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Debt Relief for a Green and Inclusive Recovery: A Proposal

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Three principles for a ‘Debt Relief for Green and Inclusive Recovery’

1. Real debt relief, not just suspension.
2. Involvement of both public and private creditors.
3. Governments receiving debt relief need to commit to align their policies and budgets with the 2030 Agenda for Sustainable Development and the Paris Agreement.


Debt Relief for Green and Inclusive Recovery
Reforms that align policies and budgets with the 2030 Agenda for Sustainable Development & the Paris Agreement
Brady-type credit enhancement to facilitate access to capital markets
Pillar 1
Comprehensive debt relief by public creditors
Pillar 2
Private-sector involvement, with creditors swapping their old debt with a haircut for new «Green Recovery Bonds»
Pillar 3
Facilitating a green and inclusive recovery through debt swaps and new SDG-aligned debt instruments
Heavily indebted countries with an unsustainable debt burden
Countries that are not heavily indebted
Enhanced Debt Sustainability Analysis

The G20 just agreed on a “Common Framework for Debt Treatments beyond the DSSI”

- This goes in the right direction but needs to be enhanced.
- Three shortcomings:
  1. It only applies to low-income countries and omits middle-income countries with unsustainable debt.
     - The World Bank estimates that as many as 155 million people will be pushed into extreme poverty due to Covid-19 by the end of 2021 – with eight out of ten of those people in middle-income countries.
  2. It envisages inadequate private sector participation and fails to address the first-mover problem.
  3. Is not geared to the SDGs and climate goals.

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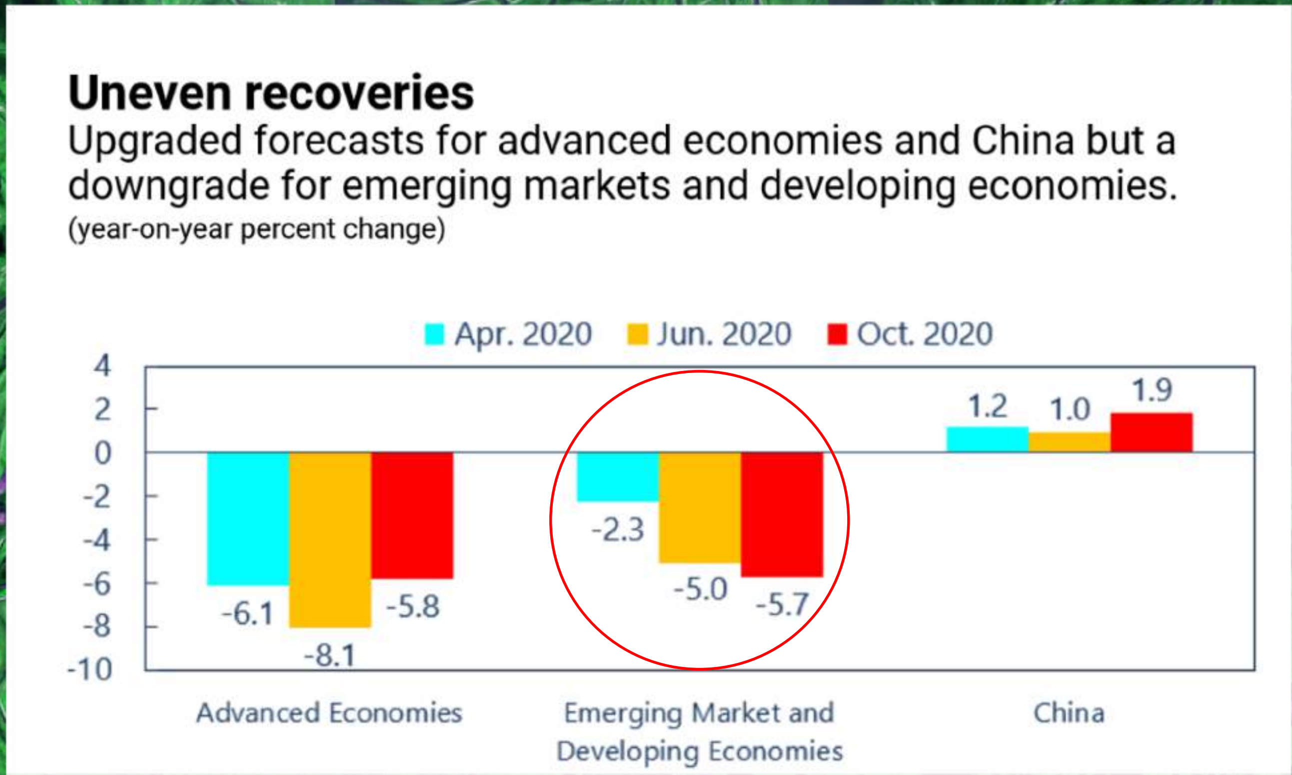
Developing country growth prospects worsening

