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Centre for Sustainable Finance
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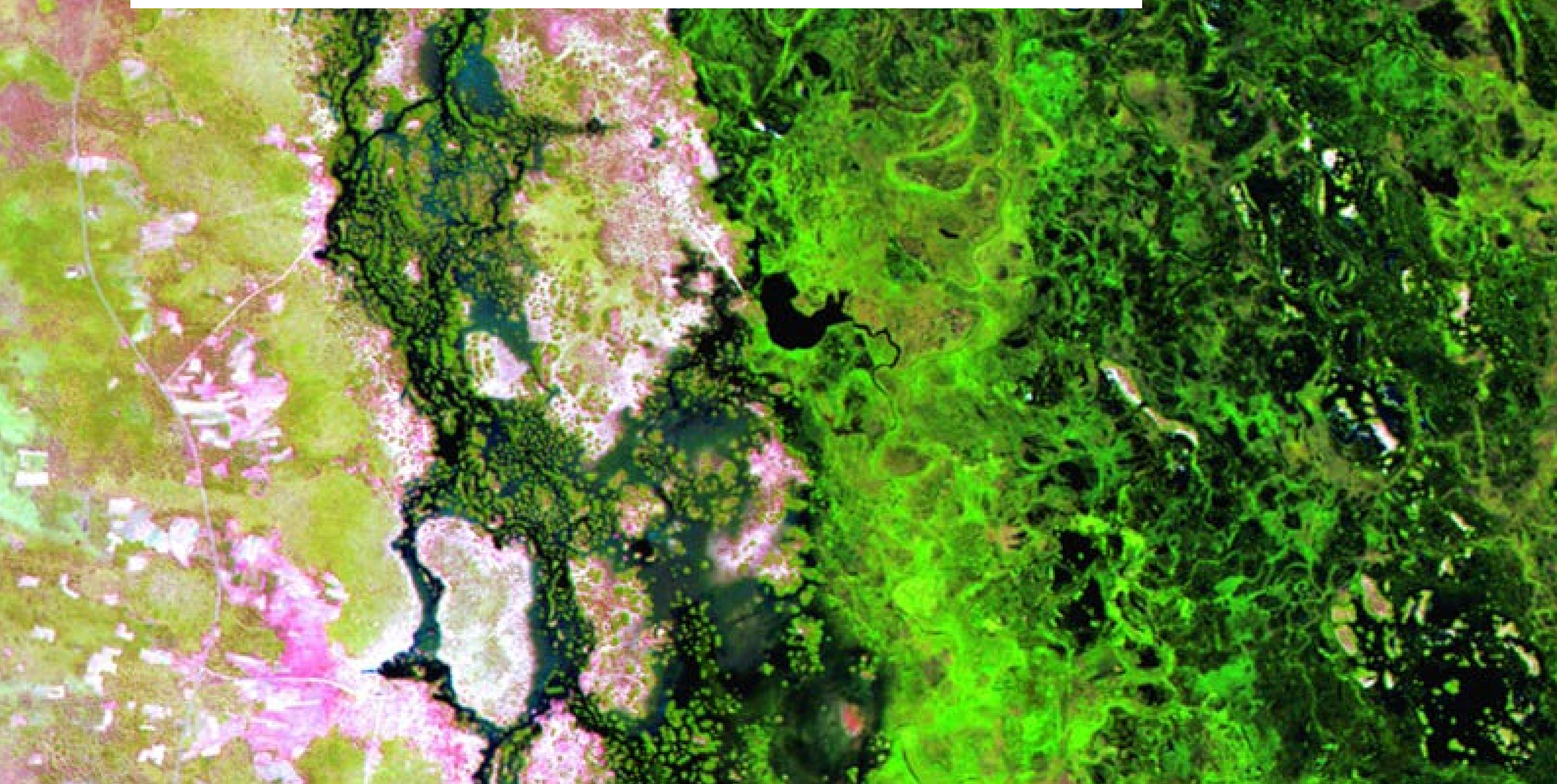
# Debt Relief for a Green and Inclusive Recovery

## Securing Private-Sector Participation and Creating Policy Space for Sustainable Development

June 2021



# Debt Relief for a Green and Inclusive Recovery: Securing Private-Sector Participation and Creating Policy Space for Sustainable Development

**By Ulrich Volz, Shamshad Akhtar, Kevin P. Gallagher, Stephany Griffith-Jones, Jörg Haas, and Moritz Kraemer**

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# Abbreviations

| | |
|---|---|
| DSA | Debt Sustainability Analysis |
| DSSI | Debt Service Suspension Initiative |
| ECLAC | Economic Commission for Latin America and the Caribbean |
| F4B | Finance for Biodiversity |
| GIRS | Green and Inclusive Recovery Strategy |
| HIPC | heavily indebted poor country |
| IDA | International Development Association |
| IEA | International Energy Agency |
| IIED | International Institute for Environment and Development |
| IMF | International Monetary Fund |
| LIC | low-income country |
| MDB | multilateral development bank |
| NDC | Nationally Determined Contribution |
| SDG | Sustainable Development Goal |
| SDR | Special Drawing Right |
| UNCTAD | United Nations Conference on Trade and Development |
| UNDP | United Nations Development Programme |

# Acknowledgements

We would like to thank Sabrina Schulz very much for coordinating our group. We would also like to gratefully acknowledge very helpful exchanges with, and comments and suggestions by, the following colleagues: Stephanie Blankenburg, Carter Brandon, Aldo Caliari, Marcello Estevao, Iolanda Fresnillo, Anna Gelpern, Lars Jensen, Jürgen Kaiser, Laura Kelly, Karen Kemper, Clemence Landers, Nancy Lee, Adnan Mazarei, Carola Meija, Daniel Mittler, Daniel Munevar, Ugo Panizza, Mark Plant, David Ryfisch, Paul Steele, Flora Sonkin, Shari Spiegel, Ted Truman, and Jürgen Zattler. We thank Robert Furlong for excellent proofreading and editing. The usual disclaimer applies.

# Suggested citation:

Volz, U., Akhtar, S., Gallagher, K.P., Griffith-Jones, S., Haas, J., and Kraemer, M. (2021). Debt Relief for a Green and Inclusive Recovery: Securing Private-Sector Participation and Creating Policy Space for Sustainable Development. Berlin, London, and Boston, MA: Heinrich-Böll-Stiftung; SOAS, University of London; and Boston University.

# Executive Summary

A debt crisis is looming in the Global South. Although international capital has partially returned to developing and emerging economies, in many low- and middle-income countries debt service is impeding crisis responses and contributing to worsening development prospects and a compromised ability to adapt to the impending climate crisis as well as threatening the achievement of the SDGs.

The G20 Common Framework for Debt Treatments will not suffice to tackle the debt problem facing many developing and emerging economies. This is a systemic problem, and a global and systemic response is needed. The international community, and the G20 in particular, need to agree on an ambitious agenda for tackling the debt crisis and providing countries with the fiscal space for sustainable crisis responses.

IMF Managing Director Kristalina Georgieva and World Bank President David Malpass both announced that their institutions would develop a scheme for linking debt relief with green, resilient, and inclusive development. This report provides a blueprint for doing so.

The G20 need to be bold, and they need to act now. Past experience tells us that delaying the response to debt crises leads to worse outcomes and higher costs for debtors and creditors alike.

The G20's Common Framework urgently needs to be revamped to include middle-income countries and allow for comprehensive debt relief by both public and private creditors oriented around a green, inclusive recovery.

To avoid a delay of debt restructuring where it is needed, the G20 should encourage all low- and middle-income countries whose debt is considered unsustainable to participate in debt restructuring. The IMF and the World Bank need to swiftly enhance their Debt Sustainability Analysis to account for climate risks and spending needs to scale-up investment in climate resilience and the 2030 Agenda for Sustainable Development.

Adequate incentives are needed to ensure that private creditors participate in debt restructuring where needed and bear a fair share of the burden. If an enhanced Debt Sustainability Analysis asserts that a country's sovereign debt is of significant concern, the IMF should make its programmes conditional on a restructuring process that includes private creditors on a comparable basis.

Brady-type credit enhancements for new bonds that would be swapped with a significant haircut for old debt would facilitate restructuring negotiations. To this end, we propose a Guarantee Facility for Green and Inclusive Recovery managed by the World Bank in close cooperation with regional development banks. If debt servicing on the new bonds is missed, the collateral would be released to the benefit of private creditors, and the missed payment would have to be repaid by the sovereign to the Guarantee Facility.

The IMF, along with the financial authorities of the major advanced economies and China, as well as those of other major financial centres, can play a key role to further incentivise commercial participation in restructurings by using moral suasion and regulatory tools.

Governments receiving debt relief would commit to reforms that align their policies and budgets with the Agenda 2030 and the Paris Agreement.

Governments participating in debt restructuring should develop their own Green and Inclusive Recovery Strategy, in which they map out a set of actions that the country would undertake to advance their development and climate goals. The Strategy should include a spending plan and policy reforms and should be guided by a set of principles that would help to ensure that the recovery is in line with Agenda 2030 and the Paris Agreement. Importantly, the Strategy plan should address vulnerabilities identified in the DSA so as to enhance the resilience of the society and economy, and hence also of public finances.

Governments receiving debt relief will also commit to enhancing debt transparency, to strengthening public debt management capacity, to adopting sustainable borrowing practices, and to strengthening domestic resource mobilisation. The Green and Inclusive Recovery Strategy should define clear targets and performance metrics.

Some portion of the restructured repayments should be channelled into a Fund for Green and Inclusive Recovery (or an already existing national fund that could be used for this purpose) that would be used by the government for investment in SDG-aligned spending, in line with the priorities expressed in its Green and Inclusive Recovery Strategy. The government would be free to decide how to spend the money from this Fund, as long as it is helping a green and inclusive recovery and contributes to achieving the SDGs.



Kenyan Water Resource Management Authority (WRMA) and The Nature Conservancy support local tea farmers along the watershed to better manage their land and so prevent soil erosion.

