggered by the pandemic has exacerbated could provide another opportunity for the establishment of an effective sovereign debt regime. In 2001, the IMF

spurred a substantial but failed attempt to establish a sovereign debt restructuring mechanism (SDRM), while, in 2014 and 2015, Bolivia and Argentina led a United Nations centred initiative with the support of the Group of 77 and China (El-Erian, 2021; Montes, 2016). Neither produced lasting results.

The analysis presented here assumes that the international financial system will remain substantially unchanged for at least a decade. During this decade, climate action cannot be set aside. The economies in the APR as a whole form one of two regions in the world that are net savers, excluding North America and Europe; the other region is the Middle East. Authorities in the APR need to acknowledge that, while these sets of countries have privileged access to international finance, they remain rule-takers, not rule-makers, in international finance.

Similarly, in international financial matters, economies in the APR function as price-takers rather than price-setters, and do not host the dominant managers of the supply of international finance. It would be prudent for the authorities in the APR to participate in and support developing country efforts intended to reform the hazard-laden international debt system, if only to protect their own development and climate action space. Authorities should not miss the opportunity - should it arise - to actively participate in a fundamental reform of the global sovereign debt regime. As internationally-oriented economies, logic dictates that these nations stand on the side of eliminating inefficiencies and inequities in the international financial system.

FINANCING CLIMATE ACTION IN AN UNFAVOURABLE FINANCIAL SETTING

There is little controversy over the lead role that states must play in climate action. Production and service activities almost everywhere depend on fossil-fuel technology. All investments and actions require the introduction of infrastructure and activities not yet in

¹¹ Interest rates on sovereign bonds fluctuate according to global market conditions and increase on countries with lower credit ratings. For rates during a period of abundant liquidity and low interest rates, see Presbitero et al. (2016). Interest for most developing country sovereign borrowing has increased with the pandemic (Chilkoti 2020).

¹² Greece as an international debtor is a recent example. See, among many other narratives, Nelson, Belkin and Jackson (2017) in which the persistent debt resolution issue always revolved around whether Greece would be able to meet the next payment owed to external creditors.

wide commercial usage. This section will focus on the matter of financing climate action. There is an urgent necessity to ramp-up public revenue performance within the ongoing global tax reform effort (Montes, Uribe and Danish, 2018). For climate mitigation action, Asian-Pacific countries seeking to introduce domestic¹³ carbon surcharges to lessen public deficits and reliance on foreign funding will require the sacrifice of part their international competitiveness in exports and in attracting foreign investment. A threat looms in recent European Community discussions about carbon border adjustment measures (CBAM);¹⁴ such measures could have implications for the APR's trade-based growth model, given its dependence on internationally dispersed production processes. Standard economic theory posits that such policies could tilt the terms of trade in favour of developed countries as a whole.

International public resources offer a second source of climate-action financing. Asian-Pacific countries have strong access to international finance institutions (IFIs). The emergence of new IFIs – notably the Asian Infrastructure Investment Bank (AIIB) and the New Development Bank, both under the leadership of China – has expanded the opportunities for the APR.

The third source is private financing from large international pools that are hypothetically available for climate finance. In the pursuit of effective climate action, with private financing mainly available as short-term placements as depicted above, governments may increasingly need to fully finance investments from tax revenues, or else compel the private sector to redirect the resources it now principally keeps in liquid financial assets towards physical investments for climate action. To compete with the private-profit bias toward quick asset-price gains, the public sector must also set priorities in extensive regulatory and standard setting actions congruent with climate priorities. These will not reduce the cost of climate action but can mobilize private investment; based on the record, public subsidies would also be required to prod private-sector behaviour towards new arrangements.

A direct route would introduce strong regulations designed to trigger private actions; such regulations would be strengthened by enforcing them via private insurance markets. For example, governments could upgrade building codes to limit new construction permits to climate-resilient facilities. These types of policies do not, however, reduce the costs of climate investments. The introduction of environmental, social and governance (ESG) standards into the activities of private companies resident in Asian-Pacific countries

“Asia-Pacific countries must take care not to walk into the trap of external indebtedness from climate action financing. International private debt markets still bear the same pitfalls as in the past”

can, of course, reduce the attractiveness of host countries.