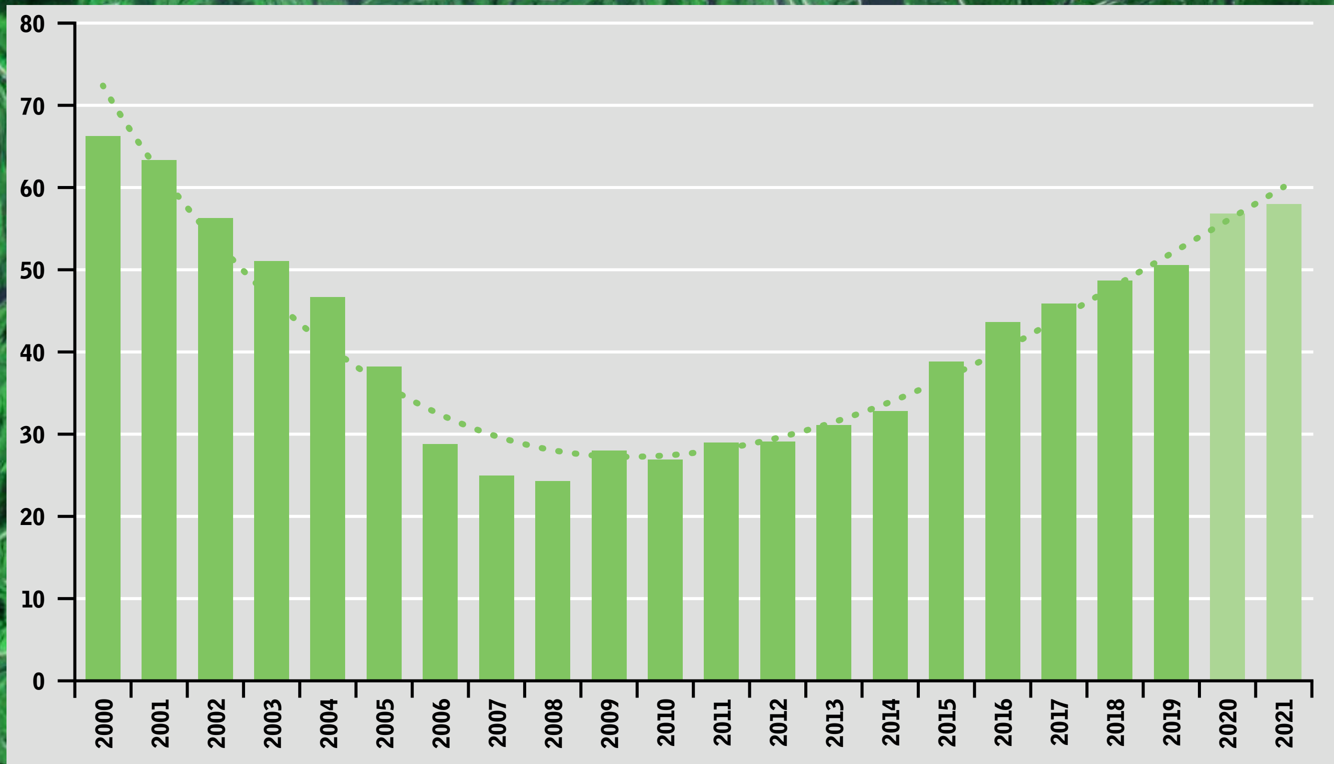


Source: IMF WEO, October 2020

The Covid-19 crisis has dramatically worsened public finances across the globe

- Public debt was already unsustainable in many developing countries before Covid-19.
- With low growth scenario and growing financing demands, public debt continues to grow.
- Settlement of debt liabilities reduce fiscal space and constrain government responses to the health, social, and economic crises caused by the pandemic.
- If not addressed, the debt crisis will hold back recoveries and undermine the development prospects of hundreds of millions of people in the Global South.

