DEBT RELIEF FOR A GREEN AND INCLUSIVE RECOVERY

Guaranteeing Sustainable Development

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ABOUT

A debt crisis is emerging in the Global South at the precise moment when substantial investment is needed to meet shared climate and development goals. Yet, the G20 Common Framework has been unable to engage all creditor classes or link debt relief to climate and development.

The Debt Relief for Green and Inclusive Recovery (DRGR) Project, a collaboration between the Boston University Global Development Policy Center, Heinrich-Böll- and the Centre for Sustainable Finance, SOAS, University of London, argues it is time for comprehensive debt reform. Utilizing rigorous research, DRGR seeks to develop systemic approaches to both resolve the debt crisis and advance a just transition to a sustainable, low-carbon economy in partnership with policymakers, thought leaders and civil society from around the world.

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DR GR

ABBREVIATIONS

DRGR	Debt Relief for a Green and Inclusive Recovery
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
G20	Group of 20
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
NDC	Nationally determined contribution
SDG	Sustainable Development Goal
SDR	Special Drawing Rights
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme

TABLE OF CONTENTS

EXECUTIVE SUMMARY

The Intergovernmental Panel on Climate Change has said it is "now or never" to make the investments necessary to limit warming to 1.5 degrees Celsius—without which, the world faces catastrophic human, ecological and economic costs (IPCC 2022). Moreover, the Independent High-Level Expert Group on Climate Finance estimates that $1 trillion per year is needed in emerging markets and developing economies (EMDEs) other than China to accomplish the Paris Climate Agreement targets and achieve the UN 2030 Sustainable Development Goals (SDGs) (Songwe et al. 2022).

Concomitantly, at precisely the moment when substantial investment is needed to meet shared climate and development goals, a debt crisis is emerging in the Global South that will create lost decades of development and put our shared climate goals out of reach. This crisis is compounded by the lack of an effective sovereign debt workout mechanism. While the G20 is to be commended for establishing an emergency 'Common Framework' in the midst of multiple crises, there is now a consensus that the Common Framework has fallen short in its inability to engage all creditor classes in negotiations and to link debt relief with development and climate goals. In a step toward more comprehensive reforms that are needed, the Common Framework needs immediate reform to provide debt relief for a green and inclusive recovery.

The Debt Relief for Green and Inclusive Recovery (DRGR) Project is a collaboration between the Boston University Global Development Policy Center, Heinrich-Böll-Stiftung and the Centre for Sustainable Finance, SOAS, University of London, that argues it is time for comprehensive debt reform. Utilizing rigorous research, the DRGR Project seeks to develop systemic approaches to both resolve the debt crisis and advance a just transition to a sustainable, low-carbon economy in partnership with policymakers, thought leaders and civil society from around the world. Our proposal has been endorsed and called for by the Group of Vulnerable 20 Finance Ministers, now 58 finance ministries across the Global South. Debt relief will not be enough to put the

world economy on a better path, and must be part of new forms of liquidity, concessional and grant financing, and affordable private sector finance.

For the most debt distressed economies of the world, regardless of income level, the DRGR proposal has three pillars, which is illustrated in Figure 1 below.

1. Public creditors should grant significant debt reductions that not only bring a distressed country back to debt sustainability, but put the country on a path to achieving development and climate goals—in a manner that preserves the preferred creditor status and AAA credit ratings for participating international organizations.
2. Private and 'commercial' creditors should grant commensurate debt reduction as public creditors. These creditors will be compelled to enter negotiations through Brady bonds backed by a guarantee fund and a payments standstill for five years for all creditor classes.
3. For countries not in debt distress but that lack fiscal space, credit enhancement should be provided by international financial institutions to lower the cost of capital for a green and inclusive recovery.

Figure 1: Three Pillars for Debt Relief for a Green and Inclusive Recovery

Source: Authors' elaboration.

Note: The ranges of the haircuts mentioned in the figure are in net present value terms.

The proposal is in many ways a modern-day version of the Brady Plan and the Highly Indebted Poor Countries (HIPC) Initiative of the 1990s combined—the last time that debt distress threatened our development goals.