Climate-motivated regulations, including ESG standards, aim to compel economic actors to internalize the prospective costs of climate change.¹⁵ These standards would apply both to public and private actors. Volz et al. (2020), for example, suggest that the countries most vulnerable to climate-change damage have paid 275 basis points more on the average on their sovereign debt. The finding derives from research measuring the implicit relationship between observed climate change costs and the sovereign risk premia. The result does not mean that finance providers have incorporated these costs directly in setting their risk premia (see the next section for a discussion on this.) Credit rating agencies, for example, have not incorporated these considerations in assigning bond ratings, although this practice has changed for large, internationally active companies.

These kinds of results bolster the argument that governments should invest and introduce regulations to reduce climate costs and strengthen environmental risk management, aiming to trigger market-driven adjustments. They have also been used to suggest that credit rating agencies should begin to incorporate climate considerations in their evaluations. However, credit agencies will only gradually apply these crite-

¹³ ‘Domestic’ is important here to preclude violating national treatment obligations in the World Trade Organization (WTO) and other trade obligations.

¹⁴ For more information, see European Commission (2020). This discussion will only intensify in the coming years.

¹⁵ For a contrary view – that markets augmented by freedom to contract already take care of externalities arising from corporate activities – see Fama (2020).

ria to corporate bond ratings because of the lack of agreed standards on methodology (see next section).

This brings us to the concept of ‘stranded assets,’ those that suffer from unanticipated or premature write-downs, devaluations, or conversion to liabilities (Caldecott, Howarth and McSharry, 2013). Collapses in the value of assets apply to all kinds of physical facilities, including farmland, manufacturing plants and power generation, and strike at the heart of the capital-gains dynamic of international financial markets – but not all at once. An effective response to such vulnerability would introduce regulations that force assets to be priced to fully reflect their climate vulnerabilities.

On 2 November 2021, during the 26th UN Climate Change Conference of the Parties (COP26), former Bank of England Governor Mark Carney, who originally warned of the systemic dangers of stranded assets (Carney, 2015), announced the formation of the Glasgow Financial Alliance for Net Zero (GFANZ), with \$130 trillion in private capital committed (GFANZ, 2021). We take the view, in line with UNEP (2015), that such an operation has the potential to wreak enormous damage on developing countries, similar to crises seen in the aftermath of petrodollar recycling in the 1970s, if global regulatory frameworks and private incentives are not comprehensively recast.

ESG STANDARDS AND FINANCE

ESG measurement methodologies involve reforms accounting standards in the first instance, augmented by other metrics to ensure that financial actors appropriately consider the climate impacts of their actions. A burgeoning global civil society movement

that aims to require IFIs – all owned by state parties – to halt all financing for all fossil-fuel energy projects is a regulatory version of this kind of consideration.

In the private sector, as reflected in the start-ups of numerous international task forces, intense interest has developed in finance, and most especially in the matters of ESG standards and climate-contingent debt instrument designs. These activities react to a mounting interest on the part of investors and willing-to-lend savers in increasing their exposure to climate change-related financing. Government climate action must emphasize the introduction of mandatory annual financial disclosures on climate risks for large enterprises.

A truly valuable development would be genuine behavioural change on the part of private companies (financial and non-financial), one that fully incorporates climate costs in their operations and in their investment decisions. Incorporating climate costs in operations will reduce accounting profits in the same instance that it can create reserves that could feed into climate-insurance pools.

“A truly valuable development would be genuine behavioral change on the part of private companies (financial and non-financial), one that more fully incorporated climate costs in their operations and in their investment decisions”

RECOMMENDATIONS

In arranging their financing for climate action, APR economies must operate within the international financial environment. Countries will have to raise climate finance in competition with external opportunities offering short-term returns. This section examines the various options countries could consider.

DOMESTIC FISCAL AND MONETARY ACTIONS

Prioritizing domestic action appears prudent in the uncertain and volatile international development climate. A first and necessary step in this direction is for Asian-Pacific countries to incorporate their climate change objectives and actions into their development planning and implementation. The all-inclusive SDG framework poses a challenge for each Asia-Pacific society in aligning its social progress, industrialization and poverty eradication ambitions with the framework's urgent call to combat climate change and its impacts.