# 1. Introduction

A debt crisis is looming in the Global South. This crisis was brewing already before the pandemic, but now the situation has deteriorated dramatically. To its credit, the G20 was quick to respond in April 2020, when it launched the Debt Service Suspension Initiative (DSSI). But although the DSSI has given some 47 countries breathing space by allowing them to postpone payments to public creditors, it did not change the net present value of those countries' debt levels; nor did the private creditors participate in this debt re-profiling. Thus, in November 2020, the DSSI was complemented by a «Common Framework for Debt Treatments Beyond the DSSI», which allows the 73 low-income countries (LICs) that are eligible for the DSSI to request debt restructuring. This, too, was a step in the right direction but still falls short of what is needed to guarantee a green and inclusive recovery from the Covid-19 crisis and to re-start the massive mobilisation of resources needed to meet the globally agreed climate and development goals in a green and inclusive manner.

The United Nations Development Programme (UNDP) sees 72 countries at high risk of external debt distress; of these, 19 are described as severely vulnerable (Jensen, 2021). Among the 72 countries identified as highly vulnerable to external debt distress, only 49 are eligible under the conditions of the DSSI and the Common Framework. Indeed, the vast majority of countries at risk in the middle-income category are not covered by the DSSI or the Common Framework.

The International Monetary Fund (IMF) warns of a divergent recovery where the advanced economies and China will see a more robust return to growth due to aggressive fiscal and monetary stimulus and a stronger command over the Covid-19 virus itself (IMF, 2021a). In contrast, many developing and emerging countries are still struggling with the virus and have suffered from a lack of fiscal, monetary, and policy space to match the economic responses of the advanced economies and China.

All too often, debt service is hampering crisis responses and worsening development prospects. In many developing and emerging countries, external public debt service is greater than health care expenditure and education expenditure (Munevar, 2021a). Thus, instead of being able to support their people to weather the crisis and invest in a sustainable recovery, governments are required to repay their creditors. UNDP estimates that close to US$1.1 trillion is due in debt service payments by developing and emerging countries in 2021 alone (Jensen, 2021). Just 2.5% of that amount would be enough to vaccinate two billion people under the COVAX initiative.

On top of the Covid-19 response, there is an urgent need to scale-up investment in development and climate resilience. Many countries, including many Small Island Developing States, are suffering a triple crisis: debt, Covid-19, and climate change. The service of public debt crowds out room for crucial investments that developing countries need to undertake in order to climate-proof their economies and achieve a green, resilient, and equitable recovery. These investments are urgent: Governments must climate-proof their economies and public finances or potentially face an ever-worsening spiral of climate vulnerability and unsustainable debt burdens (Volz et al., 2020b). There is a danger that vulnerable developing countries will enter a vicious circle in which greater climate vulnerability raises the cost of debt and diminishes the fiscal space for investment in climate resilience. As financial markets increasingly price climate risks, and global warming accelerates, the risk premia of these countries, which are already high, are likely to increase further. The impact of Covid-19 on public finances risks reinforcing this vicious circle. For instance, debt service in Caribbean countries, which are among the most climate-vulnerable in the world, currently absorbs between 30% and 70% of government revenues (Bárcena, 2020), providing little room for supporting livelihoods during the crisis, not to speak of much-needed investments in climate resilience.

Past debt crises ought to have taught us that avoiding proactive and purposeful debt restructurings will delay recoveries and ultimately drive up the cost for debtors and creditors alike. The world is still at high risk of repeating the mistakes that resulted in two lost decades of development in the 1980s and 1990s.

In November 2020, we put forward a proposal for Debt Relief for a Green and Inclusive Recovery (Volz et al., 2020a) – a call for an ambitious, concerted, and comprehensive debt relief initiative that should be adopted on a global scale to free up resources to support recoveries in a sustainable way, boost economies' resilience, and foster a just transition to a low-carbon economy. We have argued that the option for debt relief should not only apply to low-income countries – as is the case with the Common Framework – but also to middle-income countries that have been hit hard by the pandemic, with dramatic increases in extreme poverty (Atanda and Cojocaru, 2021). Importantly, our proposal has highlighted the importance of linking debt restructuring with the need to build resilience and a commitment by creditors and debtor countries alike to align newfound fiscal space with globally agreed climate and development goals.[1]

1 In our original proposal, we also proposed debt-for-climate or debt-for-sustainability swaps for countries that are not heavily indebted but have reduced fiscal space due to Covid-19. For these countries, such swaps would facilitate raising climate ambitions in the form of additional actions or investments in climate adaptation (such as in the proposal on debt-for-climate adaptation swaps developed by ECLAC (2017)) or mitigation, or biodiversity conservation. Such debt swaps would be voluntary and not conducted as a distressed debt exchange. Various other proposals for debt swaps have been put forward in the present context of the Covid-19 crisis (Steele and Patel, 2020; Yue and Nedopil Wang; Simmons et al., 2021), and first pilots are being developed (IIED, 2021). For review of experiences with debt swaps, see Caliari (2020) and Essers et al. (2021). To raise climate or other sustainability ambitions, this could be complemented by an incentive scheme for the issuance of new, sustainability-aligned sovereign debt. For further details, see Volz et al. (2020a).

In this report, we develop this proposal further. The Common Framework urgently needs to be enhanced to allow for comprehensive debt relief that is oriented around a green, inclusive recovery. To that end, we suggest the following amendments.

First, instead of waiting for countries to come forward and apply for debt relief individually, the Framework should recognise that a systemic crisis demands a systemic solution. The G20 should encourage all low- and middle-income countries whose debt is considered unsustainable to participate in a comprehensive debt restructuring. And when assessing debt burdens, the analysis must include climate and other sustainability risks – including stranded asset risks – as well as estimates of a country's financing needs for climate-change adaptation, mitigation, and achieving the broader goals set out in the 2030 Agenda for Sustainable Development.

Equally important, governments receiving debt relief would commit to reforms that align their policies and budgets with Agenda 2030 and the Paris Agreement. Some portion of the restructured repayments will be channelled into a Fund for Green and Inclusive Recovery (or an already existing national fund that could be used for this purpose) that can be used by the government for investment in SDG-aligned spending. The government would be free to decide how to spend the money from this Fund, as long as it is demonstrably helping a green and inclusive recovery and contributes to achieving the SDGs.

Moreover, the Framework needs to incorporate adequate incentives to ensure that private creditors participate and bear a fair share of the burden. If an enhanced Debt Sustainability Analysis (DSA) asserts that a country's sovereign debt is of significant concern, the IMF should make its programmes conditional on a restructuring process that includes private creditors. Here, Brady-type credit enhancements for new bonds that would be swapped for old debt with a significant haircut would facilitate debt relief negotiations with private creditors. To this end, we propose a Guarantee Facility for Green and Inclusive Recovery managed by the World Bank. If payments on the new bonds are missed, the collateral would be released to the benefit of private creditors, and the missed payments would have to be repaid by the sovereign to the Guarantee Facility.

Seven months after releasing the Common Framework, not a single restructuring (or debt «treatment», as the Common Framework calls it) has been concluded, notwithstanding a deepening crisis in several eligible countries. We consider this to be strong evidence that the crisis architecture needs further development. The G20 Common Framework for Debt Treatments will not suffice to tackle the debt problem facing many developing and emerging economies. This is a systemic problem, and a global and systemic response is needed. The international community, and the G20 in particular, need to agree on an ambitious agenda for tackling debt crises and providing countries with the fiscal space for sustainable crisis responses.

The G20 need to be bold, and they need to act now. Past experience tells us that delaying the response to debt crises leads to worse outcomes and higher costs. Kicking the can down the road will turn out to be the costlier approach, for both debtors and creditors. The international community only agreed to a comprehensive initiative – the Heavily Indebted Poor Countries (HIPC) Initiative – after more than two decades of repeated piecemeal debt rescheduling and progressively increasing debt reductions. Postponing inevitable sovereign debt restructurings caused prolonged underinvestment in health, education, and infrastructure, and it resulted in lost decades to development, with increased unemployment and poverty for the mostly African and Latin American countries trapped in a debt overhang.

Although we emphatically support the calls for a Sovereign Debt Restructuring Mechanism, we recognise that many years of discussions have not yet resulted in a workable multilateral agreement. Time is of the essence in providing countries the fiscal space to stage green and inclusive recoveries. This proposal is designed to address the immediate challenges facing indebted developing and emerging economies to enable swift recoveries and address the most urgent needs in terms of financing Agenda 2030 and the Paris Agreement. But it could also provide a stepping stone towards a new global debt architecture that is fair, transparent and efficient, and cognisant of the needs of developing and emerging countries.

IMF Managing Director Kristalina Georgieva and World Bank President David Malpass both announced that their institutions would develop a scheme for linking debt relief with green, resilient, and inclusive development (Shalal, 2021). This report provides a blueprint for doing so.

