REPORT

Breaking the cycle of risk

Addressing resilience and debt for a new global financial architecture

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About E3G

E3G is an independent climate change think tank with a global outlook. We work on the frontier of the climate landscape, tackling the barriers and advancing the solutions to a safe climate. Our goal is to translate climate politics, economics and policies into action.

E3G builds broad-based coalitions to deliver a safe climate, working closely with like-minded partners in government, politics, civil society, science, the media, public interest foundations and elsewhere to leverage change.

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Summary

As we consider how to reform the international financial architecture, we have the opportunity to map the journey out of the debt and resilience crisis for climate vulnerable countries. This paper explores the geopolitics of debt and finance in relation to the critical need to build resilience globally and specifically in relation to those countries at the forefront of climate impacts.

Studies show that investment in resilience is very worthwhile, with benefit:cost ratios ranging from 2:1 to 10:1. However the annual costs of adaptation could be as high as

$565bn

by 2050

KEY FINDINGS:

Resilience, or the ability to bounce back, is essential to the success of economies and societies.

Building resilience is a matter of coping with shocks, adapting to change and transforming in the face of persistent systemic change. Without increasing resilience, we will see more damage to people's health, and their economic and social wellbeing. While building a country's own resilience is important, each country also depends on the resilience of others, whether neighbours or in some cases countries far away, but which are essential suppliers of food or other goods.

Studies show that investment in resilience is very worthwhile, with benefit:cost ratios ranging from 2:1 to 10:1. However the annual costs of adaptation could be as high as $565 billion by 2050. There is a big investment gap, much of which will have to be met by public expenditure, and hence public borrowing. The countries most vulnerable to climate are often also highly indebted. Even as those countries are growing their economies, and developing their own capital markets, they will be increasingly dependent on borrowing. International Financial Institutions will be central to this.

Debt levels across the world have been rising, with particular pressure on low-income countries (LICs).

This creates a vicious cycle between the debt and climate crises, intertwining a lack of economic resilience with a lack of climate resilience. Vulnerability itself leads to higher interest rates, making debt harder to pay off. The current debt crisis is different to previous ones, in that the mix of creditors is much more varied, geographically and in terms of creditor types. In addition, the availability of financial aid remains inadequate.

Climate resilience, and debt restructuring are now geopolitical issues.

This means that the international discussions have now gone beyond technical fixes, to reform of global systems. This reform is now an active debate, stimulated in part by Barbadian Prime Minister Mia Mottley, that has worked through the Summit for a New Global Financing Pact in Paris in June 2023, to Brazil's presidency of G20 in 2024. However, in the absence of a global settlement, many countries are forced to rely on bilateral deals, often as much about geostrategic competition as resilience support.

Clear roadmaps, and transition plans, will help frame the roles, and actions, of debtor countries, their donors and creditors in emerging from the present crises.

However, the debt products, the institutions, and the whole social contract between these parties must move to a more mutually engaged and supportive one, if the world as a whole is to move to a more resilient future.

Introduction

The world is facing interlinked climate and debt crises. Each has the potential to make the other worse. The impacts of climate change damage economic assets, so people, businesses and states must invest to replace them. Outsized debt burdens make economies less resilient, and restrict the fiscal capacity that is needed to replace assets lost, and the investment in resilient and climate friendly solutions for the future.

The commitment by developed nations at COP15 in 2009 was to mobilise

$100bn

a year by 2020[1]

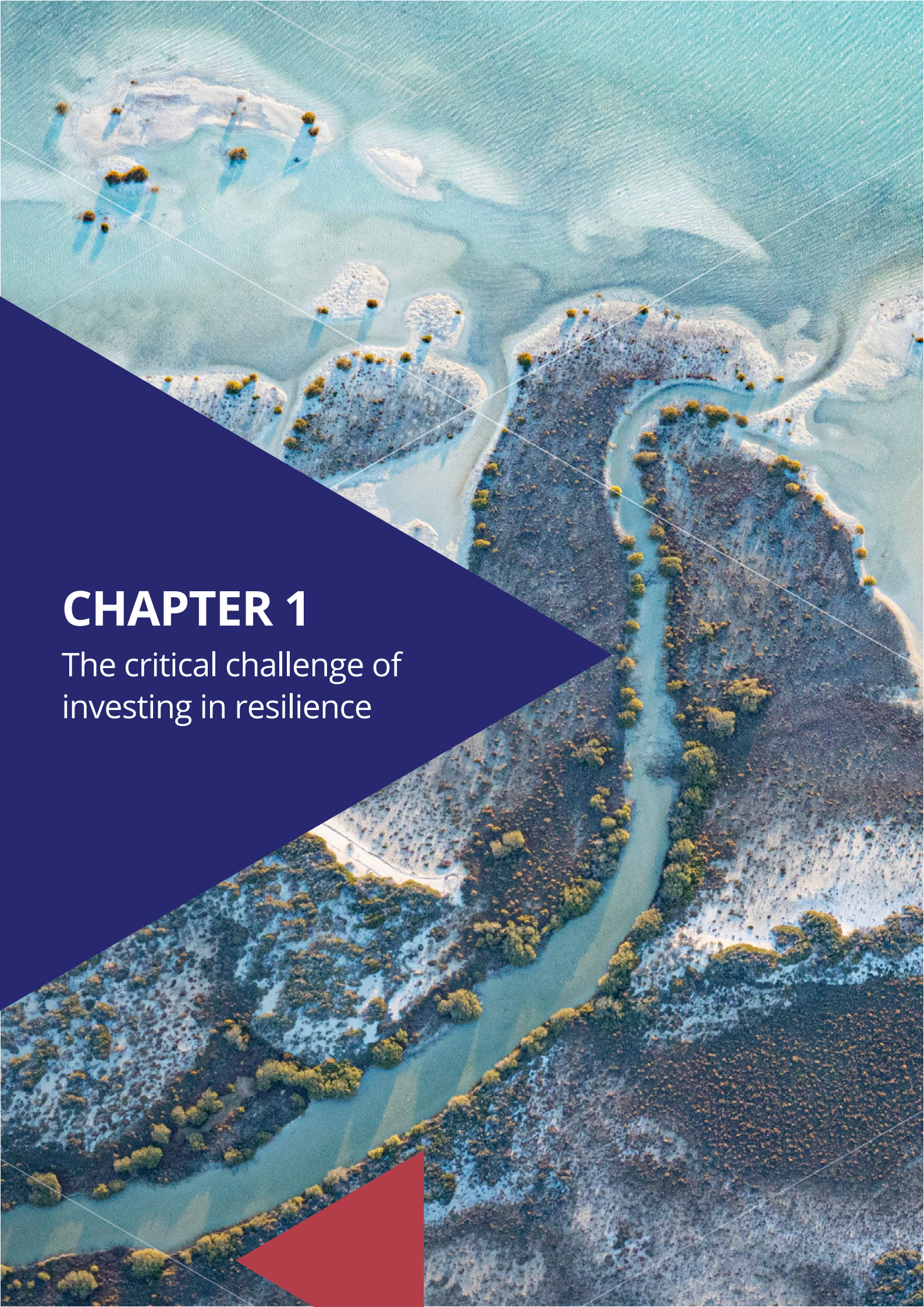
To date, much of the focus on debt and fiscal space is from the perspective of ensuring that there is sufficient finance to invest in climate mitigation and adaptation. An example is the commitment by developed nations at COP15 in Copenhagen in 2009 to mobilise $100 billion dollars a year by 2020.[1]

In this paper, we address debt and climate through the lens of resilience.

The more resilient a country is, the more it can address crises such as debt and climate. But of course, climate and debt also negatively impact the resilience of societies and economies. To ensure that these twin crises don't conspire to keep countries in frozen and climate-vulnerable states of development, we need to find pathways out of this negative feedback loop.

In this paper, we map the critical nature of resilience, especially in the light of climate change; we examine the evolving debt crisis, and what makes this present situation particularly challenging; and we explore why action is so politically and geopolitically contentious. With this background, we outline some possible ways forward to resolve these issues.

1 "In the context of meaningful mitigation actions and transparency on implementation, developed countries commit to a goal of mobilizing jointly USD 100 billion dollars a year by 2020 to address the needs of developing countries." The Copenhagen Accord of 18 December 2009. **https://unfccc.int/resource/docs/2009/cop15/eng/11a01.pdf**



CHAPTER 1

The critical challenge of investing in resilience

1

The critical challenge of investing in resilience

Summary

> Resilience, or the ability to bounce back, is essential to the success of economies and societies

> Building resilience is a matter of coping with shocks, adapting to change and transforming in the face of persistent systemic change

> Without increasing resilience, we will see more damage to people's health, and their economic and social wellbeing

> Building a country's own resilience is important, but each country also depends on the resilience of others, whether neighbours or in some cases countries far away, but which are essential suppliers of food or other goods

Resilience, and why it matters

Resilience is a widely used term, and its meaning can differ depending on the system, vulnerability and risks to which it refers. Definitions of resilience include "the ability to 'bounce back' from a shock" and having the capacity to "persist, adapt and transform in the face of change".[2]

In the context of climate change, resilience means the capacity to thrive despite the many shocks and stresses caused by a warming world, and the capacity to thrive as we make the changes to production and consumption that will be necessary to address climate change. This focus on continued development and prosperity following a shock or stress is vital. It means truly grappling with the climate crisis in the long term, rather than simply mitigating the worst possible outcomes in the short term.