Rethinking capital account openness

After decades of applauding capital-account openness on the part of development analysts and IFI staff, the IMF and analysts have begun to reconsider these kinds of policies (Kose and Prasad, 2020). Most countries in the APR have liberalized their capital accounts, even after the Asian financial crisis (Montes, 2013b). In contrast, China has applied a policy of phased opening, even after its currency qualified to become one of five in the IMF's special drawing rights (SDR) pool. In an article entitled "Neoliberalism: Oversold?" Ostry, Louganis and Furceri (2016) find the recurrence of balance-of-payments crises as a pattern that has reversed growth and worsened inequality. The authors cite Ghosh, Ostry and Qureshi (2016) on the dangers of capital surges through open capital accounts as a predicate for many of these crises. The IMF has already gone on record as supporting macroprudential controls during balance-of-payments crises.¹⁶

For expanding climate finance, capital controls offer a key advantage: a borrowing rate for physical projects that does not compete with short-term external financial returns. China supplies one example of a country that has made good use of its gradual capital account opening. China's controls help its state banks provide low-interest-rate loans to businesses. Capital controls also help China limit volatility that could otherwise im-

pair the soundness of its commercial banks—especially given the country's weak regulatory institutions—and induce price volatility in its real estate market, the main investment opportunity for Chinese households (Shaw and Eidelman, 2011).

The Republic of Korea also has a well-known record of extensive capital controls during its period of rapid growth within its state-led development strategy (Noiland, 2007). Park (2011) characterizes the shift in the view towards capital controls as one from cardinal sin to policy agenda, based on Korea's experience with financial crises from 1997 to 2011. The 2010 Seoul G20 summit, over which the Republic of Korea presided, discussed policies to reduce balance-of-payments imbalances, including capital control policies (Park, 2011).

One should recognize caveats concerning the perils of reintroducing capital controls in countries that already have open capital accounts. For these countries, whether they would have benefited on a net basis or not, private portfolio inflows and outflows remain critical for balance-of-payments health. Any reintroduction of controls should take place in a phased manner that gives external portfolio investors time to understand their purpose, to avoid drastic reversals in portfolio positions that would themselves trigger a crisis.

In the APR, private financial flows have earned a hair-trigger reputation – one susceptible to 'herd behaviour' as seen in the Asian financial crisis (Montes, 1998). For example, at the beginning of COVID-19 pandemic, to provide fiscal space for eligible low-income¹⁷ economies (such as Myanmar), the Group of 20 (G20) introduced a Debt Service Suspension Initiative (DSSI)¹⁸ that suspended developing countries' debt service payments to G20 bilateral lenders effective

¹⁶ Note that capital controls should remain available even in normal times, in order to reinstate monetary and fiscal policy tools that industrialized country authorities have increasingly made available (Montes, 2013b). See also Shaw and Eidelman's (2011) elaboration.

¹⁷ Eligibility included the least-developed countries and those participating in the PRGT or Poverty Reduction and Growth Trust (PRGT), a concessional lending vehicle of the International Monetary Fund.

¹⁸ In November 2020, the G20 began replacing the DSSI with the Common Framework for Debt Treatments Beyond the DSSI, applicable to the countries qualifying for DSSI but now recognizing the need for debt restructurings (euphemistically termed "debt treatments") to address solvency issues whilst DSSI only dealt with liquidity shortfalls (Ministry of the Economy and Finance, 2020).

May 2020 (Reuters, 2020). As of early November 2021, only 46 of the 73 eligible countries have applied for the suspension, owing to their authorities' fears of a credit rating downgrade (Kaiser and Kopper, 2020). The interpretation that debt-service suspension reduces the credit standing of an economy conflicts with a view that having greater fiscal resources improves it. To manage the introduction of capital controls, Asian-Pacific countries should seriously consider negotiating a set of mutually acceptable standards on these kinds of policies.

Reforming regulatory approaches to elicit climate finance

As discussed earlier, some of the needed financing can flow through regulatory changes. Well-known actions of this kind include feed-in tariff regimes or the upgrading of construction and building standards and codes, enforced by insurers. Authorities can withdraw incentives and subsidies for 'dirty' economic activities at a rate that avoids employment dislocation. Mandatory disclosure and reporting requirements for enterprises can elicit private actions that draw on financing flows from ESG-inspired funding pools.