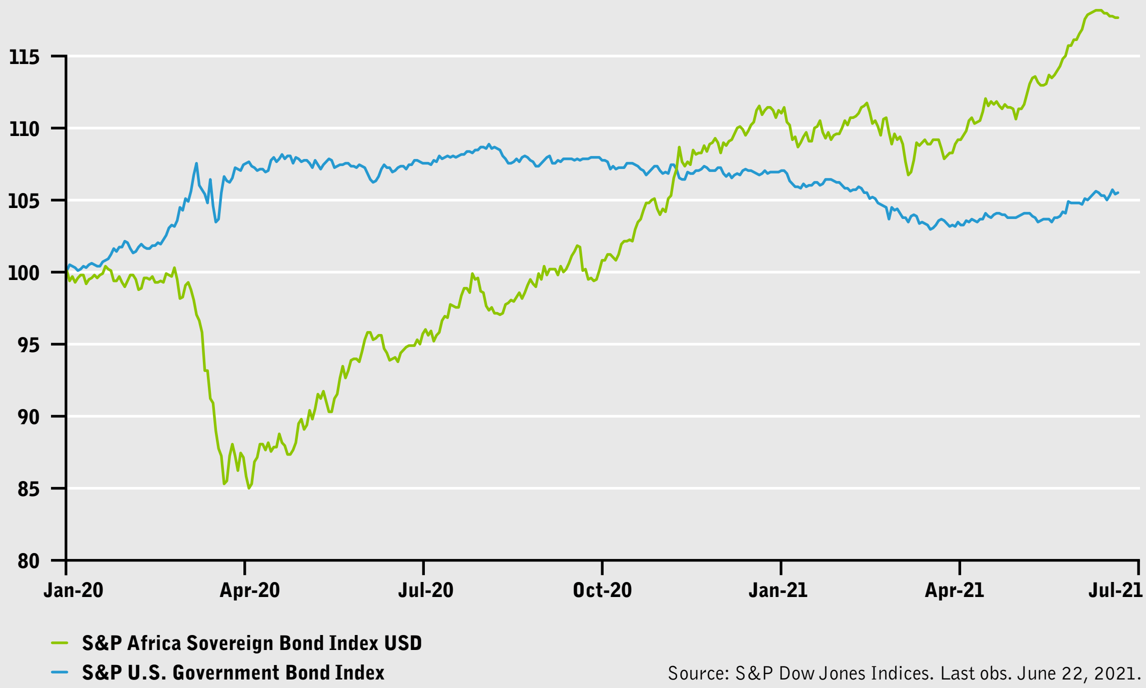
# 2. The Calm before the Storm: A Debt Crisis Is Looming

Since the heights of financial market turmoil and the large-scale withdrawal of international capital from developing and emerging economies at the outbreak of the Covid-19 crisis, markets have stabilised, and some – but by no means all – developing and emerging economies have seen a return of capital and an easing of borrowing conditions. However, although a rise in commodity prices and more favourable conditions in bond markets may provide temporary relief, they mask the deeper underlying fact that many developing and emerging economies will be hamstrung in their attempts to mobilise the resources necessary for a full green and inclusive recovery that puts the developing and emerging countries on a track to meet their climate and development goals. Moreover, risks continue to loom large, and for some countries a new round of debt issuances may indeed undermine debt sustainability. The IMF (2021a) is concerned that the recovery in advanced economies may lead to some overheating and subsequent interest rate hikes that could trigger capital outflows and exchange rate depreciations that could balloon already concerning levels of external debt across the world. Indeed, a US interest rate rise could spell trouble for developing and emerging markets (Kalemli-Özcan, 2021). In this section, we explore the issues with respect to African debt markets while recognising that the debt crisis extends well beyond Africa to many more countries.

## «Happy days» again in African debt markets?

In May 2021, investors in African sovereign debt had a spring in their steps. The buoyant mood was being driven by a robust recovery of commodity prices and the prospect that the envisaged increase in the issuance of Special Drawing Rights (SDRs) by the IMF will throw poorer countries a lifeline, raising hopes of effectively bailing out investors. Never mind the low level of progress on vaccinations and IMF warnings about «divergent recoveries» (IMF, 2021a). Although the IMF was more optimistic about advanced economies in the April update of the World Economic Outlook, weak growth forecasts for African countries have been left almost unchanged. Still, African bond prices have surged this year, regardless. Since the beginning of the year, African foreign currency government bonds have returned 3.5% (Figure 1). Over the past 12 months, they returned investors more than 20%, compared to negative returns on US government bonds. Angola's bonds have returned more than 10% so far this year, Zambia's more than 20% (Karunungan, 2021). A large majority of bonds trade above par. This is an impressive financial recovery.

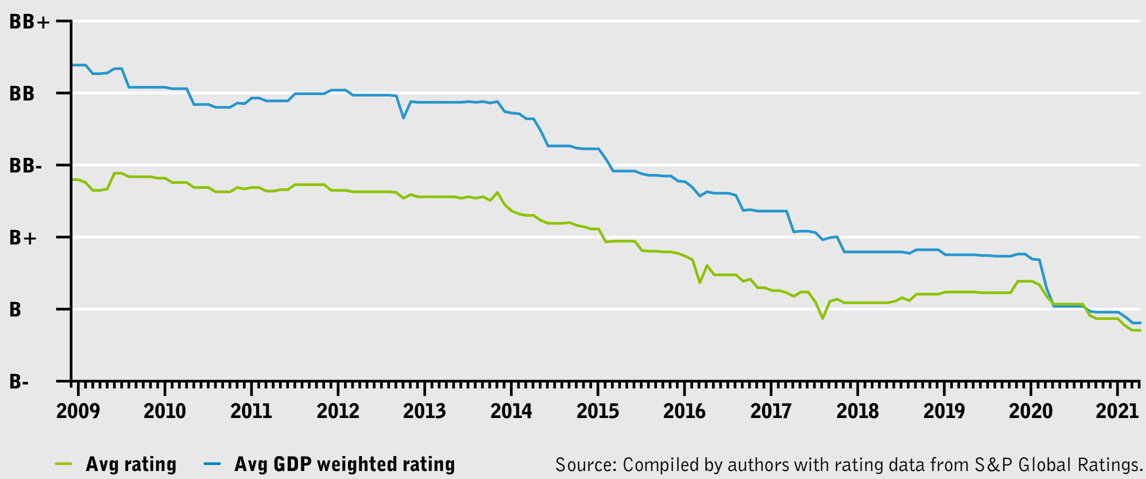
Fig. 1: Sovereign bond index (Jan. 1, 2020=100)




Source: S&P Dow Jones Indices. Last obs. June 22, 2021.

African sovereigns had taken the brunt of the Covid-19 downgrades of rating agencies last year (Kraemer, 2021a). But suddenly African upgrades crept in in early 2021 when Moody's raised Benin's rating to B+ in early March (Kraemer, 2021b). Fitch improved the rating outlooks on both Benin and Cameroon. Nevertheless, the overall rating momentum for African sovereigns remains deeply negative. Downgrades outnumbered upgrades by a ratio of 5-to-1 in the first quarter of 2021 (Kraemer, 2021b). Indeed, sovereign credit ratings of sub-Sahara African countries have shown a long-term deteriorating trend (Figure 2). Investors snapping up frontier market governments' Eurobonds in an increasingly desperate hunt for yields had ample warning that credit risk was rising.

Fig. 2: Sub-Sahara Africa Rating History, December 2008 – April 2021
Note: This comprises data for the 19 countries in Sub-Sahara Africa rated by S&P Global Ratings




Source: Compiled by authors with rating data from S&P Global Ratings.

Even some bond issuance has returned after drying up entirely between March 2020 and late 2020. In November 2020, Cote d'Ivoire (€1 billion 10 years) was the first sub-Saharan government to issue bonds since the outbreak of the pandemic. Benin followed in January 2021 (€1 billion), extending its euro-yield curve to an unprecedented 30 years (Nourou, 2021). Both sovereigns have credit metrics and debt ratings that are far superior to the averages of African peers. Both issuances were also heavily oversubscribed, as was Senegal's €775 million offering of sovereign bonds maturing in 2037 that it made in early June (Ba, 2021). However, even Ghana, a country with a much more stretched government balance sheet, was able to tap international capital markets in March, becoming the first sub-Saharan African sovereign to issue a Eurobond in US dollars since the onset of the Covid-19 pandemic (African Markets, 2021). It was also the first African government to ever issue a zero-coupon Eurobond. Such a structure helps the Treasury to push debt service costs further into the future, as no interest is due until maturity in 2025. This was widely commented upon in positive terms as an innovation. But it may just as well be a sign that the country's debt-service capabilities will be somewhat impaired over the coming years, as reflected in its low «B-« ratings by S&P and Moody's. The zero bond's yield premium of some 100 basis points also seems to indicate vulnerability (Roy, 2021). And yet, Ghana has announced its return to the Eurobond market to fill its burgeoning gap in fiscal accounts. The West African nation is planning to raise as much as US$1 billion through a sale of sustainable bonds, including Africa's first social debt to fund a flagship policy to broaden access to education (Dzawu, 2021). Premiers galore in Ghana, currently the golden boy of frontier investors.

## All that glitters is not gold

The soothing calm and palpable enthusiasm in the African debt market is deceiving. None of the problems of debt overhangs in poor countries have been resolved. Not in Africa and not elsewhere. Indeed, although 30 sovereigns in sub-Saharan Africa (or 80% of all eligible countries in the region) have participated in the G20's DSSI framework for debt owed to official creditors introduced after the outbreak of the pandemic, almost none have requested a debt «treatment» (a.k.a. a restructuring) under the Common Framework. So far, only Chad and Ethiopia have come forward. All other governments opted to kick the can down the road. The G20 decided that the road will end on 31 December 2021, when the DSSI is scheduled to be discontinued. Not only will DSSI savings no longer accumulate, but the suspended debt service costs during 2020 and 2021 will need to be made from 2022 onwards in a yet to be determined schedule. The amounts can be significant. For example, the IMF estimates that Angola's potential DSSI postponement can amount to more than US$3 billion (or 3.3% of GDP), Kenya's more than US$1 billion (1.4% of GDP), and Ghana's more than US$500 million (0.9% of GDP).

The deep-rooted reluctance to clear the deck and restructure the debt is driven by a fear of jumping into the unknown: African governments remain fearful that a debt restructuring and the concomitant declaration of a technical default by the rating agencies – would bar countries from access to capital markets for extended periods of time and make them pariahs in international finance. This concern is understandable, as it is also actively promoted by certain creditor representatives. But the fear is nonetheless misplaced.

Logic and ample precedent suggest that a restructuring would improve sovereigns' balance sheets and creditworthiness, and therefore allow them to access capital markets sooner and at better conditions (Kraemer, 2020). This is all the truer in an environment where global liquidity remains bountiful and interest rates for highly rated debt remain at rock bottom, notwithstanding some twitching signs of life in the US Treasury market. Investors can well appreciate that debt distress is the collateral damage of the most dramatic global economic shock in living memory. That is something well outside the realm of responsibility of debtor governments and will not be viewed as a precursor of future defaults.