General government gross debt of Sub-Saharan African countries as a percentage of GDP



Source: Compiled with data from IMF WEO, October 2020

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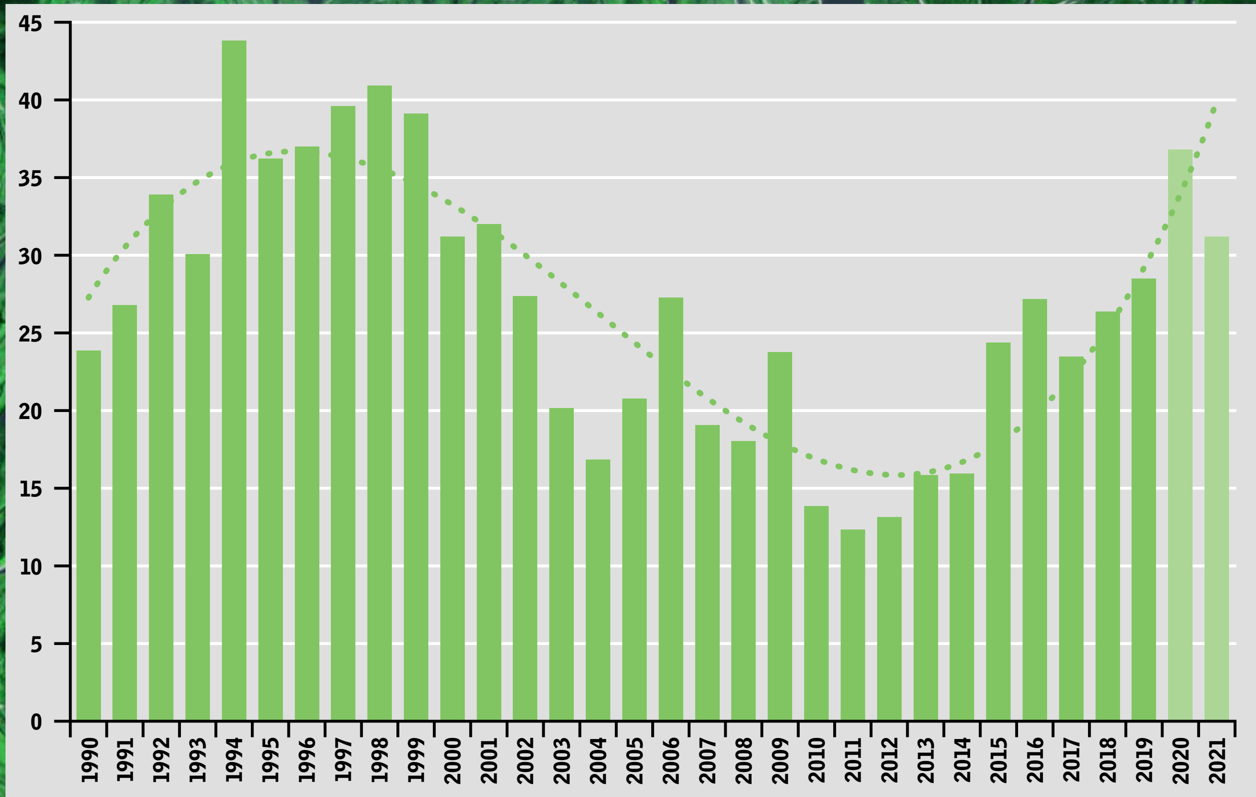
Total external debt service of Sub-Saharan African countries as a percentage of exports of goods and services