In this report, we analyze new data on the level and composition of public and private external sovereign debt for EMDEs and estimate the size of the debt restructuring and suspension necessary to achieve debt sustainability in EMDEs in or at high risk of debt distress. We further elaborate our proposal, which is supported by the most climate vulnerable finance ministries in the Global South for debt relief that supports achieving shared climate and development goals.

Main findings:

- EMDE external debt levels and service payments have more than doubled since the 2008 global financial crisis. Between 2008-2021, EMDE sovereign debt increased by 177 percent, from $1.3 trillion to $3.6 trillion.
- Climate vulnerable countries have some of the most significant debt distress. A higher climate vulnerability correlates with a lower sovereign borrowing space and high debt service payments against exports.
- For 61 countries identified as being in or at high risk of debt distress to achieve debt sustainability, more than $812 billion in debt needs to be restructured across all creditor classes. Using a range of historical precedents for the size of relief needed, we estimate that public and private creditors will have to grant haircuts between $317 billion to $520 billion in debt relief.
- Between $37.1 billion to $61.9 billion is needed to fund the guarantee facility that would provide enhancements for newly issued 'green and inclusive recovery' Brady bonds that private and commercial creditors can swap with a significant haircut against old debt.
- At least $30 billion in debt needs to be suspended over for the next five years to allow these countries to reach the sub-optimal levels of fiscal outlays they had before 2020, to provide financial assurance to new creditors, and to compel reluctant creditors to come to the negotiating table. This debt suspension estimate illustrates the scale of suspension potentially needed to provide debt distressed countries breathing room while negotiating a larger and more ambitious restructuring effort.

The DRGR proposal is designed to address the immediate challenges facing indebted developing and emerging economies, while providing a stepping-stone towards establishing a new global debt architecture that is fair,

transparent, efficient and cognizant of the needs of EMDEs. This proposal is not a panacea for the current crisis, but should be part of a package of new liquidity from issuances and recycling of Special Drawing Rights, from concessional and grant funded development finance, and from affordable forms of private capital. Nor is the DRGR proposal a substitute for a more permanent sovereign debt workout mechanism and the deeper reforms needed to reform the global financial architecture.

In 2023, the United Nations Secretary General Antonio Guterres told the United Nations General Assembly, "The global financial architecture is at the heart of the problem" (UN 2023). Echoing calls by numerous others, most notably Barbados' Prime Minister Mia Mottley's Bridgetown Agenda, Guterres added, "The global financial architecture does not need a simple evolution; it needs a radical transformation. It is time for a new Bretton Woods moment" (UN 2023; Gallagher and Kozul-Wright 2022).

In 2022, Janet Yellen, Treasury Secretary of the United States, reminded that change can come in the midst of crises, saying "officials began crafting proposals for the IMF, the World Bank and the post-war international financial architecture in 1941, as World War II raged in Europe" (Yellen 2022).

Then as now, the international community should not wait for crises to dissipate to begin advancing a new normal. Shaping a better future should start today.

Puerto Galera, Philippines.
Photo by Jules Bss via Unsplash

INTRODUCTION

Emerging market and developing economies (EMDEs) are confronting a polycrisis. A slow and halting recovery from the COVID-19 pandemic has run up against high food and energy prices driven up by Russia's war in Ukraine; escalating climate impacts have caused further distress; and interest rate hikes in advanced economies have led to a strong US dollar, depreciating currencies for many EMDEs and increasing debt servicing costs. These shocks have weakened economic growth and ballooned debt burdens. This onslaught follows the end of a long period of low interest rates and quantitative easing by major central banks, like the US Federal Reserve.

At the same time, the Intergovernmental Panel on Climate Change has said it is "now or never" for the international community to make immediate and deep cuts in greenhouse gas emissions to prevent runaway climate change (IPCC 2022). An intensified course of action must be supported by a stepwise mobilization in resources to shift from a carbon-intensive global economy to a resilient and sustainable one. This urgency is particularly acute in the face of intensifying climate impacts and the wide social and economic ramifications of transitioning away from fossil fuel-powered economies.