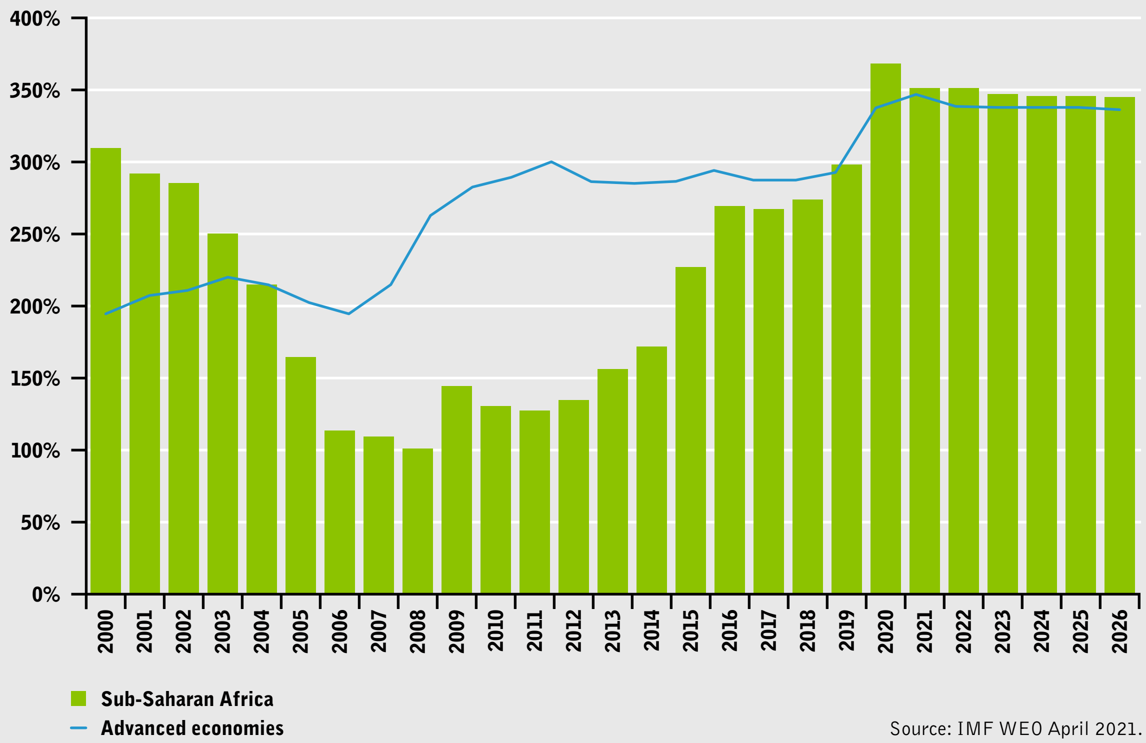
Still, not a single restructuring has been concluded. Not even Zambia appears to be close to a breakthrough. The country was in debt distress well before the pandemic started and agonisingly tried to avert default until eventually missing a Eurobond payment in October 2020, making it the first sovereign default in Africa during the Covid-19 era.

Bond buyers appear to interpret the absence of debtor demands for restructuring as an all-clear sign. But then again, maybe we are in the eye of the storm, in a brief period of deceptive tranquillity. The dearth of debt restructurings may not last. According to the IMF, six low-income sub-Saharan sovereigns were already «in debt distress» at the end of April 2021 (only one country outside of Africa, Grenada, was already in distress). A further 13 sub-Saharan sovereigns are at «high risk» of debt distress, and only two (Tanzania and Uganda) are deemed to be at «low risk» (compared to eight countries outside of Africa).

## African credit metrics do not look encouraging

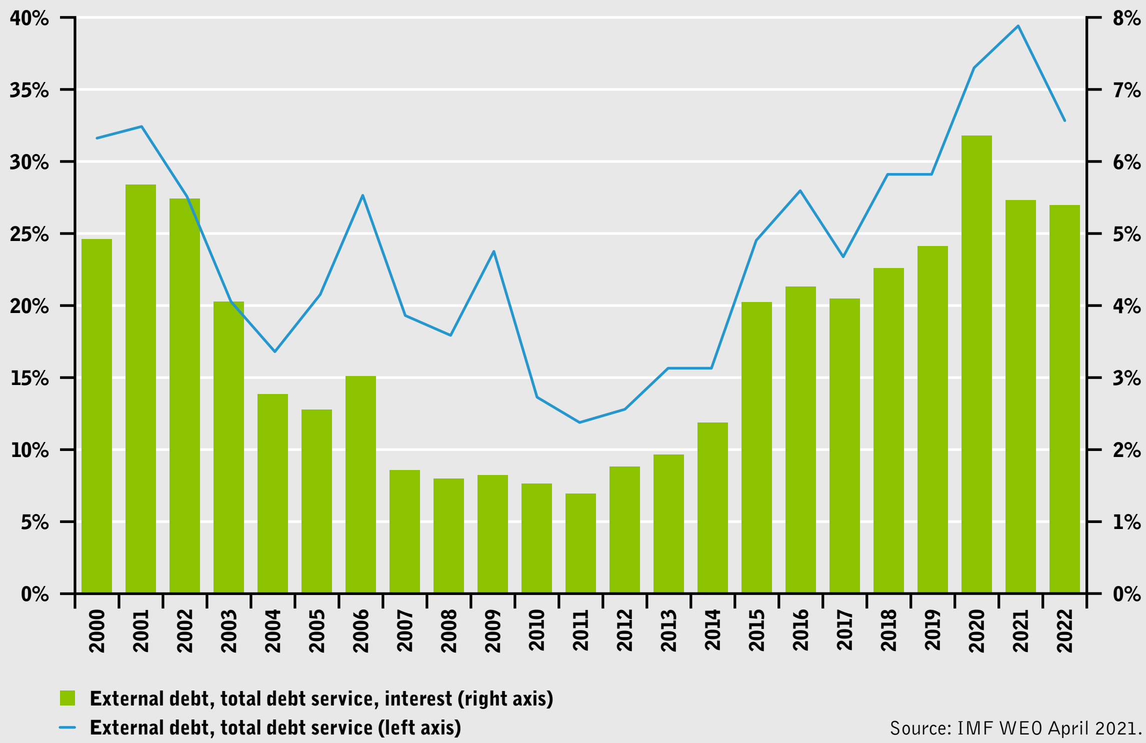
Figures 3 and 4 demonstrate that different debt burden metrics indicate that the governments' financial situations in the region remain precarious. Debt and debt service costs are, on average, where they stood at the beginning of the century, when the debt overhang was reduced in a purposeful and comprehensive debt relief effort through the HIPC initiative. And the challenging debt metrics two decades ago happened at a time when the world economic environment was much more benign than it is today. On average, more than half of the debt increase preceded the pandemic. Leverage really took off after the fall of commodity prices in the mid-2010s and the simultaneous hyper-stimulus from the world's leading central bankers, making foreign borrowing easy even for lowly-rated frontier sovereigns.

**Fig. 3: Sub-Saharan Africa: Public debt stuck near record levels (government debt as % of revenues)**




Source: IMF WEO April 2021.

**Fig. 4: Sub-Saharan Africa: External debt service burden remains at pre-HIPC levels (% of exports)**

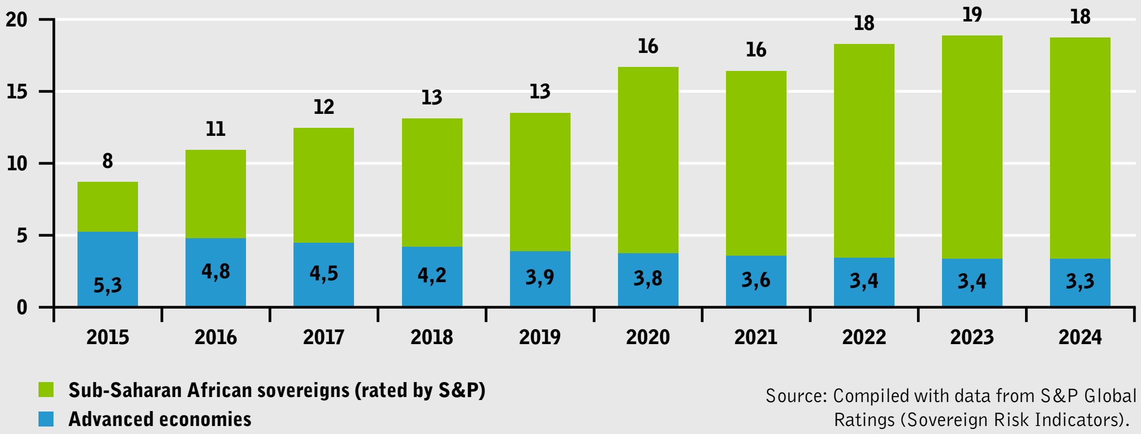



Source: IMF WEO April 2021.

As a share of revenues, African countries now have a higher debt load than the far more resilient and richer advanced economies (Figure 3). But the bad news does not end here. As Figure 5 shows, the interest burden of 18 rated sovereigns in sub-Saharan African has more than doubled since 2015, whereas it has dropped by more than a third in advanced economies, according to data from S&P Global, a rating agency. As a share of government revenue, African nations now need to stump up more than five times as much as advanced economies, up from «only» 1.6 times in 2015. And this is only the average. Individual sovereigns must dedicate even more of their scarce government resources to debt service: Five countries spend more than a quarter of government resources on interest alone (in descending order: Ghana, Zambia, Angola, Nigeria, and Kenya). On average, the interest-to-revenue ratio increased by 9.7 percentage points between 2015 and 2022, and by more than 25% points for the first three sovereigns listed in the previous sentence). All African sovereigns rated by S&P saw their interest burdens go up, with the sole exception of the Democratic Republic of the Congo, where the interest ratio declined by a marginal 0.1% of revenues. The contrast with advanced economies could not be plainer: For developed economies, the government interest-to-revenue ratio fell on average by a third, to only 3.3% of revenue, with only Israel and Japan logging (small) increases.

In many African countries, but also developing countries elsewhere, debt service is obstructing decisive crisis responses and worsening development prospects. Eurodad found that, in 2020, external public debt service was greater than health care expenditure in at least 62 developing countries, while external public debt service was greater than education expenditure in at least 36 countries (Munevar, 2021a). In other words, instead of being able to support their people to weather the crisis and invest in a sustainable recovery, governments are required to repay their creditors.