2 This is the definition used by the Global Resilience Partnership; see, for example: Global Resilience Partnership, September 2019, **Resilience Insights Report**. The Stockholm Resilience Centre similarly defines resilience as "the capacity of a system (...) to deal with change and continue to develop" (Stockholm Resilience Centre, 19 February 2015, **What is resilience?**)

Adaptation is critical in helping to reducing vulnerability and an important subset of resilience building

Climate risks will be specific to geographies. However, the strategies used to build resilient societies and economies will share commonalities across all geographies. The first step will always be a risk assessment, because that leads to the understanding of the associated risks and will enable a state to develop risk management strategies and contingency plans.

Risk is in itself made up of a hazard (the threat) and vulnerability (exposure and susceptibility to, and the capacity to cope with, the threat). In the case of human induced climate change, the only way of reducing the threat is by decreasing the level of greenhouse gases in the atmosphere. However, we have more agency, and more choice, in how we reduce vulnerability.

Having identified the vulnerabilities through an assessment of risk, we can then develop critical interventions to reduce the vulnerabilities and build resilience. The interventions needed to do this have been categorised under three headings: coping, adapting and transforming.[3] The ability to cope is clearly enhanced when a country has access to reserves, or aid, in the event of a challenge to resilience. Indeed, in any country, a climate change-induced event will require a strong element of just coping – dealing with a catastrophe, and getting back on ones feet.

Adaptation – the process of adjusting to the actual or expected effects of climate change – is critical in helping to reducing vulnerability and an important subset of resilience building.[4] Actions like preserving mangrove forests or retrofitting infrastructure to withstand stronger and more frequent storms are examples of addressing vulnerability by helping to reduce damage to physical assets. Community-focused solutions – such as insurance mechanisms that transfer risk – also play an important role in limiting the negative effects felt by communities. Combining multiple strategies together creates a comprehensive approach to managing vulnerability, and allows countries to grow and flourish despite shocks and stresses.[5]

In some cases, adaptation may only provide a temporary solution to climate vulnerability and may simply delay (or increase the cost of) more transformative approaches that could become necessary.

3 Christophe Béné, Andrew Newsham, Mark Davies, Martina Ulrichs and Rachel Godfrey-Wood, 2014, **Review article: Resilience, poverty and development**

4 Sara Mehryar, 12 September 2022, **What is the difference between climate change adaptation and resilience?** LSE Explainer

5 C2ES – Center for Climate and Energy Solutions, April 2019, **What is Climate Resilience, and Why Does it Matter?**

For example, a country may have to accept that some land will be lost to increased coastal erosion or sea level rise (so called 'managed retreat'). In other situations, a country may need to transform parts of its economy (e.g. moving away from a certain type of agriculture that is no longer possible under the new climate conditions) and/or society (e.g. adopt new working habits to deal with extremes of heat).

The costs of inaction will mount

Without investment in resilience, and investment that is itself resilient, a country will rapidly find that its realisation of other national priorities is threatened. The Working Group II contribution to the Sixth Assessment Report by the Intergovernmental Panel on Climate Change (IPCC) unambiguously shows how climate-induced disasters are already resulting in massive economic and other losses and hindering progress towards achieving development goals:[6]

The World Health Organization estimates that the annual cost of direct damages to health from climate change will be between ***$2-4bn*** *by 2030*

> The World Health Organization estimates that, by 2030, the annual cost of direct damages to health from climate change will be between $2 billion and $4 billion, and that between 2030 and 2050, air quality, vector-borne diseases and malnutrition are expected to cause 250,000 additional deaths every year.[7]

> The World Bank estimates that 216 million people will be internally displaced by 2050 in sub-Saharan Africa, South Asia and South America alone.[8]

> From the 1970s to the 2010s, global economic losses from climate hazards increased sevenfold, from an average of $49 million to $383 million per day.[9] In 2022, extreme weather is estimated to have caused insured losses of around $115 billion, well above the 10-year average.[10]

6 IPCC – Intergovernmental Panel on Climate Change, 2022, **Climate Change 2022: Impacts, Adaptation and Vulnerability,** Working Group II Contribution to the IPCC Sixth Assessment Report

7 WHO – World Health Organization, 12 October 2023, **Climate change and health**

8 The World Bank, Groundswell Report, September 2021, **Climate Change Could Force 216 Million People to Migrate Within Their Own Countries by 2050**

9 UN News, 1 September 2021, **Climate and weather-related disasters surge five-fold over 50 years, but early warnings save lives – WMO report**

10 Swiss Re, 1 December 2022, **Hurricane Ian drives natural catastrophe year-to-date insured losses to USD 115 billion, Swiss Re Institute estimates**

Each of these events impacts resilience in health, communities and the economy. The combination of such impacts damages the ability of a state as a whole to recover and thrive.

Resilience is a transboundary issue

Success in climate action and in building systemic resilience needs international action

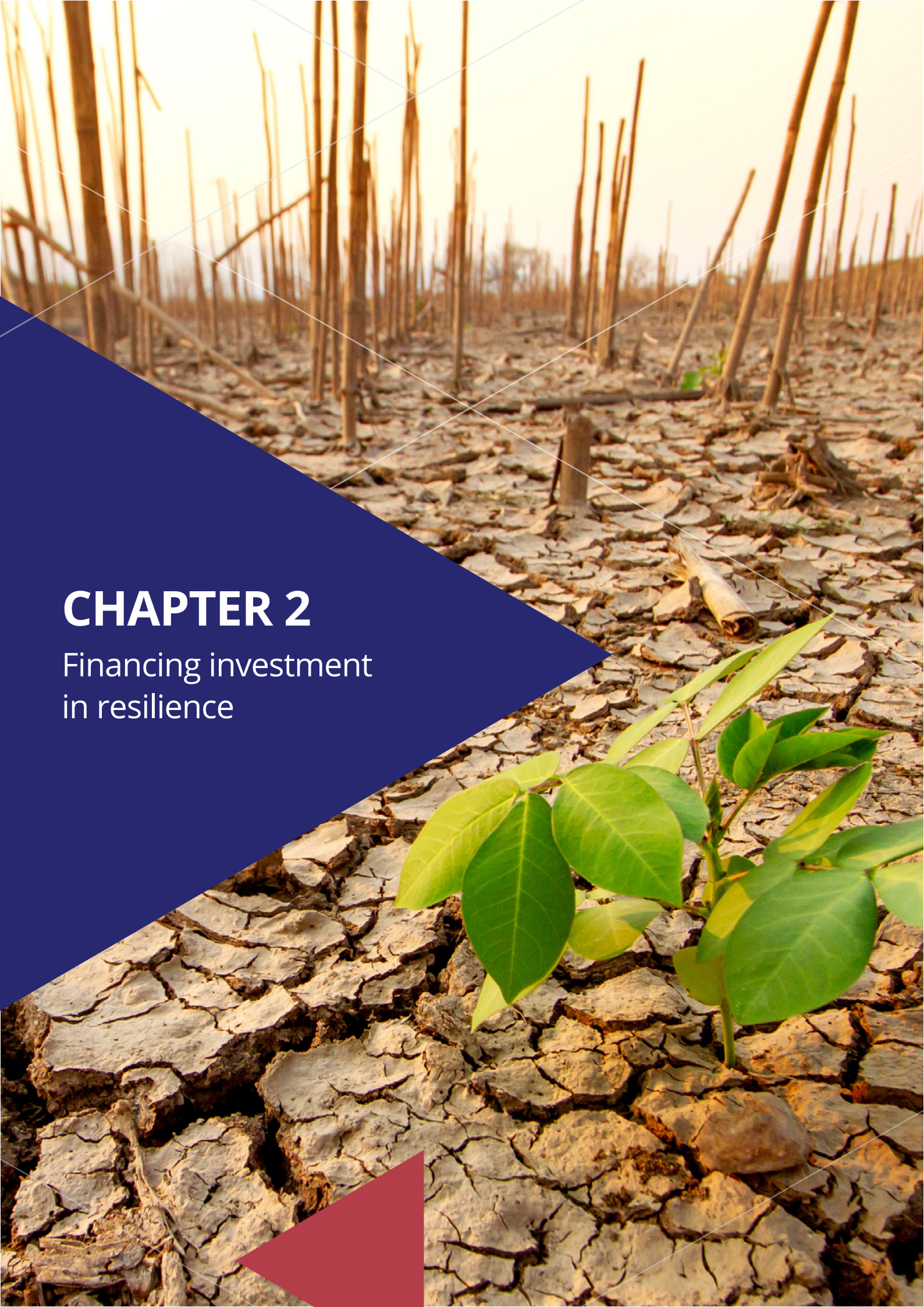
Climate impacts know no borders. The effects in any one country or region will interact with global systems in complex ways and with cascading interdependencies. During 2023, Canada saw extreme wildfires, caused by drier and more arid conditions in forests there. The smoke from the forest blew south, and many of the harmful effects to human health were also felt throughout the Eastern United States.[11] In 2019, Cyclone Idai caused catastrophic damage and loss of life in Mozambique, Malawi and Zimbabwe when it made landfall on the coast of East Africa. However, it also affected South Africa's electricity grid, because it is part of the regional Southern African Power Pool.[12] Russia's invasion of Ukraine in 2022 shook food and fuel prices globally, affecting least developed countries the most.[13]

Therefore, while it is vital to build resilience in-country, by itself that will not be enough. It is every bit as important to build the conditions for global resilience. In a very real sense, until we are all resilient, no one of us will be fully resilient. Every country needs not only to pursue its own resilience goals, but should also have a strong interest in the ability of other countries to be resilient. This means that success in climate action and in building systemic resilience needs international action.