Progress on achieving the United Nations 2030 Sustainable Development Goals (SDGs) is off track. The UN estimates that the COVID-19 pandemic has undermined four years' efforts to reduce poverty and led to an increase in extreme poverty by almost 100 million (UN 2022). Achieving the SDGs will require a redoubling of actions, including a stepwise mobilization of resources. According to recent estimates by Songwe et al. (2022), EMDEs other than China will need $2.4 trillion in climate investments by 2030 (Songwe et al. 2022).

This report was updated in May 2023 to account for adjusted analysis.

THE G20 COMMON FRAMEWORK IS NOT FIT FOR PURPOSE

The Group of 20's (G20) Common Framework for Debt Treatments is an important effort for international coordination on debt relief; however, progress under its auspices has been limited and slow.

The Common Framework was a welcome break from the past, as it represented a collective effort to adjust the existing debt architecture to the changing economic realities of the 21st century. EMDEs now borrow from a broader array of creditors than in previous years. Earlier efforts under the auspices of the UN had set their sights higher. The UN Conference on Trade and Development identified "speedy and orderly resolution" of debt restructuring deals as a responsibility for lenders (UNCTAD 2012). The Addis Ababa Action Agenda called on restoring debt sustainability, enabling access to financing under favorable conditions and enhancing the ability of countries after restructuring to achieve the SDGs (UN 2015).

The limitations of the Common Framework are widely recognized. International Monetary Fund (IMF) Managing Director Kristalina Georgieva and Director of the Strategy, Policy and Review Department Ceyla Pazarbasioglu have noted the need for a wider set of countries to be eligible—as the Common Framework is limited to low-income countries (Georgieva and Pazarbasioglu 2021). Likewise, they called for greater creditor participation, clarity on how comparability of treatment will be implemented, as well as a payment standstill while debtor governments negotiate, as an incentive for rapid resolution. In December 2022, World Bank Chief Economist Indermit Gill echoed these concerns about the Common Framework. In particular, Gill highlighted the slow and drawn out process of the case-by-case approach and urged greater clarity on the sequence and steps involved (Wheatley 2022).

The Common Framework, which was devised as a band-aid at the beginning of the pandemic, must be transformed to become fit for purpose in the polycrisis era.

CALLS FOR FUNDAMENTAL REFORM ARE GETTING LOUDER

Calls to reform the international financial architecture to address the intersecting climate and debt crises have grown louder. The Vulnerable Twenty Group of Ministers of Finance of the Climate Vulnerable Forum (V20)—a group of 58 finance ministers of climate vulnerable countries—stated support for a comprehensive debt restructuring effort and proposed

establishing a guarantee facility to issue new bonds (V20 2021). Barbados has advanced a five-point agenda known as the Bridgetown Initiative, which includes incorporating natural disaster clauses in all lending instruments to provide countries facing extreme events the fiscal space to recover (Persaud 2021). At the 2022 United Nations Climate Change Conference (COP27), Egypt launched a Sustainable Debt Coalition to advance climate-debt swaps (Egypt 2022).

The International Institute for Environment and Development estimates climate and nature-linked debt instruments could unlock $105 billion for debt relief and mobilize $329 billion in new borrowing over the short-term (Patel 2022). An IMF working paper identified the conditions under which "debt-for-climate swaps" would free up resources for governments to invest in resilience without triggering a fiscal crisis, or sacrificing spending on other development priorities. Investing in mitigation and adaptation would also reduce sovereign risk and enhance growth (Chamon et al. 2022; Task Force 2022).

THE PROPOSAL FOR DEBT RELIEF FOR A GREEN AND INCLUSIVE RECOVERY

Launched in 2020, the Debt Relief for Green and Inclusive Recovery (DRGR) Project proposes concerted and comprehensive debt relief on a global scale to free up resources in heavily indebted EMDEs to support achieving shared climate and development goals and foster a just transition to a low-carbon economy (Volz et al. 2020, 2021).