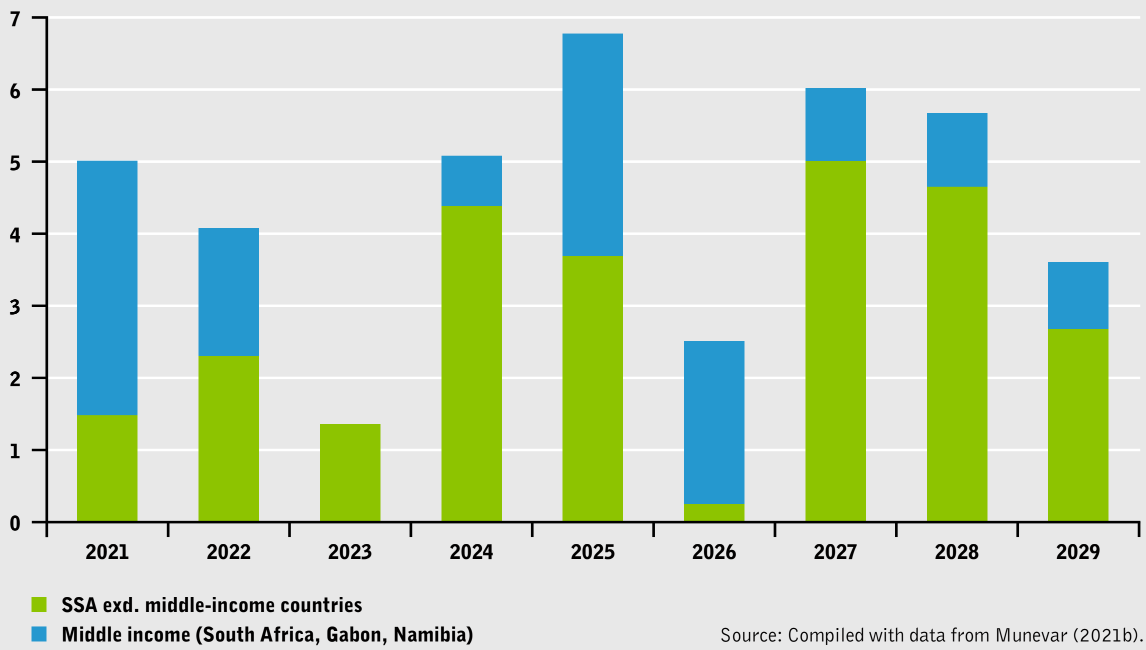
**Fig. 5: Government interest expenditure (% of gov. revenues)**




Source: Compiled with data from S&P Global Ratings (Sovereign Risk Indicators).

A specific factor may be supporting African debt markets in 2021. In the near term, relatively few sovereign Eurobonds issued by low-income governments are maturing (Figure 6). This implies that comparatively little new issuance is needed to roll over bonds coming due; 2022 will see a modest increase in maturities, but 2024 will be the crunch time. If there is no solution to the debt overhang by then, expect distressed debt exchanges to become more common.

**Fig. 6: Sub-Saharan Africa Eurobond maturities, US$ billions**




Source: Compiled with data from Munevar (2021b).

The debt service of middle-income countries has doubled since the global financial crisis and surpassed US$1 trillion even before the pandemic, according to World Bank estimates. As a share of exports, debt service was close to 5%, which is not exceptionally high by historical standards. But the average hides huge differences within this heterogeneous country grouping: The ratio is in excess of 30% for countries as diverse as Pakistan, Argentina, and Jamaica, whereas others, including China, enjoy ratios below 2%. Some middle-income countries have the same urgent needs for debt relief than their poorer peers. Any debt strategy excluding those countries will be incomplete.

Olkaria, the first geothermal power plant in Africa in Nairobi, Kenya.

# 3. Debt Sustainability Analysis: Getting It Right

Eligibility for debt relief should be a function of debt sustainability, which should be determined in a substantially enhanced DSA carried out by the IMF and the World Bank in close partnership with the debtor government, with inputs from other institutions.[2] DSAs need to be based on realistic assumptions and account for climate risks (both physical and transition risks) and spending needs to scale-up investment in climate resilience, the transition to a green economy, and Agenda 2030.[3]

The DSA is a formal framework introduced by the IMF in 2002 to examine the sustainability of public and external debt in order to «better detect, prevent, and resolve potential crises» (IMF, 2017). The IMF (2013: 147) defines debt sustainability as a situation in which «a borrower is expected to be able to continue servicing its debts without an unrealistically large correction to its income and expenditure balance». The IMF has developed two separate DSA frameworks: one for market-access countries, and one for low-income countries.

Current DSAs are not fit for the job. DSAs have been criticised for being based on overly optimistic scenarios and underestimating risks (Guzman and Heymann, 2015). Importantly, to date, DSAs have not included climate or other sustainability risks, nor have they accounted for crucial investment needs for climate adaptation or achieving the SDGs (Volz and Ahmed, 2020).

Assessing debt sustainability is a very complex task, which has been described by a senior IMF official as «more art than science» (Lawder, 2021). Projections of public debt are highly sensitive to assumptions about growth, budget outcomes, and interest rates, making it very difficult to determine ex ante whether debt levels are sustainable (Wyplosz, 2011). Integrating climate risks into public finances and crucial spending needs for climate adaptation and for achieving the SDGs adds further layers of complexity, yet ignoring factors that are likely to become major drivers of sovereign risk (Volz et al., 2020b; Klusak et al., 2021) is not an option. Empirical evidence indicates that climate change has already increased the cost of sovereign debt of vulnerable countries, and these effects are expected to increase (Buhr et al., 2018; Beirne et al., 2021). Countries that cannot invest in climate resilience and development will have even less debt sustainability in the future.

**2** For an overview of the IMF-World Bank Debt Sustainability Framework and DSAs, see Cassimon et al. (2016).

**3** See UNCTAD (2021).

Similarly, fossil fuel producing countries are facing significant stranded asset risk, and hence sovereign risk, if they continue to invest in expanding fossil fuel production facilities. As the International Energy Agency (IEA) has made clear in its recent report (IEA, 2021), no investments in new coal, oil, and gas fields are needed in a Net Zero by 2050 scenario. DSAs need to account for stranded asset risk as well as new investment needs to implement development strategies that are less dependent on income from fossil fuel exports.

The current Guidance Note on the Bank-Fund Debt Sustainability Framework for Low Income Countries for IMF and World Bank staff already gives room for incorporating sustainability considerations in the DSA. Indeed, the objective of the Debt Sustainability Framework «is to support efforts by LICs to achieve their development goals while minimizing the risk that they experience debt distress» (IMF, 2018: 5). The Framework is intended to guide «fiscal policy and borrowing decisions» in light of «sizeable public investment [needs] to address infrastructure gaps, strengthen potential output growth, and reduce poverty» as indicated in «ambitious targets, reflected in the Sustainable Development Goals» (IMF, 2018: 5). Importantly, the guidance stipulates that long-term macroeconomic projections (i.e. those beyond five years) and financing assumptions «should take account of spending pressures associated with making progress towards a country's development goals (for example, the SDGs)» (IMF, 2018: 58). However, in practice, climate and sustainability considerations have not sufficiently been incorporated in DSAs to date, if at all.

The IMF's (2021b: 38) recent Review of the Debt Sustainability Framework for Market Access Countries marked an important milestone as it recommended «to incorporate long-term macroeconomic implications of climate change» for «[c]ountries with existential or high vulnerability to climate change per exposure, susceptibility and adaptive capacity». The review recommends that DSAs include projections for growth impacts and additional climate change spending and their impact on debt ratios over a period of 30 years.

The IMF and the World Bank need to implement these recommendations swiftly and comprehensively in DSAs for both LICs and Market Access Countries, accounting for both physical and transition risks. This should include climate stress-testing countries' public finances and balance of payments under different scenarios, including a 1.5°C scenario such as the one developed by the IEA (IEA, 2021). This would, in particular, reveal macro-financial vulnerabilities of fossil fuel producers.

Regarding investment needs in resilience and the SDGs, estimating the incremental financing needs related to achieving the SDGs and climate change is undoubtedly challenging. National Sustainable Development Strategies, Nationally Determined Contributions (NDCs), and other national plans can give an idea of a country's projected financing needs, sources (national vs international), and terms (grant vs loan), but the DSA process will need to give them a critical assessment, given these are essentially political documents. DSA processes will also have to account for the fact that climate pathways that drive adaptation needs are highly uncertain, so cost estimates vary greatly depending on the assumption of what a country is «adapting to», as well as depending on a country's level of risk tolerance and preference between risk reduction investments vs risk management financing instruments. Likewise, on mitigation, assumptions concerning baseline trends as well as ambition are highly variable. Yet, despite these complexities, properly accounting for climate risks and SDG spending needs is key to ensuring that DSAs reflect the fiscal realities and needs of developing and emerging economies.[4] The IMF can build on the estimates for the spending requirements for meaningful progress on the SDGs in five key development areas – education, health, roads, electricity, and water and sanitation – for 155 countries (49 LICs, 72 emerging market economies, and 34 advanced economies) that its staff have already produced (Gaspar et al., 2019).[5] These should be factored into fiscal spending projections used in DSAs.

The enhanced DSAs should provide the basis for decisions on eligibility for debt restructuring. The assumptions and calculations of enhanced DSAs should be made fully transparent. The amount of debt relief, should it be required, should be based on the outcomes of the DSA. It should strive to provide the country with the fiscal space required to achieve a sustainable development pathway in line with the Paris Agreement and Agenda 2030. These assessments by the IMF and the World Bank could be reviewed by an independent mediator, upon request of the debtor country.[6]

**4** See Markandya and Galinato (2021) for a methodology for assessing countries' financial needs to meet the SDGs through natural capital investment.