11 Carbon Brief, 9 June 2023, **Media reaction: Canada's wildfires in 2023 and the role of climate change**

12 Adaptation Without Borders, October 2023, **The Global Transboundary Climate Risk Report**

13 See for instance this infographic from the EU: **https://www.consilium.europa.eu/en/infographics/how-the-russian-invasion-of-ukraine-has-further-aggravated-the-global-food-crisis/**



CHAPTER 2

Financing investment in resilience

2

Financing investment in resilience

Investing $1.8 trillion in climate resilience measures could generate

$7.1tr

in total net benefits by 2030[14]

Summary

> Investment in resilience is worthwhile, with benefit:cost ratios ranging from 2:1 to 10:1

> The annual costs of adaptation could be as high as $565 billion by 2050

> This leaves a big investment gap, much of which will have to be met by public expenditure, and hence public borrowing

> However, countries most vulnerable to climate are often also highly indebted

> While those countries are growing their economies, and developing their own capital markets, they will be increasingly dependent on borrowing

> International Financial Institutions will be central to this investment

Type and scale of finance

Climate impacts are becoming more frequent and intense. Investment in resilience needs to happen now. The earlier that countries can effectively invest in their own resilience, the greater the benefit. A study by the Global Commission on Adaptation found that investing $1.8 trillion in climate resilience measures could generate $7.1 trillion in total net benefits by 2030, including reduced economic losses from climate-induced disasters.[14] The overall rate of return on investments from improved resilience is high, with benefit:cost ratios ranging from 2:1 to 10:1.[15] This makes climate resilience a smart economic option, and one that requires action now.

14 Global Commission on Adaptation, September 2019, **Adapt now: A global call for leadership on climate resilience, Global Center on Adaptation**

15 Ibid.

Annual costs to respond to climate change are expected to rise. The United Nations Environment Programme (UNEP) estimates that, by 2030, the annual cost of adaptation alone will be between $160 billion and $340 billion – and could rise to $565 billion by 2050. In official reporting of nationally determined contributions and/or national adaptation plans, 76 developing countries estimate needing a combined total of $71 billion per year until 2030 for adaptation alone.[16] This need for finance is in stark contrast to the reality of what has been provided: in 2020, adaptation finance only reached $28.6 billion. In 2021, public adaptation finance was $21bn, a 15% decrease compared to 2020.[17] Given that adaptation represents a subset of overall resilience planning and expenditure, these estimates undervalue the global need for financing for resilience. And as long as the adaptation gap remains, countries will need to find ways to finance their resilience, or else risk unmitigated climate disasters without the effective means to address them.

UNEP estimates that the annual cost of adaptation alone could rise to

$565bn

by 2030

Public expenditure is key for resilience planning and managing risk. Many resilience strategies require forms of social safety nets for communities when shocks hit. Insurance can of course help, but public expenditure (and public support) is often needed also, especially for the uninsured, and/or uninsurable. To develop and deliver robust strategies for climate change, collaboration between businesses, communities and the public sector must accelerate.

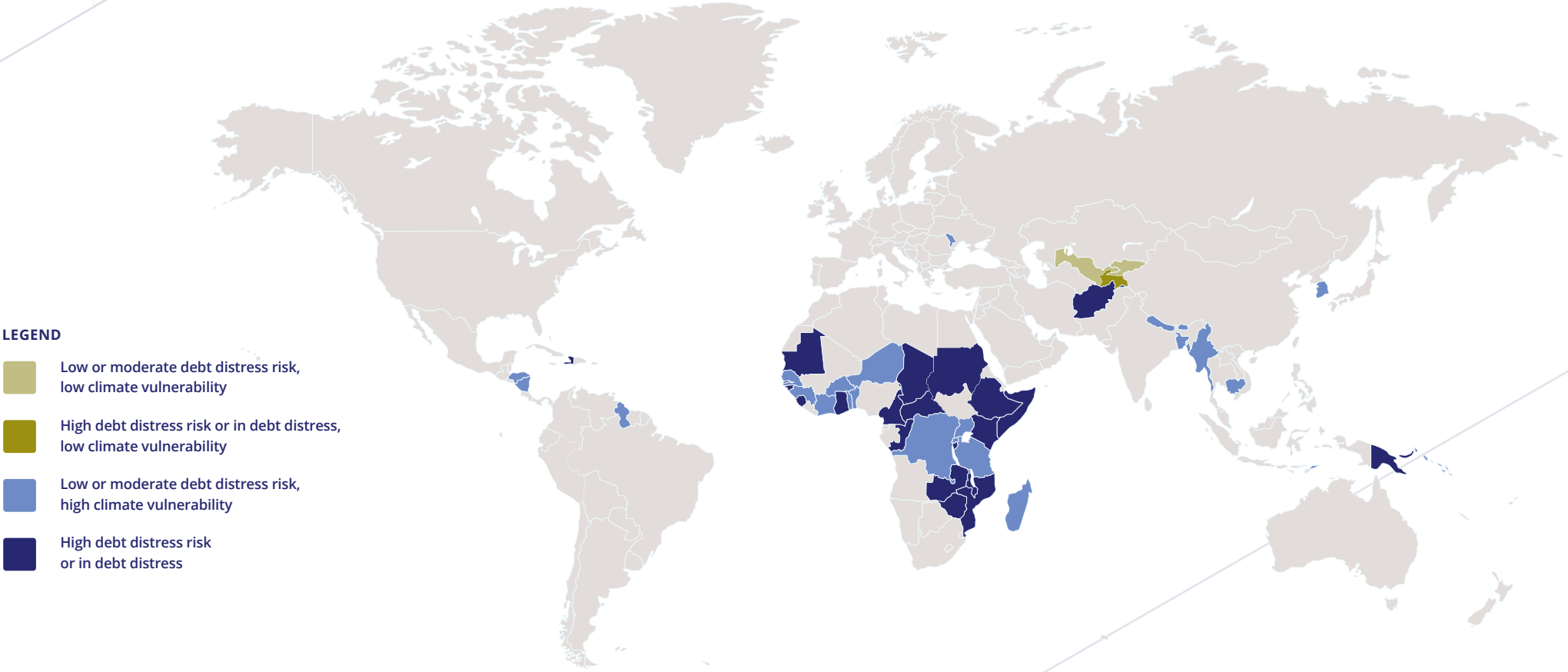
The competitive markets of today's economy tend to favour efficiency and 'just-in-time' supply chains that reduce immediate costs, but which may not be resilient to the kind of extreme shocks that a changing climate can bring. When such shocks happen, businesses may find that they have underinvested in resilience. And for the many firms that do invest in resilience, there is a risk that they will be undercut by competitors who are more focused on reducing immediate costs than on taking a longer-term perspective. Hence there is a real risk that more resilient firms may be priced out of markets, unless some incentive, or regulation, makes resilience more central to firms' decision making.

Governments need the ability to make the policy decisions for the longer term, which will result in changes which the private sector acting alone cannot, or will not make. Where finance is constrained, countries will struggle to invest in high-value resilience. Indebted developing countries, especially those that are most vulnerable to climate change impacts, will need to see a significant increase in their fiscal space if they are to be able to pursue climate resilient development. And sadly, there is a high correlation between economic indebtedness and climate vulnerability (Figure 1).

16 UNEP – UN Environment Programme, November 2023, **Adaptation Gap Report 2023**

17 Ibid.

Figure 1: Global debt and climate crises are intertwined (UNCTAD 2023)[18]



18 Risk of debt distress: UNCTAD calculations based on IMF data, 2022; Climate vulnerability: Notre Dame Global Adaptation Index, 2020; via UNCTAD, 1 March 2023, **Global debt and climate crises are intertwined: Here's how to tackle both**

While resilience needs money to invest and to help people cope, it is also about more than money. While the interventions described above will often require a significant mobilisation of resources, if a country is to deliver long-term solutions, it will have to invest in building the right coalitions, and securing public support. Coalitions and public support help to secure the buy in for mobilising resources, and enable people to better accept the costs that will come with investment, and to identify and adopt the best solutions. When resilience to climate is considered alongside other priorities (like human health, development and security), societies can change in ways that reduce the severity of climate impacts without jeopardising societal wellbeing and economic prosperity.

Where does the money come from?

Spending on resilience may take many different forms and won't always be capital investment (e.g. duplicating supply chains to ensure continuity should one fail). Where resilience is built by increasing reserves, one implication may be reduced debt repayment. However, a significant amount of resilience expenditure will entail new capital, often taking the form of new debts.

The cost of new borrowing varies. For low- and middle-income countries, the most debt-sustainable support comes from international financial institutions (IFIs), like the International Monetary Fund (IMF), World Bank and other multilateral development banks (MDBs). Low-income countries can access concessional loans – that is, with rates comparable to those extended to wealthy nations – through agencies like the World Bank's International Development Association (IDA). (By contrast, World Bank loans to middle-income countries are usually non-concessional and provided through the International Bank for Reconstruction and Development.)