In its initial 2020 report, the DRGR Project put forward a proposal resting on three major pillars. First, heavily indebted countries would receive comprehensive debt relief. Second, private sector involvement would be encouraged by swapping out old debt with a significant haircut for new bonds that are partially guaranteed by a new guarantee facility hosted by the World Bank. Finally, for countries that are not highly indebted (and hence not in need of debt restructuring), a green and inclusive recovery could be advanced through innovative financing mechanisms and new SDG-aligned debt instruments. Eligibility for debt relief would be based on an enhanced Debt Sustainability Assessment (DSA) that accounts for climate risks and incorporates the critical investment needed to build resilience and transition to a sustainable economy.

The 2020 proposal is comparable to the Highly-Indebted Poor Countries (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI) schemes in that it links debt relief to the SDGs and the Paris Agreement and sets out

a framework for all countries in need of debt relief, as opposed to a case-by-case basis. The Common Framework's case-by-case approach is proving to be a prolonged, complex and unpredictable process that puts debtor governments in a structurally weak position.

Building on the initial proposal, the 2021 DRGR report introduced a proposal to incentivize private sector participation and to ensure fair burden sharing among creditors (Volz et al. 2021). The report identified how private creditors could take a haircut on old debt in exchange for new credit-enhanced bonds. These bonds would be backed by the guarantee facility to ensure continuity of payments.

This 2023 report advances earlier DRGR proposals in three ways. First, in Section 2, it explores the debt profiles of EMDEs to better understand the composition of creditors and the characteristics of debt. Section 3 analyzes the debt profiles of countries needing immediate debt relief based on criteria set by the United Nations Development Programme (UNDP) and the IMF. In Section 4, we estimate how much debt needs to be reduced to reach sustainable levels and the size of the guarantee facility needed to issue new bonds. The fourth section also estimates the size of a debt payment suspension that could work as an incentive to gain wide participation and encourage speedy resolution among all participants.

To preview main findings, we find that external debt levels and service payments have more than doubled since the 2008 global financial crisis, with climate vulnerable nations among the most exposed. External public and publicly guaranteed (PPG) debt has jumped from $1.3 trillion in 2008, to $3.6 trillion in 2021. Debt service payments on PPG debt has doubled since 2010 and is expected to peak in in 2023 and 2024.

61 countries, many of them among the most climate vulnerable, are acutely at or near debt distress and need immediate debt relief alongside other measures. For these countries, termed 'New Common Framework countries,' external debt has also doubled over the period and they have largely been cut off from global capital markets. These countries are in urgent need of relief and a number of them are already in restructuring negotiations at the G20 and the IMF.

The Common Framework must be immediately reformed to address debt distress of these 61 countries so that they can achieve debt sustainability and mobilize finance for achieving shared climate and development goals. The DRGR proposal can serve as the foundation for reform discussions. Under our analysis, a New Common Framework would need to:

1. Facilitate the restructuring of $812 billion (present value) of debt owed by 61 debt distressed countries. Using a range of historical precedents for the size of relief needed, we estimate that public and private creditors will have to grant haircuts between $317 billion to $520 billion in debt relief.

2. Compel creditors to participate in debt restructuring with a guarantee facility of $37.1 billion to $61.9 billion to provide credit enhancement for newly issued 'green and inclusive recovery' bonds that Chinese, private and commercial creditors can swap with a significant haircut against old debt.

3. Suspend debt payments totaling to $30 billion to incentivize rapid resolution of debt restructuring negotiations and keep countries afloat amid negotiations. Building on analyses by the IMF and UNDP, this report estimates that 55 of the most debt distressed countries in the world need around $30 billion in debt suspension to reach the sub-optimal levels of the fiscal outlays they had before 2020. Due to data availability, the suspension calculation covers 55 of the 61 countries identified as needing immediate debt relief. This debt suspension estimate illustrates the scale of the suspension potentially needed to provide debt distressed countries breathing room while negotiating a larger and more ambitious restructuring effort.