**5** See also Benedek et al. (2021).

**6** UNCTAD is performing several DSA analyses and could serve as external expert and mediator.

# 4. Creating Incentives for Private-Sector Participation

Any debt restructuring framework needs to incorporate adequate incentives to ensure that private creditors participate and bear their fair share of the burden. If a DSA asserts that a country's sovereign debt is of significant concern, the IMF needs to make potential new programmes conditional on a restructuring process that includes private creditors.[7]

Debtor countries that seek bilateral haircuts will be required to seek commensurate relief from private creditors, and incentives need to be designed to ensure that private creditors grant such relief. Lending by multilateral development banks (MDBs) and humanitarian assistance will continue to flow, but on condition that it is not used to pay private creditors. Debt owed by multilateral institutions would only be restructured for countries eligible for support from the International Development Association (IDA). To safeguard the preferred creditor status of multilateral institutions, their losses would need to be financed with bilateral contributions, the proceeds from gold sales, or potentially through the recycling of allocations of SDRs.

To secure the participation of private creditors in debt restructuring, these need to be convinced that participation is better than abstention. Experience with past debt restructurings suggests that a combination of positive incentives («carrots») and pressure («sticks») is required. Our proposal involves both.

## 4.1 Guaranteeing Restructured Debt through a Facility for Green and Inclusive Recovery

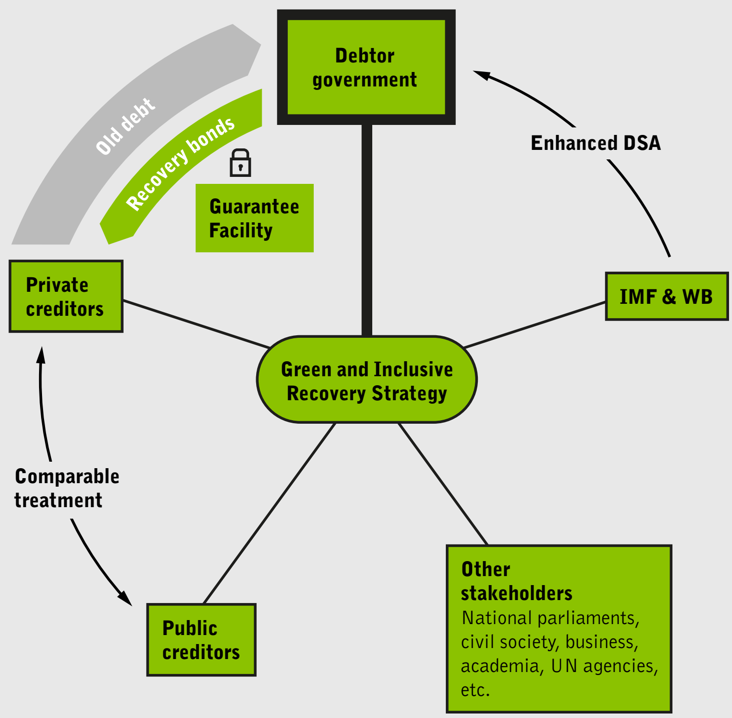
Drawing on past successes of debt restructuring that involved significant participation from the private sector, we propose a World Bank sponsored Guarantee Facility. The Facility will back the payments of newly issued sovereign bonds that will be swapped with a significant haircut for old and unsustainable debt. The Facility will provide a partial guarantee of the principal, as well as a guarantee on 18 months' worth of interest payments, analogous to the Brady Plan. The credit enhancement and security of the new bonds has served as a «carrot» to bondholders in the past, especially when paired with «sticks» that would penalise those bondholders for not participating. It should be noted that this would not amount

7 As during the debt restructurings under the Brady Plan, the IMF could adopt a flexible approach to disbursing loans while the debtor government is negotiating for debt relief with the private creditors (Griffith-Jones et al., 2021).

to a public bailout of private creditors, as these would have to accept a significant haircut on their old debt.

Figure 7 outlines how the full scheme will work. The first step is an enhanced DSA that is performed by the IMF and the World Bank and incorporates realistic revenue mobilisation needs and considers the potential for climate risk for participating countries (see Section 3). That process determines which countries may need restructuring and what the size of the debt relief may need to be.

**Fig. 7: Guaranteeing a green and inclusive recovery**

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The linchpin of our proposal is a new guarantee facility, the Facility for Green and Inclusive Recovery, designed to entice the commercial sector to engage in the restructuring. This new Facility will be administered by the World Bank. Private creditors would swap old debt for new bonds at a significant haircut determined by the enhanced DSA. The new Guarantee Facility would provide credit enhancements for new bonds that would be swapped for old debt, facilitating restructuring negotiations. If payments on the new bonds are missed, the collateral would be released to the benefit of private creditors, and the missed payments would have to be repaid by the sovereign to the Guarantee Facility.

The Guarantee Facility could be financed in a number of ways. One option is financing the Facility from the World Bank's existing balance sheet, with additional contributions from regional development banks. A number of studies have shown that for the past decade, the World Bank and other MDBs have not been optimising their balance sheets and could lend upwards of US$200 billion without jeopardising their AAA ratings (see Munir and Gallagher, 2020). Another option is through a World Bank capital increase, funded through recycled SDRs or by developed member countries. While the World Bank would have to «book» their guarantees as loans, they only have to account for 25% of each guarantee (World Bank, 2021).[8] On the debtor side, they only pay relatively small fees for the guarantee unless the guarantee is activated in the case of a missed loan payment (World Bank, 2021).[9]

Guarantees on new debt issuance swapped for old and unsustainable debt proved very valuable to bring commercial creditors to come to the table in the past, as was the case with «Brady-bond» restructurings at the end of the last century (see Griffith-Jones et al., 2021). When countries are in debt distress, such that there is a risk they may default, commercial actors (bond holders, commercial banks) are more apt to restructure so that they can recoup at least some amount of their initial investments.

The proposed World Bank Guarantee Facility would ensure that the commercial actors (whether bondholders or commercial banks) will receive up to 18 months' worth of interest payments in the case that the sovereign misses a payment, and provide a (partial) guarantee of the value of the new bonds. This will be attractive to the holders of those new bonds, as well as to those that may want to purchase those bonds on secondary markets. This brings another incentive: Bondholders and commercial banks can reduce their concentration risk by selling the bonds on secondary markets if they wish. This may not only be attractive to bondholders, but also to commercially oriented banks that have longer term bank loans to distressed countries on their balance sheets. Those loans could be converted to bonds and then sold in order to reduce concentration risks and help the balance sheets of commercial banks.

8 On guarantees, see also Studart and Gallagher (2018).

9 In the case of countries eligible to receive support from the International Development Association, Landers (2020) discusses operational details on how – if suitably adapted – such a mechanism could operate and be funded. For low-income countries and IDA-eligible lower-middle-income countries, the IDA could issue policy-based guarantees through its non-concessional scale-up facility. This has two advantages. First, it means that the guarantee does not come out of a country's performance-based allocation envelope, so it would not reduce a country's overall IDA program, including especially new loans. (Countries in the past have been hesitant to apply for guarantees because each dollar assigned to a guarantee reduces its overall IDA enveloped by 25 cents; the countries that did use this scale-up facility, such as Ghana in 2015 for bond issuance, actually used up quite a bit of their quota for new borrowing with the IDA.) Second, IDA finances the scale-up facility through its own bond issuances, not donor contributions, so the IDA would not need to fundraise for this mechanism – it could simply issue more debt and pass along the low cost of funds it obtains through its triple A rating to the borrowing country.

## 4.2 Supporting Measures: Regulatory Incentives and Moral Suasion

History has shown that carrots work best when accompanied with a stick. Here, the IMF and G20 countries such as the United States, the United Kingdom, and China can play a key role. The vast majority of distressed debt in middle-income countries is bondholder debt, whose contracts lie in New York and the City of London. One of the largest sources of low-income country debt that is distressed is from commercial and overseas development banks in China. In the past, the United States and European countries have used moral suasion and regulatory tools to further incentivise commercial participation in restructurings.

During the restructurings of the 1990s, the IMF threatened to hold back emergency financing until a restructuring was underway and to be the first to disburse upon a successful restructuring. In tandem, the United States Federal Reserve threatened that commercial banks might be required to increase their reserves if they did not participate (ECLAC, 1990; Griffith-Jones et al., 2021). In the first major debt restructuring under the Brady Plan, senior officials in the US Treasury and Federal Reserve put strong pressure on US banks to reach an agreement with Mexico and took the unusual initiative of «inviting» top-level negotiators of the banks to negotiate a debt reduction agreement with the Mexican economic authorities (ECLAC, 1990). Several countries also introduced tax incentives for banks to participate in debt restructuring (Griffith-Jones et al., 2021). More recently, the United Kingdom ruled in 2010 in a manner that prevented creditors from acting

The Gautrain is the backbone of the local traffic system in Gauteng, South Africa, connecting Johannesburg, Pretoria and the international airport Tambo.

against nations participating in the HIPC initiative, and the United States has issued executive orders to deal with potential litigation during the restructuring of Iraqi war debt in 2002 (Buchheit and Gulati, 2018; Hagan, 2020).

Today's creditor structure differs significantly from previous episodes of debt distress, in which sovereign debt was owed to a relatively small group of commercial banks in the major advanced economies. Still, the financial authorities of the jurisdictions in which the major private creditors reside could nevertheless use strong moral suasion and regulations on accounting, banking supervision, and taxation to improve creditors' willingness to participate in debt restructuring. Even though the identities of around three-quarters of the holders of outstanding developing and emerging country bonds is unknown, the remainder is held by institutional investors, with a high concentration in large asset managers based in the United States as well as the European Union, the United Kingdom, and Switzerland (Munevar, 2021b). For low-income country debt, the major Chinese commercial and overseas development banks are the largest holders. China's role in resolving debt problems is therefore vitally important.[10] Along with the IMF, the financial authorities of the major advanced economies and China, as well as those of other major financial centres, could play a critical role in getting commercial creditors to accept and implement debt reduction.

**10** Chorzempa and Mazarei (2021) suggest that creditor committees could be helpful in facilitating debt restructurings and in coordinating debt relief with China.

# 5. How to Link Debt Relief to a Green and Inclusive Recovery

Debt relief should not only provide temporary breathing space. It should also empower governments to lay the foundations for sustainable development by investing in strategic areas of development, including health, education, digitisation, cheap and sustainable energy, and climate-resilient infrastructure.