Borrowing from IFIs and MDBs depends on those institutions being able to provide support at scale for the countries that need it most. The box below highlights three sources of multilateral finance aimed at bolstering resilience. When these sources of more sustainable borrowing are exhausted, countries will look to riskier, higher-cost options. Other sources of external borrowing include bilateral loans from other countries, which are sometimes tied to specific projects or investments, and loans from foreign commercial banks. Countries may also raise new capital through domestic borrowing – the issuance of bonds and treasury bills by governments that are sold to individuals, institutional investors and financial institutions within the country. In those cases, where a country is borrowing in its own currency from its own citizens and residents, the borrowing is more resilient in the face of exchange rate risk, which is why developing domestic capital markets will, in itself, be a significant source of resilience over time.

Three examples of multilateral financing that support resilience.[19]

The Adaptation Fund is one of the finance pools of the United Nations Framework Convention on Climate Change (UNFCCC) that supports resilience in developing countries. It focuses specifically on financing adaptation projects and programmes, to which national entities have direct access, and can help address urgent adaptation needs. Financing from the fund comes mainly from the sales of certified emission reductions. The Fund has disbursed over $1 billion since 2010. Although a key component of adaptation funding, the Fund remains very project-focused. It can help at the local level, but a broader resilience approach is also needed to tackle national and regional needs.

The IMF's Resilience Sustainability Trust, established in 2021 as a response to the COVID-19 pandemic, helps low-income and vulnerable middle-income countries to build resilience to external shocks and ensure sustainable growth. It complements the IMF's existing lending toolkit by providing longer-term, affordable financing to cover the fiscal needs of longer-term challenges (like climate change and pandemic preparedness). This concessional financing can be a great tool for indebted countries, as it contributes to longer-term balance of payments stability. However, to access it, governments need to show systemic reforms, which can be challenging both politically and practically for many countries.

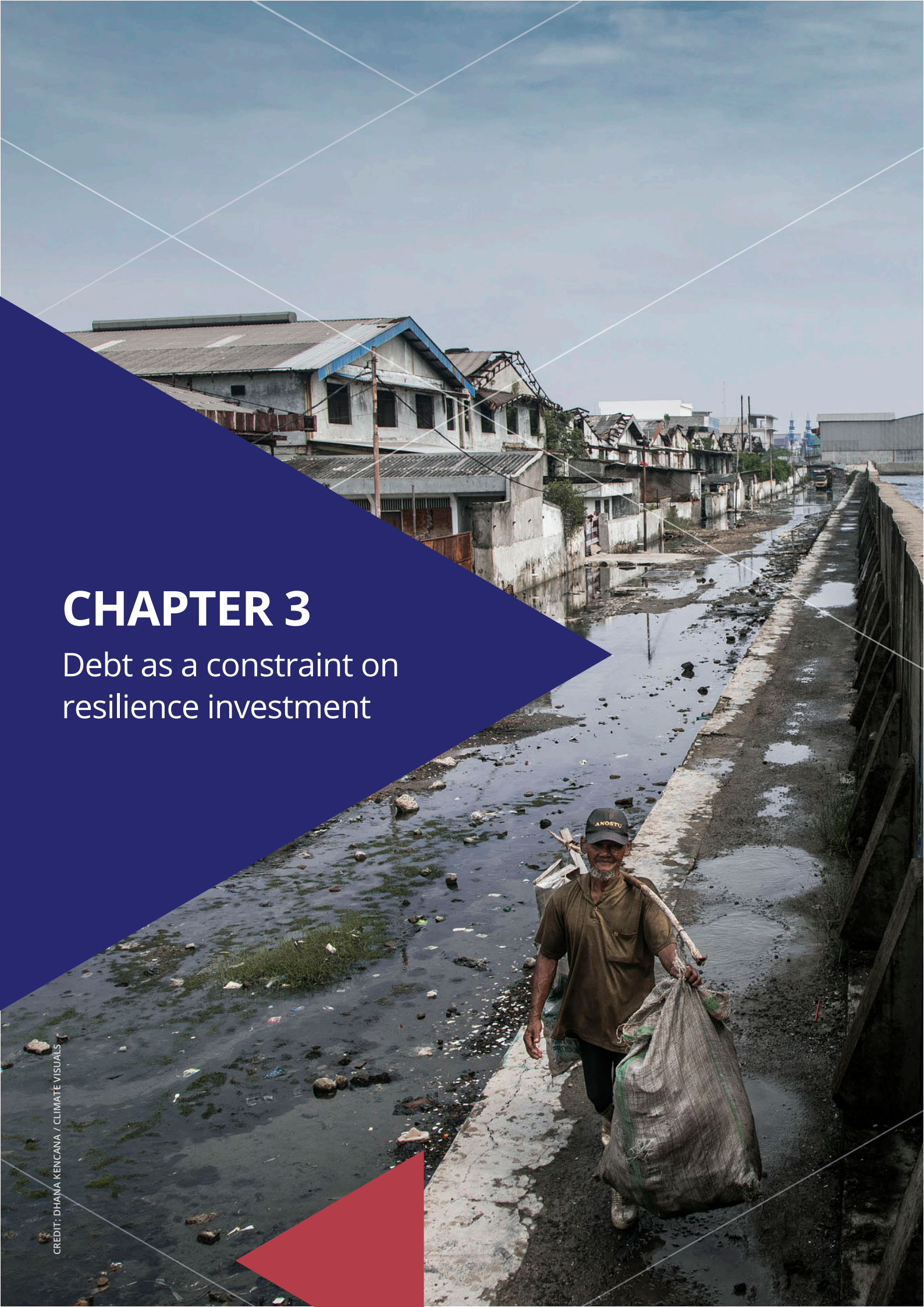
Multilateral development banks – such as the African Development Bank and the European Bank for Reconstruction and Development – can play a significant role in climate resilience, as they can offer concessional finance to developing countries. Such banks have a range of 'windows' that provide borrowing or indeed grants for adaptation.[20] These institutions can also play a role in policy and institutional reforms, regulations and standards that promote climate resilience. Given their regional expertise, MDBs can also provide technical assistance and help vulnerable countries build their capacity to manage climate risks at regional and national level.

19 For a more comprehensive overview of sources of climate finance, The Climate Policy Initiative has produced this **Global Landscape of Climate Finance 2021 - CPI (climatepolicyinitiative.org)**

20 See this table: "**Main funding windows under the MDB for climate change adaptation and resilience**" from Timilsina,G.R. Financing Climate Change Adaptation: International Initiatives. Sustainability 2021,13,6515. **https://doi.org/10.3390/su13126515**

CHAPTER 3

Debt as a constraint on resilience investment



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3

Debt as a constraint on resilience investment

Since 2009, the external debt of non-G20 countries has doubled, including a three-fold increase in sovereign debt owed to private creditors

Summary

> Debt levels across the world have been rising, with particular pressure on low income countries

> This creates a vicious cycle between the debt and climate crises, intertwining a lack of economic resilience with a lack of climate resilience

> Vulnerability itself leads to higher interest rates, making debt harder to pay off

> The current debt crisis is different to previous ones, in that the mix of creditors is much more varied, geographically and in terms of creditor types.

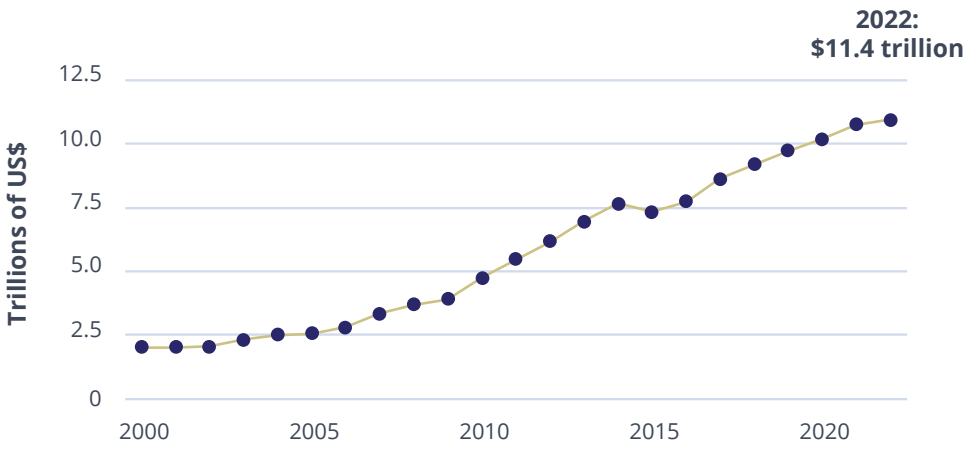
> In addition the availability of financial aid remains inadequate

Growing indebtedness

Throughout this century, levels of external debt have been rising in low-income developing countries, especially over the past decade (Figure 1). Since 2009, the external debt of non-G20 countries has doubled, including a three-fold increase in sovereign debt owed to private creditors.[21]

21 Joseph Stiglitz and Hamid Rashid, July 2020, **Policy Insight 104: Averting catastrophic debt crises in developing countries – Extraordinary challenges call for extraordinary measures, Centre for Economic Policy Research**

Figure 2: The total external debt of developing countries has risen substantially over the past decades.[22]



Around 25% of developing economies and ***60%*** *of low-income nations are already experiencing or are at risk of experiencing a debt crisis*

Already trending upwards, debts were then supercharged by government spending during the COVID-19 pandemic as needs increased and economies rapidly shut down. Low-income countries (LICs) saw the largest jump from 2010 to 2019, LICs' debt-to-GDP ratio increased on average by 1% per year, but during 2020 the increase skyrocketed to 13%.[23] This trend has continued through the Russian aggression in Ukraine and global inflation.