Strengthening national tax systems

Actions that strengthen national tax systems and make them more progressive will build a longer-term underpinning for APR development financing. Such actions can include increasing taxes on monopoly-position rents. Countries could initiate these even while the pandemic continues. Developing countries in the APR would do well to expand their participation in growing efforts to change international standards of allocating taxing rights among tax jurisdictions. Unfortunately, predominant standards backed by developed countries through the Organisation for Economic Cooperation and Development (OECD) facilitate the transfer of profits out of the territory where they originate, disadvantaging developing countries that host foreign investment (Montes, Uribe and Danish 2018). Because it was launched on the mandate that the OECD project on Base Erosion and Profit Shifting (BEPS) would sidestep issues involving the allocation of taxing rights between source and resident countries, the outcomes of the project did not address the channels through which profit transfer facilitation takes place in developing countries, such as in mining subsidiaries and payments for technical services among related companies (Montes, Uribe and Danish 2018). The Wall Street Journal (2021) characterized the resulting October 2021 G20 agreement on OECD-designed tax reforms as "G-20 Backs Tax Overhaul That Makes Rich Countries Big Winners."

Asian-Pacific countries must oppose trade regimes that create a permanent hole in their public finances, such as making permanent the tariff moratorium on digitalizable goods trade under the World Trade Organization (Kelsey et al., 2020).

Governments will need to direct new and additional public resources toward climate and development action consistent with efforts to achieve the SDGs – and not toward external debt service.

TAPPING EXTERNAL SOURCES OF FINANCE

The modalities, the volume, and the possibility of external financing for climate action have garnered the greatest policy and diplomatic attention; the discussion of the previous section must serve as a corrective and a caution. Given the potentially enormous resources required for climate action, Asian-Pacific countries must take care not to walk into the trap of external indebtedness from climate action financing. Here we shall review various actions for accessing external finance and examine their implications for national indebtedness and development space.

Borrowing from international sources

Sovereign borrowing from international sources has evolved in a variety of ways. The number of funds has proliferated, driven by donor interest and the variety¹⁹ of needs with perceived climate-related purposes. For example, dedicated funds now exist for adaptation, but these remain of a much smaller size than the variety of mitigation funds set up by donor countries. Each of these funds has its own modality of access, but all share the feature of lending based on intended projects (or programs) for repayment. The Green Climate Fund, the financial agency under the UNFCCC, has the distinction of having a board providing equal representation among industrialized and developing countries.

This section will not evaluate these funds from the point of view of APR climate funding. Mariama Williams (2019) provides a useful summary and state of play of these funds. Instead, this section will focus on new developments in borrowing for climate financing. Many of the caveats identified in this section would also apply to other funds with a longer record.

¹⁹ For a listing of the existing funds, see Henrich Böll Stiftung and ODI (2020).

Green bonds and SDG bonds

In keeping with the overall growth of debt finance globally, green bonds have recently shown robust growth. While no single standard exists for what constitutes a green bond, the equity fund Blackrock (Weng, 2020) reports an estimated \$700 billion of green bonds outstanding – less than 1 percent of the size of the global bond market (about \$128.3 trillion). Nevertheless, these kinds of bonds have attracted much attention, and the largest equity and hedge fund companies' home pages trumpet their interest in financing climate sustainability. In the APR, China is one of the large issuers globally; other countries have done issues on a much smaller scale, including Indonesia, the Philippines, Singapore, and Thailand, even though the attractiveness of green bonds suffers in comparison with standard bonds given their higher costs to the issuer (O'Donnellan, 2019).

The SDG bond has emerged as a new and significant type, with its first example in an offering that UNDP (2020) helped to facilitate in September 2020, generating substantial interest. Because a key feature of the first SDG bond involves domestic economic reforms, questions that bedevilled the conditional lending that IFIs undertook as part of the structural adjustment effort in the 1980s and 1990s resurface. In those years, indebtedness in exchange for economic reforms did facilitate a faster rate of access to foreign exchange but did not necessarily bring about the necessary increase in output and domestic incomes required to service external debt. In the case of structural adjustment loans, trade liberalization was supposed to bolster exports performance (for example), but such increases did not materialize in a timely manner, and the loans instead resulted in higher external debt²⁰ when imports increased much faster.