Source: Compiled with data from IMF WEO, October 2020

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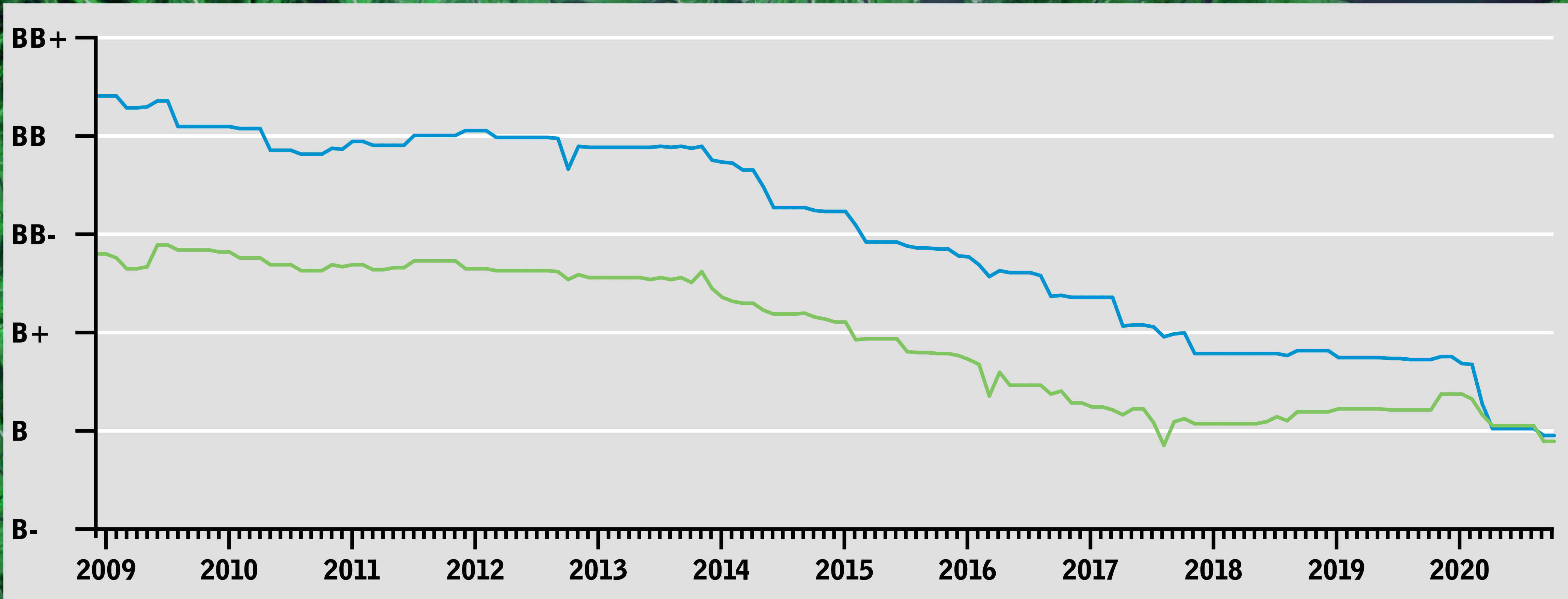
Sub-Sahara Africa rating history, December 2008 – October 2020



Source: Compiled with data from S&P Global, October 2020

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We need urgent climate action

- This decade is our last chance to avoid catastrophic global warming.
- Countries need to invest in mitigation and adaptation to increase climate resilience.
- As much as possible, we need to use economic stimulus and recovery measures to strengthen the resilience of our economies and engineer a just transition.

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Climate vulnerability threatens fiscal sustainability

- Climate change raises the cost of capital of climate vulnerable countries and threatens debt sustainability.
- Governments must climate-proof their economies and public finances or potentially face an ever-worsening spiral of climate vulnerability and unsustainable debt burdens.