Although an agreement on debt restructuring would require debtor countries to commit to reforms that align their policies and budgets with Agenda 2030 and the Paris Agreement, the country commitments would be designed by country governments under the involvement of the parliaments and in consultation with the relevant stakeholders – that is, not imposed on them by the global community – and reflect the needs and priorities of each country.

We hence propose that debtor governments advance their own Green and Inclusive Recovery Strategy, in which they map out a set of actions that the country will undertake under this scheme to advance its development and climate goals. Developing the GIRS should not be a time-consuming and bureaucratic exercise. The GIRS should be a short document that highlights the government's policy priorities for the recovery, along with a set of key performance indicators that it seeks to achieve. Importantly, the GIRS should build on countries' already existing national strategies, plans, and visions, including National Development Plans; National Sustainable Development Strategies; NDCs and NDC updates; National Adaptation Plans and National Adaptation Plans of Action; National Biodiversity Strategy and Action Plans; and Economic Sectoral Plans.[11] The GIRS should include a spending plan and policy reforms and be guided by a set of principles that ensure that the recovery is in line with Agenda 2030 and the Paris Agreement (Figure 8).[12] Importantly, the GIRS should address vulnerabilities identified in the DSA so as to enhance the resilience of the society and economy, and hence also of public finances. Governments participating in debt relief for green and inclusive recoveries should also commit to enhancing debt transparency, strengthening public debt management capacity, adopting sustainable borrowing practices, and strengthening domestic resource mobilisation. The GIRS should define clear targets and performance metrics.

**11** For an overview of key performance indicators for climate and nature outcomes in debt management, see IIED (2021).

**12** These principles draw on Sanchez et al. (2020).

**Fig. 8: Principles for a green and inclusive recovery**

1. Policies and spending should be directed towards supporting green and inclusive recoveries, in line with the SDGs set out in the Agenda 2030, and with the goals of the Paris Agreement.
2. No public money or guarantee should be used to finance the development of new fossil fuel supply.[13]
3. Fossil fuel subsidies should be shifted towards the provision of clean and affordable energy.
4. The recovery should not diminish the integrity of a country's ecosystems but maintain its biodiversity in line with global biodiversity targets.[14]
5. Measures and policies should contribute to enhancing the overall resilience of the society and economy so they are better prepared for a volatile future.
6. Public policies should ensure that the low-carbon transition is a just one.

| | |
|---|---|
| 2030 | Substantiable Development Goals |
| 2050 | Net-zero |

Compiled by authors.

Some of the GIRS may not have any fiscal outlay implications, for example committing to shift subsidies from coal or oil derivatives to renewables and social adjustment, whereas other parts of the plan will have. The envisaged spending under this plan would be sourced from a Fund for Green and Inclusive Recovery (or already existing national fund that could be used for this purpose), into which a portion of the restructured repayments (including cancelled payments to both public and private creditors) would be channelled.[15] The government will be free to decide how to spend the money from this Fund, as long as it is in line with the goals set out in the GIRS.

The draft GIRS would undergo a public and transparent consultation process facilitated by an independent mediator, involving all relevant national stakeholders, in particular the parliament, but also civil society and academia, as well as international stakeholders (including bilateral and private creditors, the World Bank and regional development banks, the IMF, and UN agencies) in order to ensure that the GIRS reflects and achieves the development needs and aspirations of the debtor country, and that it is informed by the

**13** This principle relates to the 1.5 C goal of the Paris Agreement, and the implications of the IEA (2021).

**14** This principle relates to the Convention on Biological Diversity and the Aichi Biodiversity Targets: *https://www.cbd.int/sp/targets/*.

**15** This would be similar to the proposal made by the United Nations Economic Commission for Latin America and the Caribbean (ECLAC) for the creation of a Caribbean Resilience Fund that would be funded out of a debt-for-climate adaptation swap (ECLAC, 2017). A similar proposal was made by Buchheit and Gulati (2021) to fund environmental conservation projects.

latest scientific knowledge regarding the unfolding sustainability crisis. The debtor-country government would revise the GIRS plan based on feedback from this consultation process. The GIRS will then form the basis for a debt restructuring to which debtor government and public and private creditors agree.

An appropriate, transparent mechanism for monitoring, reporting, and verification will be needed to assert that the policy commitments are being implemented and that money from the Fund for Green and Inclusive Recovery is spent by the debtor government according to the GIRS plan. We propose that the responsibility for monitoring, reporting, and verification rests with a steering committee at the Guarantee Facility, involving relevant national and international stakeholders in equal proportions.[16]

In the complex and often conflictive process of debt restructuring, an independent and impartial mediator could help broker good and balanced outcomes. The mediator could be proposed by the UN Secretary-General and agreed upon by the debtor country and a majority of creditors. The mediator would chair the stakeholder hearings regarding the first draft of the GIRS, broker the conversations on the GIRS between debtor countries and creditors (including the IMF and the World Bank), and chair the steering committee to supervise the implementation of the GIRS.[17] On the steering committee, the independent mediator could have a tie-breaking vote. Upon request of the debtor or creditor countries, the mediator could also review the decisions of the DSA regarding the size of the haircut.

If a sovereign were to be found in deliberate and significant violation of their GIRS commitments, the steering committee could decide that the government loses some or all of the haircut. In this case, the country would have to make payments into an escrow account at the Guarantee Facility that is equivalent to the net present value difference of debt service of old and new obligations. If the country's policies are again in compliance with the GIRS commitments within two years, up to two years' worth of excess debt service would be returned to the country and flow into the Fund for Green and Inclusive Recovery for it to be invested in line with previous commitments. If it gets back on track only after a period longer than two years, however, it also gets two years back but loses the remaining payments for good, which will have moved from an escrow account into the general use of the Guarantee Facility. This process would keep incentives intact to come back to the commitments quickly.

**16** The monitoring, reporting, and verification function of the Guarantee Facility could build on the plans developed by the World Bank with the IMF and other stakeholders for a «Collaborative Platform on Debt, Climate, and Nature», which is envisaged as a platform to support a green economic recovery by bringing together the demand and supply of financing for climate and nature action. A similar facility, a «Nature and Climate Sovereign Bond Facility», has been proposed by F4B (2021).

**17** Kaiser (2012: 26) elaborates on the historic example of Hermann Abs, chair of the board of Deutsche Bank and board member of the German state-owned KfW, serving as a mediator in the complex debt negotiations between the Paris Club and Indonesia in 1969.

**Flowchart for debt restructuring**

**Revised DSA accounting for climate risks and investment needs in resilience and the achievement of Agenda 2030 indicates need for debt restructuring**

**Debtor government develops a Green and Inclusive Recovery Strategy**

**Public, transparent consultations with stakeholders, including national parliaments and civil society, academia, bilateral and private creditors, IMF, World Bank, MDBs, and UN agencies**

**Government revises Green and Inclusive Recovery Strategy**

**Agreement on Debt Relief for Green and Inclusive Recovery between debtor government and steering committee**

1. **New Green and Inclusive Recovery Bonds with credit enhancement are swapped with a significant haircut for old debt held by private creditors; commensurate debt relief from bilateral creditors; debt relief by multilateral institutions only for IDA-eligible countries**[18]
2. **Guarantee Facility for Green and Inclusive Recovery managed by the World Bank secures Green and Inclusive Recovery Bonds**
3. **Countries implement Green and Inclusive Recovery Strategy**
4. **A portion of the restructured repayments are channelled into a Fund for Green and Inclusive Recovery (or an already existing national fund that could be used for this purpose) that is used by the government for investment in SDG- and Paris-aligned spending**
5. **Ongoing monitoring, reporting, and verification to assert that the policy commitments are being implemented and that money from the Fund for Green and Inclusive Recovery is spent by the debtor government according to its GIRS**

18 As mentioned before, to safeguard the preferred creditor status of multilateral institutions, their losses would need to be financed by bilateral contributions, the proceeds from gold sales, or potentially through the recycling of SDR allocations.

# 6. The Way Forward

A debt crisis is unfolding in the Global South. Even though a rise in commodity prices and more favourable conditions in bond markets may provide temporary relief for some countries, they mask the deeper debt sustainability problems facing a large number of low-income and middle-income countries. As highlighted by the Group of Thirty (2021: 1), «It would be wrong to conflate recent good economic news with an adequate policy framework at the global level, disregarding major risks ahead.» Protracted recoveries due to insufficient fiscal stimulus and slow progress in vaccinations, as well as a rise in US interest rates could spell havoc for developing and emerging markets.

Already now, high debt service levels are impeding crisis responses and contributing to worsening development prospects, threatening the achievement of the SDGs. Moreover, high debt service levels are crowding out the room for crucial investments in climate resilience. Insufficient amounts of investment in climate adaptation and resilience will undermine both development prospects and public finances. Countries that fail to climate-proof their economies and public finances face an ever-worsening spiral of climate vulnerability and unsustainable debt burdens.

Against this backdrop, we have developed a proposal for comprehensive debt relief for both the low-income and middle-income countries that need it, from both public and private creditors – debt relief that is oriented around a green, inclusive recovery.

Our proposal emphasises the need to enhance the Debt Sustainability Analysis carried out by the IMF and the World Bank to account for climate risks and essential spending needs to scale-up investment in climate resilience and Agenda 2030. To facilitate restructuring negotiations where needed and incentivise private creditors to participate in debt relief and bear a fair share of the burden, we propose a Guarantee Facility for Green and Inclusive Recovery managed by the World Bank. This Guarantee Facility would provide credit enhancements for new bonds that would be swapped for old debt. Governments receiving debt relief would develop their own Green and Inclusive Recovery Strategy and commit to reforms that align their policies and budgets with the Sustainable Development Agenda and the Paris Agreement. Some portion of the restructured repayments would be channelled into a Fund for Green and Inclusive Recovery or an already existing national fund that could be used for this purpose. The government would be free to decide how to spend the money from this Fund, as long as it is demonstrably helping a green and inclusive recovery and contributes to achieving the SDGs.