Around 25% of developing economies[24] and 60% of low-income nations[25] are already experiencing or are at risk of experiencing a debt crisis. And with 2024 and 2025 being key years for debt servicing, the issue is only going to grow in the near term.[26] In the face of a looming global recession, and increasing interest rates, countries will be unable to roll over debts as the past decade of abundant liquidity ends.

22 UNCTAD SDG Pulse, 2023, **Escalating debt challenges are inhibiting achievement of the SDGs**, accessed 2 January 2024

23 Chuku Chuku et al., April 2023, **Are we heading for another debt crisis in low-income countries? Debt vulnerabilities: Today vs the pre-HIPC era**, IMF Working Paper No. 79

24 Developing economies include low- and middle-income countries. Tariq Khokharumar Serajuddin, 16 November 2015, **Should we continue to use the term "developing world"?**, accessed 2 January 2024

25 For 2022–2023, low-income countries were those with a gross national income (GNI) per capita of less than $1,085. Nada Hamadeh et al., 1 July 2022, **New World Bank country classifications by income level: 2022–2023**, accessed 2 January 2024.

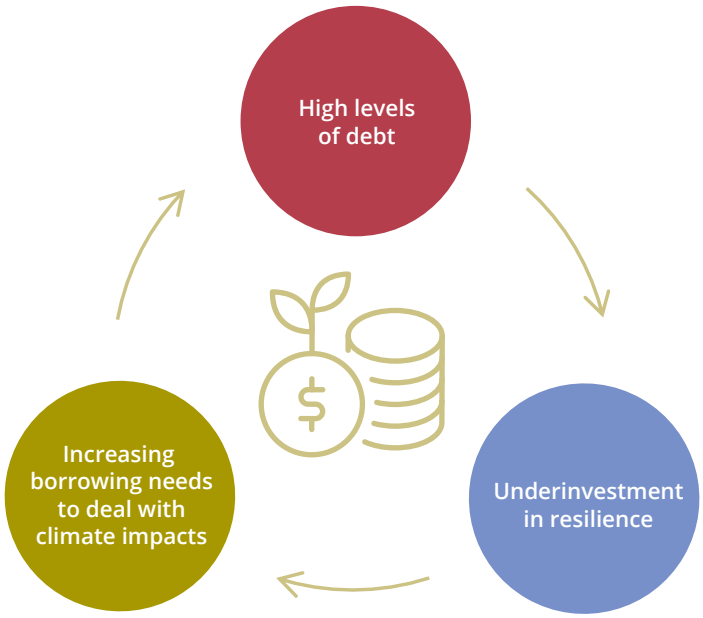
26 InterRegional for Strategic Analysis, 14 December 2022, **Global debt: Is the world heading towards a financial crisis?**, accessed 2 January 2024; World Economic Forum, 24 February 2023, **Global debt drops but hits record high in developing countries, plus other economy stories you need to read this week**, WEF Centre for Financial and Monetary Systems

A vicious cycle

Debt is, of course, only one crisis among many that countries face. However, high debt levels are a serious issue because they severely constrain countries' fiscal space – that is, their ability to allocate resources, implement policies and respond to economic shocks without undermining fiscal sustainability and macroeconomic stability.[27] This undermines their ability to invest in responding to other crises such as those of climate, food and health. The costs of repayment, alongside the fear of default, have a chill effect on spending for developing and especially emerging economies.

Once a developing country has been through a debt crisis, it can take a considerable time before it can borrow to invest. And the country's economic policy makers will be understandably cautious and focus on building up reserves to reduce the risk of a future crisis, further reducing the scope for investment (Figure 3).

Figure 3: Underinvestment due to high debt levels only leads to more debt.



27 Peter Heller, June 2005, **Back to Basics – Fiscal Space: What It Is and How to Get It**, Finance & Development 42(2)

Case study: Mozambique

Mozambique is one of the world's most climate-vulnerable countries, having experienced some 57 climate events in the period from 2000 to 2019.[28] In 2019, less than a year before COVID-19 pandemic took hold, Mozambique was confronted by two tropical cyclones (Idai and Kenneth) in as many months. Mozambique borrowed US$ 118 million to respond to the damages.[29] The impact of these cyclones shows up in the country's debt to GDP ratios, rising from 78.9% to 101.3% in a year.[30]

Vulnerability and the cost of borrowing

For highly climate-vulnerable countries, debt levels may be compounded by the increased cost of capital. Studies suggest that these countries are already paying risk premiums based on their vulnerability, with climate risk estimated to have cost Vulnerable Twenty Group (V20)[31] countries more than $40 billion in additional interest payments over the past ten years.[32]

This dynamic will likely extend beyond the V20, given that almost half of low-income countries are both at risk of debt distress and highly vulnerable to climate change.[33] Moreover, pricing of climate risk will only become more certain as understanding of climate risk grows.

The inflation and related interest rate rises across the world in the aftermath of COVID-19 have added to the cost of borrowing. Prior to this, demographics and productivity changes had been reducing real interest rates across the world, as charted for developed countries by the IMF.[34]

28 **Global Climate Risk Index 2021**, Germanwatch, David Eckstein, Vera Künzel, Laura Schäfer

29 Ibid.

30 **World Bank estimates of Central Government Debt to GDP ratios**, accessed on 3 March 2024.

31 As of January 2024, the Vulnerable Twenty Group of Ministers of Finance of the Climate Vulnerable Forum has 68 members from Africa, Middle East, Asia-Pacific, and Latin America and Caribbean regions.

32 Imperial College Business School and SOAS, 2018, **Climate change and the cost of capital in developing countries: Assessing the impact of climate risks on sovereign borrowing costs**

33 UNCTAD, 1 March 2023, **Global debt and climate crises are intertwined: Here's how to tackle both**

34 Jean-Marc Natal and Philip Barrett, 10 April 2023, **Interest rates likely to return toward pre-pandemic levels when inflation is tamed**, IMF

Rates for less developed countries will be broadly related to these, often with a premium on top. As rates have risen in developed countries to choke off inflation, so also will the rates, and the interest payments for less developed countries. It also means that new borrowing will be at higher rates.[35] In 2022, according to the World Bank International Debt Report,[36] "developing countries spent a record $443.5 billion to service their external public and publicly guaranteed debt in 2022".[37]

A diverse cast of creditors

For low-income, climate-vulnerable countries, having the fiscal space to build resilience may depend as much on reducing their current debt servicing burdens as it does on access to new grant or concessional finance. Efforts to confront the debt crisis have been gathering momentum in multiple forums,[38] but significant shifts in the creditor landscape have made cooperation on debt relief and restructuring much more complicated than it once was. Since the mid-1990s, which saw the last major debt restructuring and the launch of the IMF/World Bank Heavily Indebted Poor Countries Initiative (HIPC), the spread of creditors has become more diverse.[39]

While the debt profiles of individual countries vary, there has been a steep rise in debts to Chinese state-owned banks such as Exlm and a particular trend towards private ownership of sovereign debt. China is now the world's largest sovereign creditor. Private creditors are also large holders.

Climate-vulnerable countries are already paying risk premiums based on their vulnerability, with climate risk estimated to have cost more than

$40bn

in additional interest payments over the past ten years

35 Tobia Adrian, 10 October 2023, **Higher-for-longer interest rate environment is squeezing more borrowers**, IMF

36 World Bank, 13 December 2023, **International Debt Report 2023**

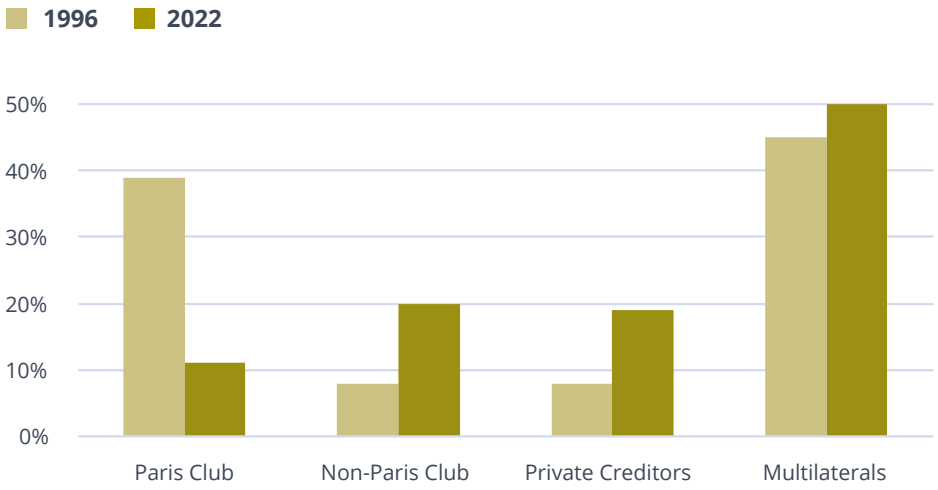
37 World Bank, 13 December 2023, **Developing countries paid record $443.5 billion on public debt in 2022**, Press Release

38 David Malpass, 21 March 2023, **The April 2023 Global Sovereign Debt Roundtable: Time for meaningful debt restructuring**, World Bank Blogs; **The 2022 Bridgetown Initiative for the Reform of the Global Financial Architecture , Barbados Foreign Affairs and Foreign Trade, September 23, 2022**

39 See Box O.4 Sovereign Debt Market Fragmentation in Highly Indebted Poor Countries, from **World Bank. 2022. International Debt Report 2022: Updated International Debt Statistics**.