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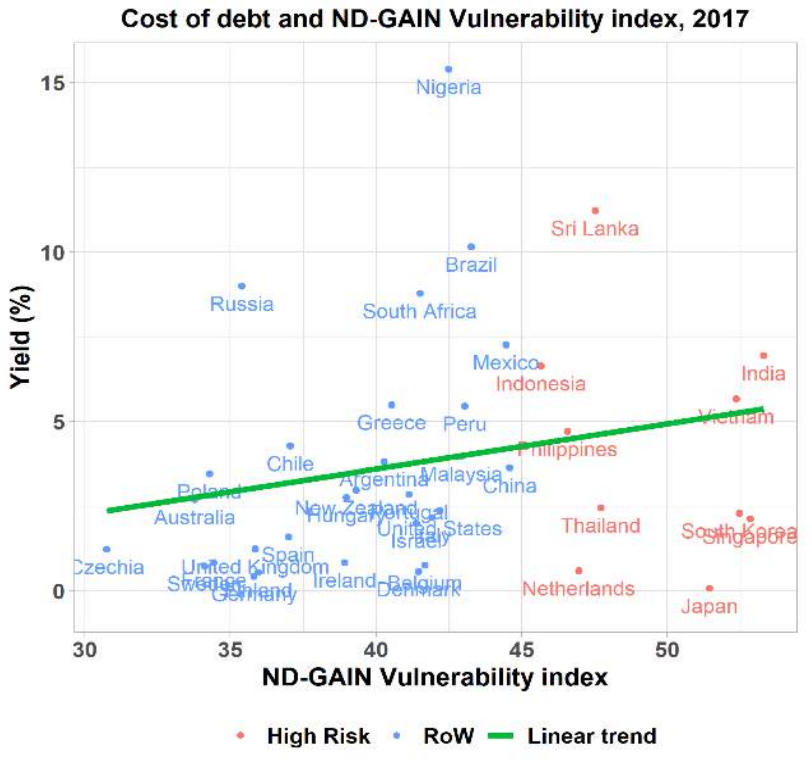
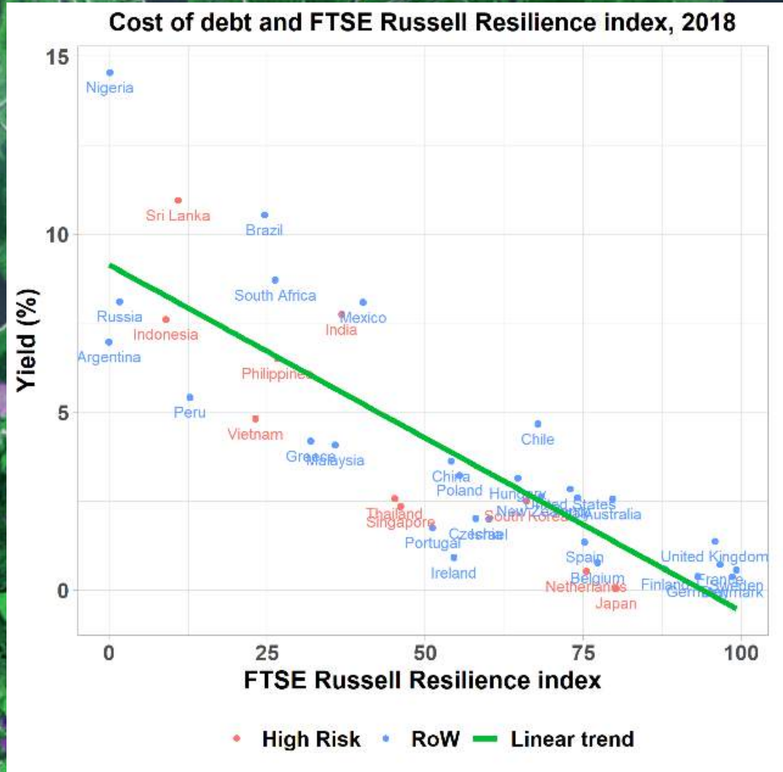
Climate vulnerability and resilience affect the cost of capital





Source: Volz et al. (2020).