Implementing such a debt relief for a green and inclusive recovery would not only address short-term needs but also lay the foundation for more sustainable growth and development. It could also provide a stepping stone towards a new global debt architecture that is fair, transparent, and efficient as well as cognisant of the needs of developing and emerging countries. Such an architecture should be centred around a Sovereign Debt Restructuring Mechanism fit for the 21st century, building on the proposal raised by the IMF two decades ago (Krueger, 2002; Hagan, 2005), and provide much-needed transparency on sovereign debt contracts (Gelpern, 2018). Our proposal could also pave the way towards a more widespread use of state-contingent debt instruments by sovereigns.

The time to act is now. Neither low- nor middle-income countries can afford a debt overhang during the most daunting crisis of generations. They should also not be hamstrung in responding to the unfolding climate crisis during the most important decade for resource mobilisation of our times. The world cannot afford to do too little too late while facing a planetary emergency.

Delaying an inevitable debt restructuring will leave overindebted countries and their populations worse off. Governments will fail to safeguard their populations during this terrible health and social crisis, and they will be unable to invest in climate-proofing their economies. It is time for the G20 to step up and provide all countries with the opportunity to pursue a green, inclusive, and resilient recovery. Extending and pretending will not do. We cannot afford a delay nor a replay of past debt crises.

Although debt relief will be crucial for many countries, it will not suffice. Debt relief has to be part of a broader agenda for enabling green and inclusive recoveries in countries around the world. A debt relief effort such as the one proposed should be coupled with significant new lending that is mobilised from development finance institutions, facilitated by capital increases, and possibly a new and ambitious allocation of SDRs in 2022 (on top of the agreed allocation envisaged for autumn 2021). This will provide the fiscal space for emerging markets and developing countries to adopt sustained counter-cyclical responses to the crisis.

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# Authors' Bios

**Shamshad Akhtar** is a development economist and diplomat. She is chairperson of Pakistan Stock Exchange and Chair of the Board of Directors of Karandaaz Pakistan, a collaborative innovative finance and digital financial inclusion platform which is supported by DFID and the Bill & Melinda Gates Foundation. She was the 14th Governor of the State Bank of Pakistan, Pakistan's central bank, the first woman to assume this position. She also served as Finance Minister of Pakistan, holding several economic portfolios during the last interim government. Shamshad served as Under-Secretary-General of the United Nations and was the 10th Executive Secretary of the UN Economic and Social Commission for Asia and the Pacific, leading global work on the 2030 Sustainable Development Agenda, climate change, and financing for development. As Senior Special Economic and Finance Advisor to UN Secretary-General Ban Ki-moon, she was the UN Sherpa for the G20. Shamshad was the World Bank's Vice President for the Middle East and North Africa Region, Director General at the Asian Development Bank, and Special Senior Advisor to the ADB President. She was a post-doctoral Fulbright Fellow at Harvard University, holds a PhD in Economics from the University of Paisley, a Master in Development Economics from the University of Sussex, and an MSc in Economics from Quaid-i-Azam University. She serves on a few key global and regional advisory councils and boards. She was listed among the 'Ten Women to Watch in Asia' by the Wall Street Journal and received the 'Central Bank Governor of the Year in Asia' award in 2008.

**Kevin P. Gallagher** is a professor of global development policy at Boston University's Frederick S. Pardee School of Global Studies, where he directs the Global Development Policy Center. Kevin P. Gallagher is the author or co-author of six books: The China Triangle: Latin America's China Boom and the Fate of the Washington Consensus; Ruling Capital: Emerging Markets and the Reregulation of Cross-Border Finance; The Clash of Globalizations: Essays on Trade and Development Policy; The Dragon in the Room: China and the Future of Latin American Industrialization (with Roberto Porzecanski); The Enclave Economy: Foreign Investment and Sustainable Development in Mexico's Silicon Valley (with Lyuba Zarsky); and Free Trade and the Environment: Mexico, NAFTA, and Beyond. Gallagher serves on the United Nations' Committee for Development Policy. He previously served on the investment sub-committee of the Advisory Committee on International Economic Policy at the US Department of State and on the National Advisory Committee at the Environmental Protection Agency, and co-chaired the T-20 Task Force on International Financial Architecture at the G-20. Gallagher has been a visiting or adjunct professor at the Paul Nitze School of Advanced International Studies at Johns Hopkins University, the Fletcher School of Law and Diplomacy at Tufts University; El

Colegio de Mexico in Mexico; Tsinghua University in China, and the Center for State and Society in Argentina.

**Stephany Griffith-Jones** is the Financial Markets Director at the Initiative for Policy Dialogue, based at Columbia University; Emeritus Professorial Fellow at the Institute of Development Studies at Sussex University; a Senior Research Associate at the Overseas Development Institute; a non-resident Fellow at the Center for Global Development; and a Distinguished Fellow at ClimateWorks Foundation. She is also co-coordinator of the research program for the November 2020 Research Conference part of the Finance in Common Summit, the first global meeting of all public development banks. Professor Griffith-Jones is researching and providing policy advice on reforming international and national financial architecture, with emphasis on a development perspective, and special focus on development banks; capital flows to emerging and low-income economies; debt crises and their management; and debt for nature and development swaps. She has led many major international research projects on international and domestic financial issues. Publishing widely, having written or edited over 25 books and numerous journal and newspaper articles. A 2010 OUP book, coedited with Joseph Stiglitz and Jose Antonio Ocampo, Time for a Visible Hand, dealt with financial regulation. Her most recent book, co-edited with Jose Antonio Ocampo, The Future of National Development Banks, was published by OUP in 2018. She has advised many international organizations, including the European Commission, European Parliament, World Bank, Commonwealth Secretariat, IADB, and various UN agencies and several governments and central banks, including in the UK, Chile, Sweden, South Africa, Tanzania, Brazil and Czech Republic.

**Jörg Haas** is Head of International Politics at the Heinrich Böll Foundation, covering international financial and economic affairs and global governance. He studied Geography and Ethnology at the University of Trier in the 1980s, with postgraduate studies at the Seminar for Rural Development in Berlin. In the early 1990s he worked for GTZ in a rainforest project in Ecuador. In 1993 Jörg joined the Heinrich Böll Foundation, where he first headed the Latin America Division and subsequently the Ecology Division, with a focus on climate and energy policy and the ecological governance of globalization. Jörg was also Director of the European Climate Foundation's Global Climate Policy Program, supporting the global climate negotiations with technical and economic analysis, and in bilateral climate finance initiatives after the Copenhagen climate conference. From 2014 to 2017 he worked at Campact, a progressive digital citizen's movement.

**Moritz Kraemer** is a Senior Fellow at the Centre for Sustainable Finance at SOAS, University of London, Chief Economist of *CountryRisk.io*, a country- and ESG-risk platform, and Chair of the Economic Adisory Panel at R.J.Fleming & Co. Moritz is the co-founder of the Initiative Neues Wirtschaftswunder, which aims through publications and community outreach to anchor the social and ecological transformation of the European economy across the political spectrum. He also serves as Independent Non-Executive Director of Scope Ratings, the largest Europe-headquartered Credit Rating Agency. Until 2018 he was at S&P Global as the Sovereign Ratings Group' Global Chief Ratings Officer, overseeing the analytical work on assessing the creditworthiness of over 130 national governments worldwide. At S&P he introduced innovative analysis on the impact of the megatrends of global warming and demographic change on sovereign ratings. Moritz started his professional career as an Economist at the Inter-American Development Bank in Washington, D.C. He has lived on four continents and has professionally interacted with senior policymakers in over 100 countries. Moritz holds a PhD in Economics from the University of Göttingen. He studied Economics, Latin American Studies and Literature in Frankfurt, Southampton and San Diego.

**Ulrich Volz** is Director of the Centre for Sustainable Finance and a Reader in Economics at SOAS, University of London. He is also a Senior Research Fellow at the German Development Institute and Honorary Professor of Economics at the University of Leipzig. At SOAS, he previously served as Head of the Department of Economics and Member of the University's Executive Board. Ulrich is a director of the Global Research Alliance for Sustainable Finance and Investment and serves on the advisory board of the International Sustainable Finance Centre. Ulrich was Banque de France Chair at EHESS in Paris, and also taught at Peking University, Kobe University, Hertie School of Governance, Freie Universität Berlin, Central University of Finance and Economics in Beijing, and the Institute of Developing Economies (IDE-JETRO) in Tokyo. He spent stints working at the European Central Bank and the European Bank for Reconstruction and Development and held visiting positions at the University of Oxford, University of Birmingham, ECB, Bank Indonesia, and Aoyama Gakuin University in Tokyo. Ulrich holds a PhD from Freie Universität Berlin and was a Fox International Fellow and Max Kade Scholar at Yale University. Ulrich was part of the UN Inquiry into the Design of a Sustainable Financial System and has acted as an advisor to several governments, central banks, international organisations and development agencies on matters of macroeconomic policy, sustainable finance and development. He is currently advising the Brazilian central bank on developing an environmental and social risk analysis framework and has worked with the Finance Ministers of the V20 climate vulnerable countries on ways to address macrofinancial risks stemming from climate change. Ulrich was lead author of a recent study on Climate Change and Sovereign Risk as well as a 2018 UN report on Climate Change and the Cost of Capital in

Developing Countries. He is a co-editor of the NGFS volume on Case Studies of Environmental Risk Analysis Methodologies and the Routledge Handbook of Banking and Finance in Asia.

# Imprint

Editors: Heinrich-Böll-Stiftung e.V., Schumannstraße 8, 10117 Berlin, *www.boell.de*
Center for Sustainable Finance, SOAS, University of London, Thornhaugh Street, Russell Square, London WC1H 0XG, UK, *www.soas.ac.uk/centre-for-sustainable-finance/*
Global Development Policy Center, Boston University , 53 Bay State Road, Boston, MA 02215, USA, *www.bu.edu/gdp/*

Place of publication: *www.drgr.org*
Release date: June 2021
Cover: Photo by USGS, *https://unsplash.com/photos/h4iGssC1iME* – Southern Africa's Okavango River spreads across the pale, parched landscape of northern Botswana to become the lush Okavango Delta. The delta is designated as World Heritage Site by Unesco. Oil drilling by Canadian company ReconAfrica is feared to threaten water resources in the upper catchment of the Okavango river.