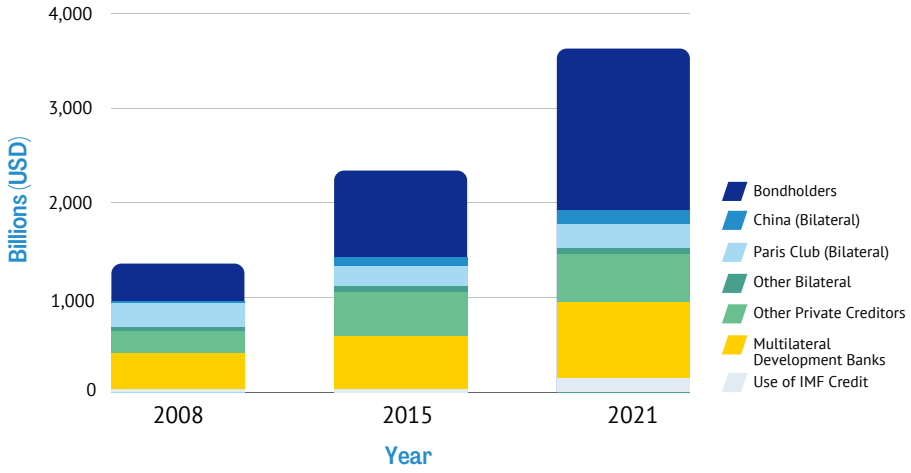
4. Support EMDEs in using the fiscal and borrowing space gained from immediate debt relief efforts to pursue a low carbon, socially inclusive and resilient future.

EXTERNAL DEBT LEVELS

According to the International Debt Statistics, external sovereign debt in EMDEs has more than doubled relative to the levels during the 2008 global financial crisis (World Bank 2022). Concomitantly, not only has the level of debt increased, the creditor composition has become more complex. Relative to 2008, there has been a significant increase in the share of private capital market debt, financing from the IMF and loans from China, whereas the share of financing from multilateral development banks (MDBs), the Paris Club and other bilateral public and private creditors has fallen. These magnitudes are displayed in Figures 1 and 2.

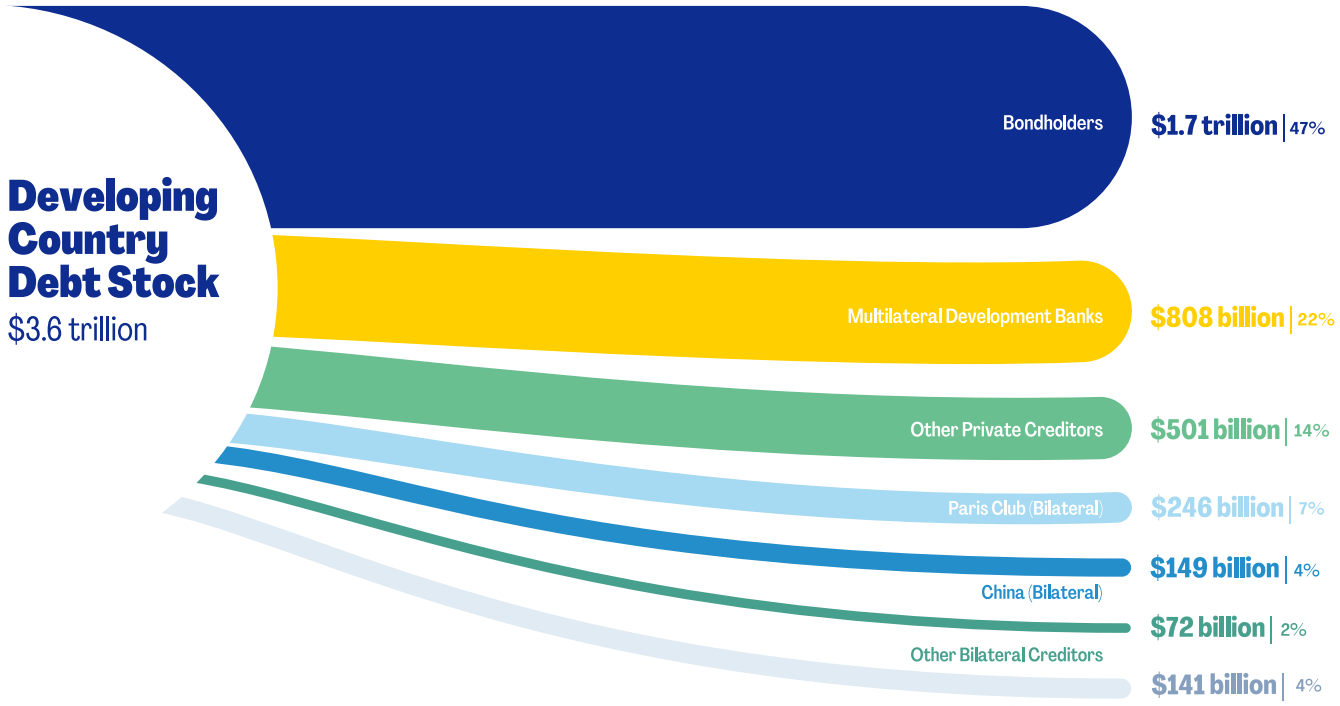
Between 2008-2021, EMDE sovereign debt increased by 177 percent, from $1.3 trillion to $3.6 trillion. The composition of public external debt is much more diverse and complex than in 2008. Figure 2 captures a snapshot of sovereign external debt stock in 2021. Private bondholders hold 47 percent of the $3.6 trillion in EMDE debt, followed by the MDBs at 22 percent, other private creditors, Paris Club (bilateral) and China (bilateral).