Many opted to look for returns in low-income and developing countries given historically low interest rates in developed economies.[40] This results in a very different profile of creditors compared to 1996,[41] when the IMF and World Bank launched the Heavily Indebted Poor Countries (HIPC Initiative),[42] as shown in Figure 4. One particularly striking shift is the move away from debt held by members of the **Paris Club**, an informal group of official creditors whose role is to find coordinated and sustainable solutions to the payment difficulties experienced by debtor countries (which notably doesn't include China). Members of the Vulnerable Twenty Group (V20)[43] have seen a similar shift, with private creditors holding 36% compared to the 13% held by members of the Paris Club.[44]

Figure 4: Distribution of low-income countries' debt by creditor type[45]



40 Eurodad, March 2021, **A debt pandemic: Dynamics and implications of the debt crisis of 2020**

41 The data in Figure 3 is drawn from Chuku Chuku et al 2023. **Are We Heading for Another Debt Crisis in Low-Income Countries? Debt Vulnerabilities: Today vs the pre-HIPC Era.** IMF Working Paper 2023/079, International Monetary Fund, Washington, DC, also cited under Footnote 45

42 **Debt Relief Under The Heavily Indebted Poor Countries (HIPC) Initiative**, IMF Factsheet, February 2023

43 As of January 2024, the Vulnerable Twenty Group of Ministers of Finance of the Climate Vulnerable Forum has 68 members from Africa, Middle East, Asia-Pacific, and Latin America and Caribbean regions.

44 Global Development Policy Center, 16 September 2022, **V20 Debt Review: An account of debt in the Vulnerable Group of Twenty**, accessed 2 January 2024

45 Chuku, C., Samal, P., Saito, J., Hakura, D.S., Chamon, M. d, Cerisola, M.D., Chabert, G., Zettelmeyer, J., April 2023, **Are We Heading for Another Debt Crisis in Low-Income Countries? Debt Vulnerabilities: Today vs the pre-HIPC Era**, IMF working paper

The shortage of international finance

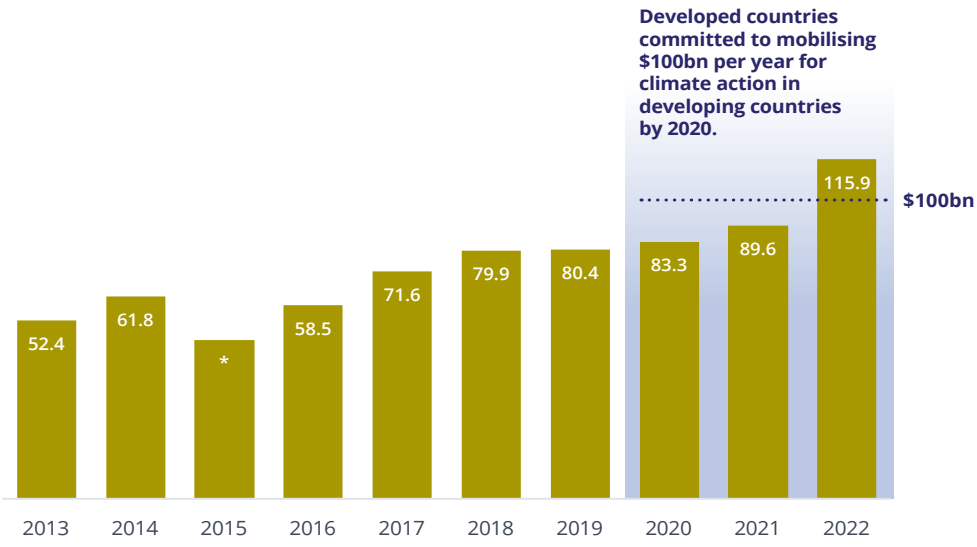
International climate finance is a potential source of funding for resilience investment, albeit with significant limitations in terms of fulfilled commitments and focus. However, despite donor countries committing to deliver $100 billion in climate finance every year by 2020, they delivered only $83.3billion in 2020 (Figure 5).[46] Indeed, the target was only reached in 2022.[47]

Moreover, only a small percentage is going towards indebted and vulnerable states. For example, in 2018, Least Developed Countries (LDCs) received received 18.3% of climate finance in 2022 and SIDS received 2.8% based on the new OECD data.[48] Furthermore, international climate finance is still heavily skewed towards climate mitigation, with less than 29% of the total provided in 2020 going to adaptation despite this being an essential part of building climate resilience.[49] Without international funds to provide the scale of finance necessary, vulnerable countries will bear the brunt of climate resilience costs. This makes tackling the debt crisis all the more important.

Despite donor countries committing to deliver $100 billion in climate finance every year by 2020, they delivered only

$83.3bn

Figure 5: Climate finance contributions from wealthy countries against their 2020 target ($billion)[50]



* There is a data gap in 2015 for mobilised private finance as a result of implementation of enhanced measurement methods. The 2015 total therefore appears lower than reality.

46 ONE Data & Analysis, no date, **Time to deliver on a 13 year old climate promise**, accessed 2 January 2024

47 OECD, **Climate Finance and the USD 100 Billion Goal**

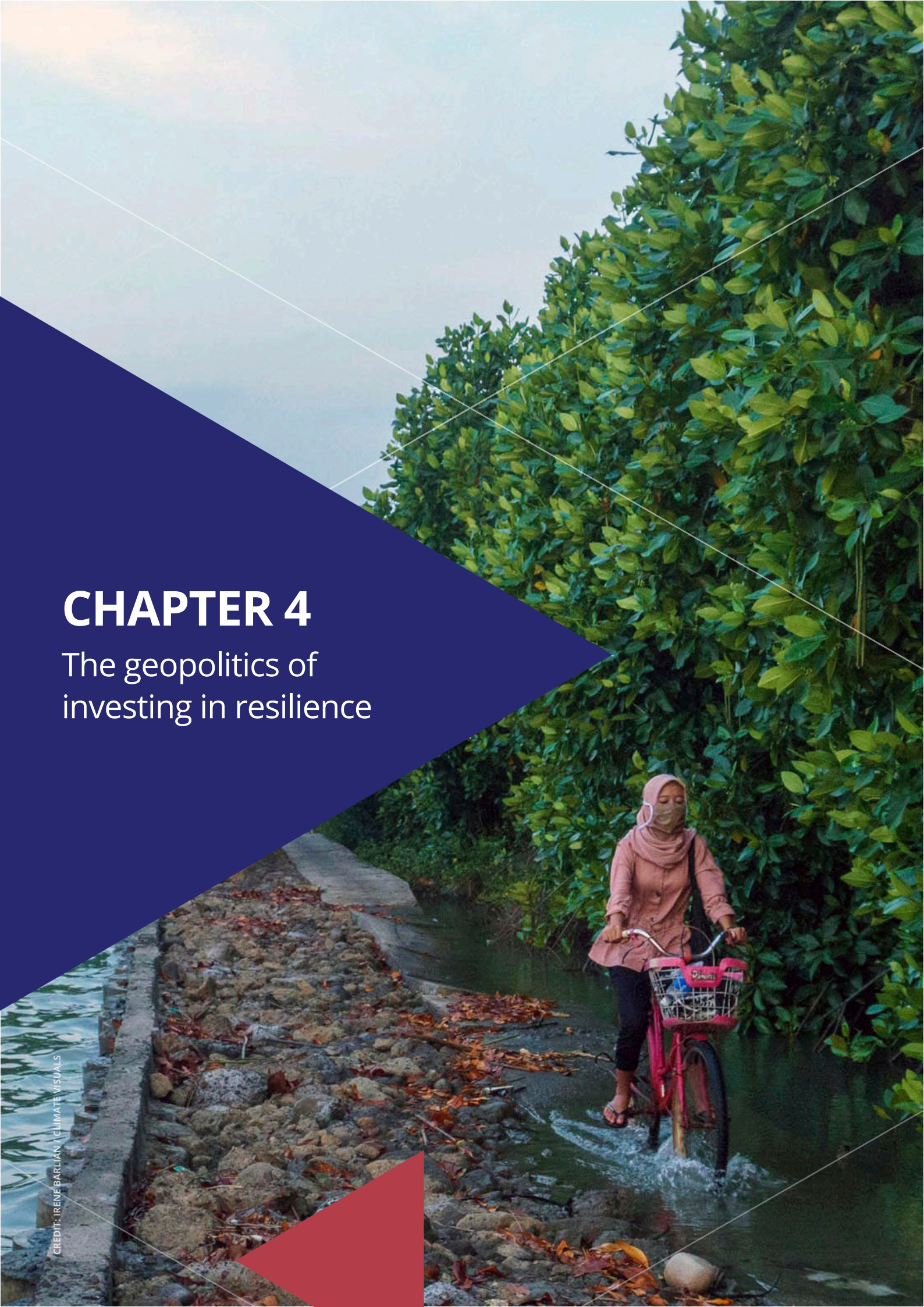
48 OECD, 2024, **Climate Finance Provided and Mobilised by Developed Countries in 2013-2022**