In the case of climate finance, the main issue – paralleling the one that authorities should have paid attention to in the case of structural adjustment – concerns timing: the point when shadow prices from environmental considerations will generate actual user payments and additional tax revenues, making it possible to service the green or the SDG bonds. How much longer will fossil-fuel prices remain low in actually existing markets? These considerations also argue for giving more attention to adaptation and loss-and-damage projects, which may generate user fees or savings in terms of avoided damage from climate disasters.

International private debt markets also still bear the same pitfalls as in the past, though now with a greater variety of lenders and investors. The main drawback is

the debtor-bearing-all default-risk feature, as in other external funding instruments. In an important sense, and even as green bonds have already become more expensive to the issuer, these debt instruments are mispriced, in that they do not reflect the possibility of restructuring and debt service delays if the underlying assumptions prove overly optimistic.

Asian-Pacific countries must consider restricting external borrowing for climate finance to those portions of a project or program that genuinely require hard currency: for instance, features requiring imports. Relying on green bonds or SDG bonds to fund chronic trade deficits that externally-obtained resources will not directly alleviate could eventually prove inimical to climate action.

DEBT RESTRUCTURING FOR CLIMATE FINANCE

Since the developing country debt crises of the 1980s, various mechanisms have been proposed that might generate climate finance.

Debt-for-nature swaps

The periodic onset of developing country debt crisis has elicited debt-for-nature swap proposals; a few of these have been tried, with mixed results (Fresnillo, 2020; Kessel 2006). While debt swaps for environment projects could serve as part of the climate finance toolkit of those Asian-Pacific countries in need of debt restructuring, they call for very judicious use to avoid the pitfalls of previous projects.

Almost all debt-restructuring operations have involved the swapping of one bond for another - a debt-for-debt swap, with the new debt extinguishing a portion of previous debt service obligations but with an upgraded seniority status. Debt-for-nature swaps apply to specific loans and projects, instead of involving an overall (national) debt workout; in this lies the basis of many of their difficulties. These kinds of swaps came from suggestions made by the international environmental movement. Their pitfalls and vulnerabilities have generated a longstanding literature arising from public priority distortions. Solving the debt-servicing problems of a particular loan or project raises the priority of that project in the universe of domestic economic priorities. In many cases,

²⁰See, for example, Kızılgöl and İpek (2014) for Turkey and Zafar and Butt (2008) for Pakistan.

these kinds of swaps create privileged claims for certain policies and for specific sectors in the domestic economy whose agendas coincide with the interests of the foreign financing party, but not necessarily with domestic priorities. Indebted countries should only consider such swaps if they are willing to reorder domestic priorities in their favour.

Swaps raise the issue of the role of policy conditionality. These debt manoeuvres have often required the mediation of international financial institutions whose policy preferences may clash with those of distressed sovereign states. There are cases where these swap projects have ridden roughshod over the rights of indigenous groups, as have other foreign-funded projects, especially since national governments may pay little attention to these local issues, such as the need for a livelihood (Bryant and Bailey, 1997).

Because of their complex payment schedules, there could be cases where a straight write down of the face value of the debtor country's external liability could free more resources for climate action than a debt-for-nature swap. Swaps can also create claims on future public current expenditures if they trigger yet-unbudgeted operating and enforcement activities.

Voluntary debt buybacks

Developing country debt crises create opportunities for voluntary debt buybacks. Savings from debt buybacks can go towards financing climate action, as recently proposed by Stiglitz and Rashid (2020). A voluntary debt buyback takes advantage of the discount on the face value of sovereign debt paper. Stiglitz and Rashid (2020) propose a Bretton Woods-mediated process. The IMF can play a central role by purchasing developing country bonds at the discount, perhaps funded through its New Agreements to Borrow facility or donations of SDRs. Such an approach to a debt crisis offers the advantage of avoiding the austerity measures often required for countries in distress to maintain debt service.

Stiglitz and Rashid (2020, p. 19) further propose an alternative conditionality – that debtors “agree to spend the savings on creating and promoting global public goods,” in which they include public health expenditures and climate change mitigation and adaptation (but not loss-and-damage). They argue that this will enhance donor buy-in and inhibit creditors whose bonds do not receive buyback from resorting to litigation. Nothing would prevent developing countries from buying their own bonds using the resources they have on hand, for example using some of their international reserves, especially with steep discounts available.

This will create climate finance space in the future at the cost of drawing down current reserves.