Figure 1: Developing Countries Debt Composition by Creditor, 2008-2021, in billions



Source: Compiled by authors using World Bank (2022).

Figure 2: EMDEs' Public External Debt Stock Composition in 2021, in billions



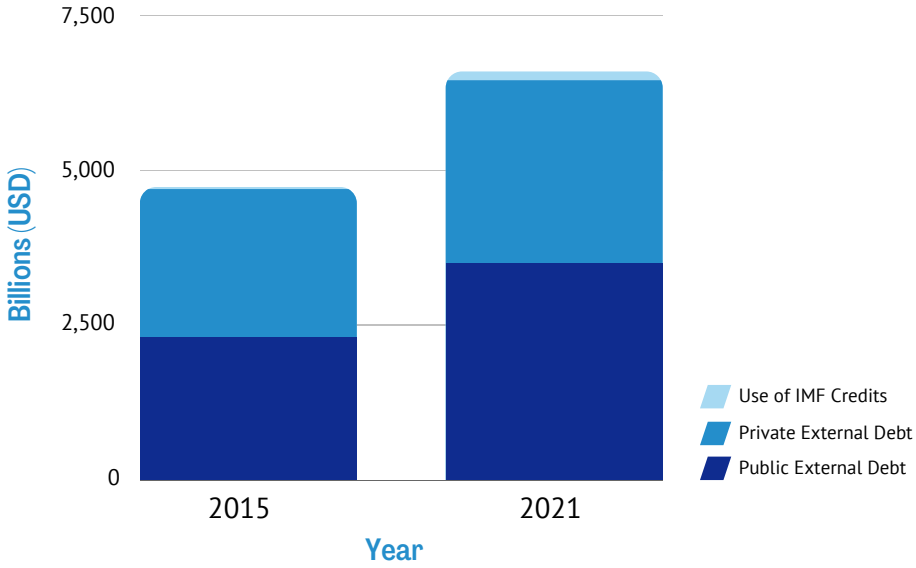
Source: Compiled by authors using World Bank (2022).

The relative shares of creditors holding external debt has changed in the past decade. MDBs and Paris Club bilateral obligations have declined in EMDEs' balance sheets. Private bondholders and Chinese loans saw the largest increases during the last decade, with private bondholder debt stock increasing from $401.6 billion to $1.7 trillion between 2008-2021, and bilateral Chinese loans increasing from $14.8 billion to $149.5 billion over the same time period (Figure 1).