49 OECD, 2022, **Aggregate trends of climate finance provided and mobilised by developed countries in 2013-2020,** Climate Finance and the USD 100 Billion Goal

50 OECD, May 2024, **Climate finance provided and mobilised by developed countries in 2013–2022**

CHAPTER 4

The geopolitics of investing in resilience



CREDIT: IRENE BARLIAN / CLIMATE VISUALS

4

The geopolitics of investing in resilience

Summary

> Climate resilience, and debt restructuring are now geopolitical issues

> This means that the international discussions have now gone beyond technical fixes, to reform of global systems

> This reform is now an active debate, stimulated in part by Barbadian Prime Minister Mia Mottley, that has worked through the Summit for a New Global Financing Pact in Paris in June 2023, to Brazil's presidency of G20 in 2024

> However in the absence of a global settlement, many countries are forced to rely on bilateral deals, often as much about geostrategic competition as resilience support

Climate resilience is now a key national and global priority. This means it will begin to influence international relationships, especially around questions of finance. Climate impacts are already changing countries' foreign policy through climate negotiations under the UNFCCC, bilateral and regional aid programmes, climate foreign policy strategies, and growing calls for international financial reform. For climate-vulnerable countries, securing support to deal with a climate crisis they did little or nothing to cause is essential for their survival and ability to thrive. For wealthy donor nations, providing climate finance is becoming a means of exerting soft power over important regions and allies. In a time of constrained finances, resilience to climate change also intersects with other processes, including current negotiations on addressing the debt crisis.

Looking beyond the near term, escalating climate shocks over coming decades will necessarily change international relations by heightening the importance of finance. The geopolitical environment could lead towards outcomes that favour broad support for climate resilience, but only if trust between key stakeholders is built.

If, however, international institutions are unable to adapt and finance for resilience remains well below needs, multilateral cooperation will be threatened further as polluting nations look ever inward.

Geopolitics of debt restructuring

Multilateral development banks could unleash hundreds of billion dollars to developing countries, if they were to reform what risks they could take

Climate change raises the stakes for resolving the debt crisis. Through coalitions such as the V20, debtor countries have called on the G20 and key stakeholders within international institutions to create a more sustainable approach to debt specifically because of the threats from climate change.[51] However, coordination on debt has become a difficult task for the international community, with a lack of trust between the West and China slowing any kind of restructuring negotiations. This is all the more so given the fragmentation of creditors shown in the previous chapter. The large and diverse group of private creditors have also been difficult to corral, with debt justice groups accusing them of profiting off poor countries by delaying debt relief in a crisis.[52]

Since the COVID-19 pandemic, the key forum for addressing debt distress has been the G20. India made debt a priority during its 2022–2023 G20 presidency, working on proposals to support countries that were severely affected by the pandemic and instability resulting from the Russian invasion of Ukraine. In 2020, members of the G20 and the Paris Club agreed to the G20 Common Framework on debt,[53] an initiative to coordinate cooperation on debt restructuring for low-income countries. However, at the time of writing only Chad and Ghana have received debt relief under the initiative and at that, after considerable delays. Ethiopia and Zambia remain inside the process. The framework is arguably not working and there have been numerous proposals to fix it, including from IMF Managing Director Kristalina Georgieva who has called for "more predictable, timely and orderly processes... under the framework".[54, 55]

51 V20, 23 June 2023, **V20 Statement on Emergency Coalition for Debt Sustainability and Climate Prosperity;** V20, 27 October 2021, **V20 Statement on Debt Restructuring Option for Climate-Vulnerable Nations**

52 The Guardian, 25 April 2023, **Finance companies 'may make $30bn' by delaying debt relief for five countries**

53 **The G20 Common Framework for Debt Treatments beyond the DSSI**, agreed during the Saudi Arabian presidency of the G20, at the Extraordinary G20 Finance Ministers and Central Bank Governors' Meeting of November 13, 2020

54 Kristalina Georgieva and Ceyla Pazarbasioglu, 2 December 2021, **The G20 Common Framework for Debt Treatments must be stepped up**

55 IMF, 25 February 2023, **IMF Managing Director Kristalina Georgieva urges G20 Leadership to strengthen the international financial architecture, IMF Press Release No. 23/53**

Process improvements are only part of the solution. A key issue is that bilateral creditors cannot agree on who should bear the financial cost of a reduction of the amount that will be repaid to creditors (a "haircut" in financial jargon). As one analyst argues: "No framework for coordination among official creditors can work if official creditors don't have enough in common."[56]

The impasse between China and Western nations, in particular, does not bode well for poorer countries. And the February 2023 meeting of G20 Finance Ministers only seemed to further harden positions.[57] In recognition of the need to get past the stalemate, co-chaired (with the IMF and the World Bank) a new Global Sovereign Debt Roundtable (GSDR) that brought together official and private sector creditors and debtor countries.[58] A few countries have since seen the beginnings of comprehensive restructuring. However, as is the case with Zambia, these remain complex and difficult.[59]

Disagreements are likely to continue through 2024. China had been calling for the World Bank and other MDBs to take a haircut alongside other bilateral and private sector creditors, a move supported by some analysts.[60] However many MDB shareholders are opposed,[61] given it would affect MDB creditor status and thus their ability to provide necessary concessional finance in the future. Broader geopolitical tensions between China and the other major MDB shareholders make it harder to find common ground.

Countries in debt distress are left in untenable limbo, forced to cut spending on public services (in the first instance) as they wait for bilateral and private creditors to agree a way forward. Meanwhile, investment in climate resilience is delayed even further.

56 Brad W. Setser, 26 March 2023, **The Common Framework and Its Discontents, Council on Foreign Relations**

57 W. Gyude Moore, 10 March 2023, **Breaking the logjam on African debt relief: A third way? , Center for Global Development**

58 IMF, **Questions and answers on the Global Sovereign Debt Roundtable, accessed 2 January 2023**

59 **Zambia raises hopes it will complete long-delayed debt restructuring**, Financial Times, February 7, 2024

60 **Multilateral Development Banks Must Participate in Debt Relief**, Ulrich Volz and Marina Zucker-Marques, Project Syndicate, October 4, 2023

61 Reuters, **Yellen urges Zambia debt restructuring after talks with China**, January 24, 2023

Geopolitics of reform to international institutions

As discussed in Chapter 2, for countries that cannot access low-cost capital, borrowing through concessional sources, such as IFIs, is critical. Yet, even without including the question of loss and damage, IFIs are insufficiently prepared to deal with the scale of global financing needed. According to a study presented to the G20 in 2022, multilateral development banks could unleash hundreds of billion dollars to developing countries, if they were to reform what risks they could take.[62 & 63]

To unlock more finance for both climate mitigation and adaptation, leaders of climate-vulnerable countries and others are championing transformational agendas to 'green' the world's IFIs and the system of financial architecture as a whole. This includes aligning IFI investments and operations with climate goals, reducing carbon footprints, and shifting portfolios towards low-carbon and climate-resilient investments. The Bridgetown Initiative,[64] led by Barbadian Prime Minister Mia Mottley, called for immediate liquidity for crisis-response in affected countries and more sustainable approaches to debt, recommending increased access to IMF condition-free financing facilities and the temporary suspension of IMF interest rate surcharges, among others. Alongside these shorter-term measures, the Initiative also called to expand financing for development through the mobilisation of more private sector finance and increases in official development spending.

Some of these were progressed through the June 2023 Summit for a New Global Financing Pact in Paris. The Summit initiated a series of roundtable discussions and negotiations on IFI reform, which included many of the Bridgetown Initiative's recommendations. Vulnerable countries attended the Summit in force, but the outcomes were a mixed bag. Paris did not deliver on large-scale debt restructuring but it did lay out a roadmap for changes throughout the international financial architecture to take place over the next few years.[65] The list of reforms is extensive, with a timeline that reflects how to align the various changes across institutions. If implemented, these changes – such as channelling Special Drawing Rights through MDBs – would increase the appetite of IFIs to take on risk and increase their lending capacity.

62 Devex, 20 July 2022, **Exclusive: G-20 report says MDBs are holding back hundreds of billions**

63 Boosting MDBs' investing capacity. (2022). An Independent Review of Multilateral Development Banks' Capital Adequacy Frameworks, **accessed here**.

64 See footnote 48

65 French Presidency, June 2023, **Proposed roadmap to build on key milestones of the international agenda as a follow-up to the Summit on a New Global Financing Pact (PDF)**

At the Summit, the World Bank, France, the US and the UK also committed to issuing climate resilient debt pause clauses in new loans. These clauses allow countries affected by natural hazard-related disasters to pause their debt repayments for a period. Brazil is committed to continuing the process of reform during its presidency of the G20 in 2024.[66]

These reforms would certainly help bridge the gap for climate-resilient finance. However, some developing countries, especially those in sub-Saharan Africa, see a potential risk that this shift towards climate investments will mean less finance available for development. There are fears that more climate finance will mean a shift of resources away from low-income and towards middle-income countries. In 2021, only a quarter of World Bank climate finance went to low-income countries.[67] Some fear that the shift will result in less development finance for other development goals such as health and education.[68]

However, what is clear is that the need for climate resilience will mean that most development investments will need to be planned with a climate lens. Investing in sustainable development and climate resilience are two sides of the same coin – both essential to achieving the Sustainable Development Goals, reducing economic losses from climate-induced disasters, and mitigating the impact of climate change on vulnerable populations.