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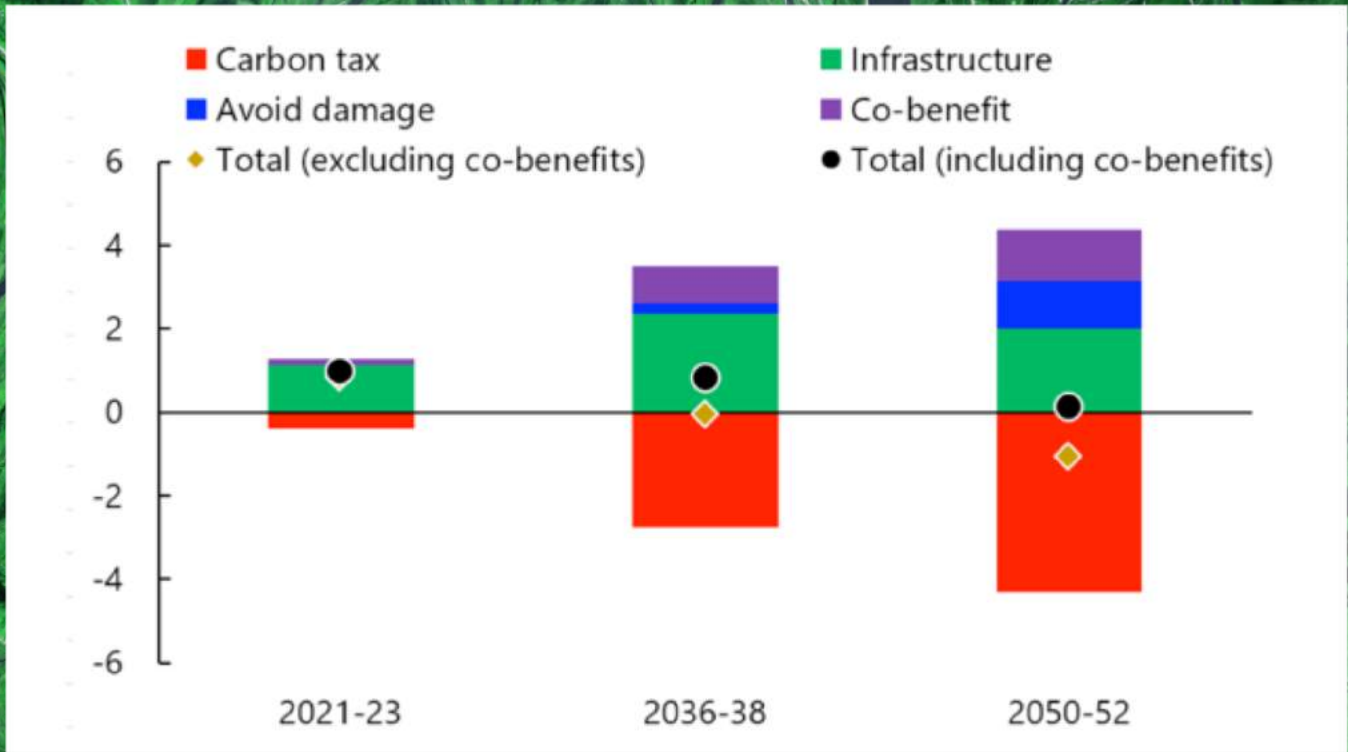
A green recovery makes economic sense

- Evidence show that green projects can generate more employment and deliver higher short-term returns per dollar spent, compared to conventional fiscal stimulus.
- The recent World Economic Outlook 2020 highlights that a green recovery is not only environmentally sensible, but also good economic policy as it lays the foundations for longer term economic success and debt sustainability.

The right climate policy mix can boost global GDP and help the recovery from COVID-19



Source: IMF WEO, October 2020

Countries mired in debt will be unable to invest in a green and inclusive recovery

- To enable a green and socially just recovery for all countries, public debt problems need to be urgently addressed.
- Governments must have the fiscal space to finance crucial health and social spending and invest in a green recovery.
- We need a new framework that will provide debt relief to countries that require it, while ensuring that the relief is calibrated towards attacking the virus, protecting the vulnerable, and staging a green and inclusive economy.

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1st step: Comprehensive Debt Sustainability Assessments for all LICs and MICs with public debt problems

- To be carried out by the IMF and the World Bank, with inputs from other institutions.
- DSAs need to be based on realistic assumptions and account for climate risks.
- If the DSA asserts that the public debt of a country is of significant concern, the G20 should coordinate with all bilateral and multilateral creditors about a debt restructuring, and the IMF should make its programmes conditional on a sovereign debt restructuring involving private creditors.

Pillar 1: Debt relief for heavily indebted countries by public creditors

- Comprehensive and significant debt relief granted to heavily indebted countries with an unsustainable debt burden by public creditors, analogous to, but improving upon, the HIPC/MDRI model.
- Governments receiving debt relief need to commit to align their policies and budgets with the 2030 Agenda and the Paris Agreement.
- Debt owed by multilateral institutions would only be restructured for IDA-eligible countries.
  - 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 the issuance of new SDRs.