Unlike a new-issue SDR, voluntary debt buybacks do not create additional fiscal space instantaneously. They have usually appeared in debt restructuring processes involving conflicts with private creditors or with credit-rating agencies. These agencies have the power to determine the market basis of such actions – that is, whether they are truly voluntary or the equivalent of a default that could affect the indebted country's credit standing. Even with the bespoke participation of a market-maker, such as the IMF, credit rating agencies could very well classify a buyback as a loan restructuring, effectively a default, just as in the case of the Brady bond swaps in the late 1980s (Federal Reserve System, 2011). Furthermore, in previous experiences (most recently for Greece), news of the possibility of a generous buyback shrank the discount and thus the level of debt reduction achieved, although that did not prevent large hedge funds from making enormous asset gains from the transaction by buying early at the lower price (Thomas, 2012).

SPECIAL DRAWING RIGHTS-FACILITATED CLIMATE FINANCE

SDRs are international reserve assets of the 189 member states of the IMF. SDRs are not issued by the IMF staff but by IMF-member countries, as provisions to increase their supply of bank reserves useful for international transactions. Countries can use SDRs to meet external financing needs, help ward off financial crises, balance payments crises, and maintain the confidence of financial markets.

New issues of SDRs

SDRs are a liability of the IMF, which is a cooperative, rather than the debt of any single country. The IMF pays interest on SDRs based on the weighted average of the short-term rates of the five currencies in the SDR basket (US dollar, Euro, Japanese yen, pound sterling, Chinese renminbi). Developing countries pay much higher interest rates on their external borrowings. Newly-issued SDRs thus provide developing countries access to the holiest of holies, usually only reserved to the world's largest economies – expansion of their fiscal space using international resources at the lowest interest rates possible.

The standard method of SDR allocation follows existing quotas, which means that countries with more

votes in the IMF get considerably more resources. Industrialized countries, with their greater weight of IMF votes, will receive an overwhelming proportion of a standard SDR distribution (Mnuchin, 2020). However, large SDR distributions may have considerable scope without risking global inflation, as suggested in a study commissioned by the IMF that finds the probability of SDRs igniting global inflation highly unlikely, with other factors serving as more important determinants (Cooper, 2011). Larger SDR distributions can augment the reserves of the smaller countries, which can convert these new reserves to hard currency for financing climate action, without taking on more debt.

Another possibility is the use of SDRs as asset backing for the issuance of international bonds to finance climate action, as explored in Bredenkamp and Patillo (2010). IMF member states could authorize issuance of new SDRs for this purpose. Countries that do not need their SDRs could donate their balances as equity to the fund. Such a fund would borrow on international capital markets and on-lend the resources for climate projects.

A third possibility would be to issue SDRs independent of the IMF quota allocation, as proposed by the Group of 77 (G77) and China at the United Nations “Conference on the World Financial and Economic Crisis and Its Impact on Development” (24-30 June 2009, New York). Both this kind of action, and one for a new SDR issuance beyond the current capital corpus of the IMF, will require US Congressional approval. However, the executive branch of the United States can vote for an amount equal to the IMF’s capital (around SDR 500) and only requires notification of Congress.

As an example, in response to the COVID-19 pandemic, an overwhelming majority of IMF members supported a call for a new issuance of SDRs in 2020. With its 16.5 percent voting weight in the IMF, and seigniorage advantages in the global payments system, the United States has an essential role in situations when SDRs are urgently needed. Under its new administration, the United States joined other IMF members so that on 23 August 2021, a new general allocation of SDR 500 billion (about \$650 billion) became effective (IMF, 2021). This sets a precedent for further new allocations.

SDR facilities to bolster climate financing could increase soon

At the COP26 in November 2021, Barbados Prime Minister Mia Mottley called for another new, annual SDR issuance of \$500 billion for 20 years to be applied to climate finance (Worley, 2021). New SDR issuances can support climate finance in two ways – first on a coun-

try-by-country basis, second as backing to raise international finance. The first option would provide hard currency resources for Asian-Pacific countries without creating new debt. The second one would create a pool of funds that provide a lending facility.

Should the prime minister’s proposal find concurrence, it could finance a significant proportion of the commitment made by developed countries in 2010 under the UNFCCC (United Nations, 2011a) to provide \$100 billion annually in climate finance beginning in 2020, a deadline they missed.