The push to transform the international financial system began in a climate-vulnerable country, Barbados, and went mainstream in 2023 through the Paris Summit and at COP28. The reform agenda, however, will require political buy-in over a long period of time to see full implementation.

Geopolitics of bilateral finance for climate resilience

Without a sustainable approach to debt for climate vulnerable countries, and a lack of finance at scale from IFIs, investments in climate resilience from bilateral sources becomes more important. Bilateral creditors and aid agencies may (and already do in some cases) tie finance to foreign policy priorities, meaning support flows primarily towards strategically significant countries or regions.

66 "... the [Brazilian] president explains why reforming the system of international governance is Brasil's third priority during his term in office: "We want greater participation by emerging countries in the decisions of the World Bank and the International Monetary Fund. The unsustainable foreign debt of the poorest countries needs to be resolved." **A G20 with a Brazilian twist**

67 Development Policy Centre, 13 July 2023, **Climate finance from the World Bank: pluses and minuses, Devpolicy Blog**

68 **Do Clients Want the World Bank to Focus on Climate?** Charles Kenny et al, CGD Blog Post February 23, 2023

For example, for Pacific Island nations, geostrategic competition and climate priorities are overlapping. As a vital region for the flow of ships and traded goods alongside its military bases, the Pacific is beginning to see the US and China compete for influence – with climate as a key nexus. The US has ramped up its engagement with the region, opening new embassies in Vanuatu, Kiribati and Tonga for the explicit reason of countering Chinese influence.[69] Chinese engagement has similarly picked up pace, increasing its diplomatic relationships and foreign assistance for Pacific Island countries, often at the expense of breaking diplomatic engagement with Taiwan. In 2022, Both the US and China announced new support for climate resilient investments to these countries as a part of their competition to curry favour with these governments.[70]

Pacific Islands recognise the opportunity that international attention presents. The region is under existential threat from climate change due to rising sea levels, coral reef and ecosystem degradation, and more frequent and intense storms.[71] As major recipients of development assistance, and many at high risk of debt distress, the Pacific islands are utilising their geostrategic importance to strengthen their resilience and pursue their own development priorities. Leaders in the Pacific make their priorities known as Fiji's Prime Minister Frank Bainimarama: "Geopolitical point-scoring means less than little to anyone whose community is slipping beneath the rising seas, whose job is being lost to the pandemic, or whose family is impacted by the rapid rise in the price of commodities."[72]

It is not always clear how these bilateral finance agreements will expand and what kind of finance will be offered. The Pacific receives most of its bilateral development aid (other than that provided by China) in the form of grants; in the future, however, new finance may be delivered through concessional loans. For instance, the Biden Administration's flagship international adaptation strategy, "PREPARE", looks to de-risk projects and mobilise private sector capital as a major part of its programming.[73] The kind of finance offered through bilateral relationships will be vital in determining how successful the offer will be and its effect on debt sustainability.

69 Office of the US Senator Marsha Blackburn's (R-Tenn.), 29 December 2022, **Blackburn, colleagues' Pacific Islands Embassies Act becomes law, News Release**

70 The White House, 29 September 2022, **FACT SHEET: President Biden unveils first-ever Pacific partnership strategy**

71 Asian Development Bank Independent Evaluation Department, 2015, **Pacific risks, vulnerabilities, and key impacts of climate change and natural disasters**

72 Reuters, 30 May 2022, **China, Pacific islands unable to reach consensus on regional pact**

73 The White House, 2021, **President's Emergency Plan for Adaptation and Resilience (PREPARE) (PDF)**

This kind of financial assistance for climate resilience as a part of foreign policy strategy is likely to grow, especially when multilateral finance is unavailable. Though a few nations may benefit, countries seen as strategically insignificant will not. Rather than reflecting a universal recognition of the importance of resilience, development and growth, outcomes will be based on sovereign interests and geopolitical competition.

CHAPTER 5

Getting out of the vicious cycle

CREDIT: YUICHI ISHIDA/UNDP TIMOR-LESTE

5

Getting out of the vicious cycle

Summary

> Clear roadmaps, and transition plans, will help frame the roles, and actions, of debtor countries, their donors and creditors in emerging from the present crises

> However, the debt products, the institutions, and the whole social contract between these parties must move to a more mutually engaged and supportive one, if the world as a whole is to move to a more resilient future

Mapping the journey out of the debt and resilience crisis

Countries need a map that will set out a way to extricate themselves from their current position of exposure and vulnerability to the threats of climate change and indebtedness. The map can show the way into investing in building strong, climate-resilient economies and societies. This map should reflect the following key elements of the journey towards resilience:

> An acknowledgement of the dual challenges of climate risk and debt risk, alongside the central point that without investing in resilience, and by implication without taking on more debt, many economies will remain trapped in a state of high vulnerability to climate, whatever the state of their external debt.

> The possible development pathways that countries can take, that will combine a growing resilience, with development gains, noting that resilience to climate change is key to preserving those gains, preventing losses and advancing progress.

> The role of investment in the development pathway, so that countries can build physical, human and social capital (and reserves), backed up by a realistic assessment of what can be done by taking on sustainable levels of debt, maximising the use of domestic resources, and using donor grants.

The dimensions of coping, adapting and transforming must all be incorporated into this thinking. **Developing this map will require a solid understanding of the elements at play, showing:**

> the real risks, recognising that clarity on just how vulnerable some countries are may make them less attractive to investment.

> the opportunities – for instance, many of the countries facing both debt and climate crises are demographic growth spots, or in a position to be major processing bases for the clean economy of the future.

Such plans are not only visible statements of opportunity and intent, but they can also provide a borrowing country, its creditors and donors, with guardrails to keep sustainable development on track. In drawing up the map, all parties must also recognise that there is a potential economic turning point taking place. For example, a new global energy system allows for new industrial opportunities for borrowing countries, and will remove them from the commodity price volatility that they have faced in a global economy subject to swings in oil prices. One way of operationalising such a map would be to go down the route of Transition Planning, a measure already being refined for businesses,[74] but which could also become part of a country's toolbox.

The nature of the debt on offer needs to change. Countries are already introducing clauses in new debt that will trigger payment halts in the event of a crisis or disaster, like a severe weather event. The World Bank has stated that these clauses will not only be a feature of future loans but also existing loans.[75] There are other, innovative ways of designing debt to capture, for instance, growth in human capital, to encourage and support countries to keep their debt sustainable.

There will also have to be some level of institutional reform. At a most basic level, there have been calls to reform the role of the IMF in ensuring that countries have rapid access to support when they are facing a crisis,[76] and better support to address the impact of climate change.[77] The IMF is the one institution that is on hand to protect the resilience of the global economic

74 See, for example, the UK's **Transition Plan Taskforce**, which aims to "develop the gold standard for private sector climate transition plans."

75 **World Bank Group Announces Comprehensive Toolkit to Support Countries After Natural Disasters**, Factsheet, June 22 2023

76 Center for Global Development, 7 June 2023, **Urgent: The IMF Must Reform**

77 Task Force on Climate, Development and the IMF, 2023, **The International Monetary Fund, Climate Change and Development: A Preliminary Assessment.**

system and that of its member economies. However, many countries hesitate to turn to the IMF, because of its reputation for imposing conditions that are seen as being harsh or ideologically driven.

For new debt, some have called for the reform of current measures and institutions, including for instance the reform of the existing Credit Rating Agencies, or even for the creation of alternatives to them.[78] This reflects ongoing concerns that many existing institutions fail to adequately capture not just the real risks, but also the very real opportunities for developing countries.[79]

Finally, the nature of the "contract" between IFIs, donor countries and recipient countries must be rebalanced. MDBs and donors must make a determined commitment to stay the course, supporting vulnerable countries through a climate disaster strikes, rather than abandoning them. This is especially important given the additional volatility that the economic transition to a decarbonised, net zero economy will bring, alongside the increasing volatility of the climate crisis itself.

This also means that the safety net available to countries when they hit a debt or other financial crisis, needs to be reconsidered in the context of this new contract. The role of the IMF in particular, as the international body most powerful in such crises, will be particularly important.

The IMF, the World Bank, and the international financial architecture as a whole, must come to act, and to be seen to act as, a trusted partner for countries to emerge from the current crises

The IMF, the World Bank, and the international financial architecture as a whole, must come to act, and to be seen to act as, a trusted partner for countries to emerge from the current crises, enabling them to become more resilient, through good times and through tough times. Because there will still be tough times ahead, before we can get to where economies and societies are truly resilient, to climate and economic shocks.

78 Libby George, 12 September 2023, **African Union plans to launch its own credit ratings agency**, Reuters

79 Nora Chirikure, Olumide Abimbola and Grieve Chelwa, 19 April 2022, **How are the 'Big Three' rating agencies impacting African countries?** Africa Policy Research Institute

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