Pillar 2: Private sector involvement

- The experience with the HIPC initiative shows clearly that compulsory participation will be necessary from not only for official creditors, but the private sector alike.
- If a DSA reveals problems, the IMF should make its programmes conditional on a sovereign debt restructuring involving private creditors, and debtor countries seeking bilateral haircuts will be required to seek commensurate relief from private creditors.
- Private creditors participating in the debt restructuring would swap their old debt holdings with a haircut for "Green Recovery Bonds".
- The reduced debt service burden from the debt relief by private creditors should be partially used by the debtor government for spending on a green and inclusive recovery.

- Any new debt issued by countries participating in debt restructuring could receive Brady-type credit enhancement in exchange for a commitment to dedicate receipts into SDG-linked spending items.
  - The credit enhancement could be secured by an issuance of bonds by a triple-A rated multilateral institution or SDRs issued by the IMF.
- Such a credit enhancement mechanism would help countries undergoing debt restructuring under the Debt Relief for Green Recovery Initiative to regain access to international capital markets.

Pillar 3: Enhancing climate action and supporting a green & inclusive recovery through debt swaps

- Debt-for-climate or debt-for-sustainability swaps for countries that are not heavily indebted, but have reduced fiscal space due to COVID-19.
  - Debt swaps would facilitate raising climate ambition in the form of additional action or investment in climate adaptation or mitigation.
  - Debt swaps under this pillar would be voluntary and not conducted as a distressed debt exchange.
- This could be complemented by an incentive scheme for the issuance of new sustainability-linked sovereign debt.
  - Brady-type credit enhancement in exchange for a commitment to Paris-aligned NDCs and to dedicate receipts to SDG-linked spending items.

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- Commitments to align policies and budgets with the 2030 Agenda for Sustainable Development and the Paris Agreement would be monitored by an inter-institutional steering committee.
- This should involve public and private creditors, the UN as well as civil society representatives.

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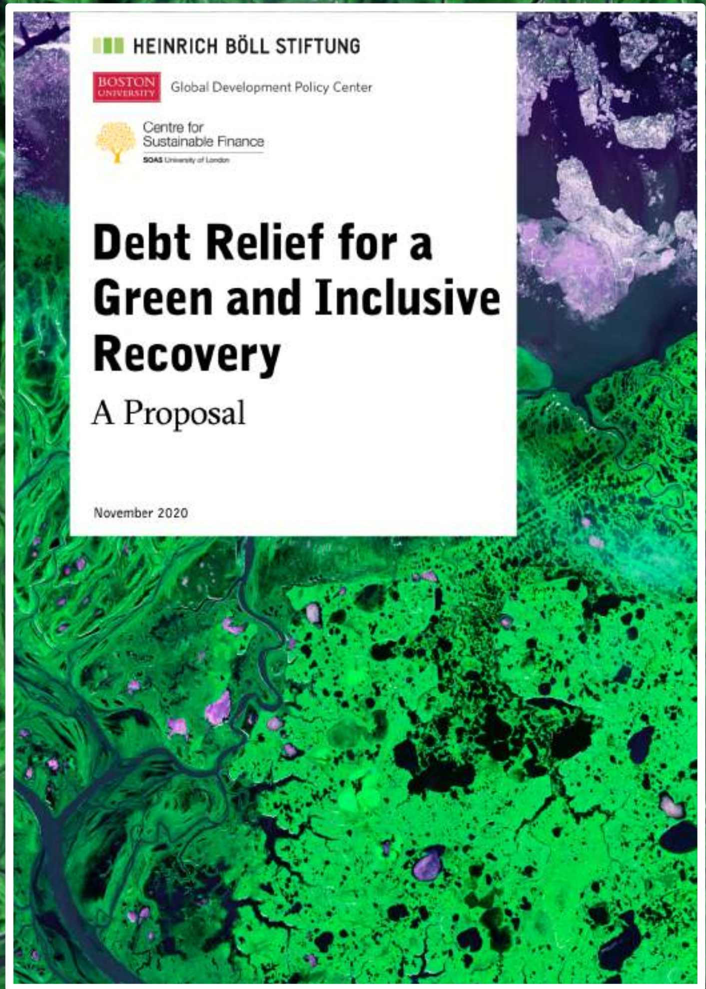

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