The most climate-secure path to turn this proposal into a reality would start with a decision of the country-Parties in the UNFCCC. That would be followed by the IMF board of governors enacting the annual SDR distribution to its members (who are the same country-Parties), because new SDR distributions require an 85 percent majority of weighted IMF-member votes in order to be accepted. Once again, the United States, which controls 16.5 percent of the weighted votes, must be part of this UNFCCC and IMF decision.

Such an SDR distribution, when distributed in the standard way according to quotas of member states, would be deposited as additional balances in IMF members’ international reserves. When distributed according to existing quotas, the group of developing countries would receive 39.5 percent of the issuance. Because the resources originate with the UNFCCC, the developing countries would be morally bound to apply them to climate action.

Developed countries would be similarly bound to apply their share of the new resources to financing climate action in developing countries. The developed countries could either donate these resources directly to an IMF-managed trust fund or they could make grants directly to developing countries, using facilities mediated by the IMF. The advantage of direct grants is that they do not require conditionality and do not increase developing-country debt.

POLITICAL ECONOMY CONSIDERATIONS

This analysis rests on the premise that the structural features of the international financial system severely hamper climate finance options. Developing economies in the APR must contend with high financing costs for their physical climate investments because they must compete with the higher returns available to their private investors. The remedies proposed in this paper, beyond a proliferation of genuinely national climate action plans, call for greater regulation of international capital flows, strengthened tax systems and support from authorities in the APR for reformed sovereign-debt processes and increased use of SDRs. As an analysis addressed to the APR, these proposals carry important political economy considerations.

While the APR is not a dominant venue of financial centres, a few of its countries have sought to expand their reach and ascendancy in these markets. These countries would tend towards scepticism and hostility to greater national interventions regarding capital flows, in taxation and sovereign-debt resolution reforms. This paper argues that the proposed remedies would not only be appropriate for financing climate action; they would also prove necessary for the long-term sustainability and efficiency of international financial markets.

The differences among sovereign states in the APR also arise from dissimilar notions about what constitutes efficiency in international markets, or about the most effective strategies for development. Even with these differences, more detailed research can inform progress toward action – for example, on the borrow-

ing rate needed to finance physical investments that reduce the cost of extreme weather damage. From this basis, the APR may to consider how to facilitate finance for such requirements.

Most probably, authorities in the APR will wade into financing climate action within the existing financial system. In 2021, interest rates have begun to rise in response to indicators of a solid economic recovery in the United States; this will raise external funding costs in developing countries (Adrian, 2021). Higher external funding costs will increase the probability of debt restructuring events in developing countries, a trend which had already begun in 2020 (Munevar, 2021). There is a non-zero probability of a global financial crisis beginning in 2022 if real economic recovery in industrialized countries proves unexpectedly strong. Authorities in the APR should move quickly toward a more proactive stance in addressing the sufficiency of climate finance and placing their financial sectors on a surer footing.

“Could the APR simply continue current development paths without the extensive and expensive alternative investments? Recent events suggest that the answer is 'No,' and that the business-as-usual option may be no more feasible than desirable”

LIST OF TABLES

Table 1: Range of climate change impacts on Asia-Pacific country GDP, 2040-2059

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ABOUT THE AUTHOR

Manuel F. Montes works as a senior advisor for the Society for International Development. Previously, he served as a permanent observer to the United Nations and as a senior advisor at the South Centre. Montes also worked as development strategies chief for the UN Department of Economic and Social Affairs (UNDESA), UNDP regional programme coordinator for the Asia Pacific Trade and

Investment Initiative, program officer at the Ford Foundation, economics studies coordinator at the East-West Centre (Honolulu), and associate professor of economics at the University of The Philippines. Montes has held visiting research fellowships in Tokyo (IDE), Helsinki (UNU/WIDER) and Singapore (ISEAS) and holds a doctorate in economics from Stanford University.

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REIMAGINING DEVELOPMENT POLICY AND STRATEGY IN ASIA-PACIFIC

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Strategy, Policy and Partnerships Team
UNDP Regional Bureau for Asia and the Pacific (RBAP)
One UN Plaza, New York, NY 10017, USA
Tel: +1 212 906 5000
www.asia-pacific.undp.org