EMDEs have also become increasingly exposed to private sector debt. This is concerning, given that sovereign defaults or significant economic slowdowns can trigger private sector defaults, which in turn can undermine the financial health of the public sector in other countries (Panizza, Sturzenegger and Zettelmeyer 2009). According to the IMF, private debt in EMDEs amounted to 67.6 percent of GDP in 2007; in 2021, it has more than doubled to 130.1 percent of GDP (IMF 2022a).

Low-income developing countries display a similar trend. In 2007, private debt in low-income developing countries amounted to 19.7 percent of GDP, which doubled to 40 percent of GDP in 2021 (IMF 2022a). Advanced economies, however, did not register a similar increase in private debt. In 2007, private debt amounted to 164 percent of GDP, which slightly decreased to 153 percent in 2021 and was largely driven by lower levels of corporate

Figure 3: EMDE Public and Private External Debt Stock



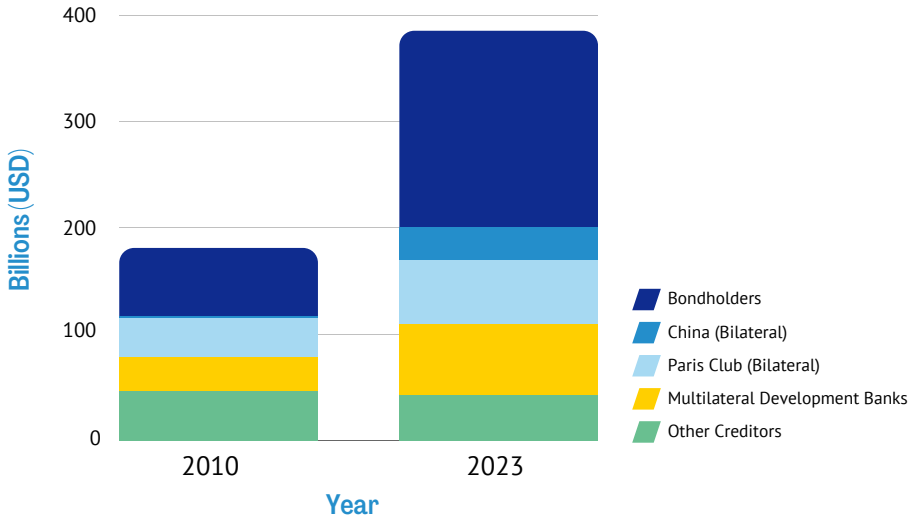
Source: Authors' elaboration using World Bank data (2022).

debt (ibid). Figure 3 compares sovereign and private external debt stock of EMDEs in 2015 and 2021.

In the aftermath of the 2008 global financial crisis, many countries could easily access international capital markets to borrow, as quantitative easing policies encouraged a search for yields across emerging and frontier markets. In 2020, many EMDEs again found themselves relying on international capital markets to withstand the COVID-19 pandemic. In contrast, advanced economies deployed a wide range of monetary and fiscal tools to cope with the pandemic and boost their domestic economic recoveries. As a result, relative to pre-COVID-19 pandemic levels, EMDEs suffered much higher medium term (2024) losses at 8 percent compared to around 1 percent in advanced economies (IMF 2021a). While institutions like the IMF took extraordinary measures to support the global economy, such as by issuing $650 billion in Special Drawing Rights (SDRs), overall crisis support for EMDEs was insufficient (IMF 2021b). With advanced economies hiking interest rates, a strong US dollar and slowing economic growth, EMDEs face significant financial strains.

Debt service payments are projected to be substantially higher than in the past. More specifically, Figure 4 shows EMDEs will pay $385 billion in 2023 in debt service payments, a 113 percent increase from 2010. The share owed to private bondholders has rocketed up by 190 percent compared to 2010 levels. Chinese lenders will see an even more significant jump of 1450 percent in their previous debt service payments. In 2010, China received approximately $2 billion in debt service payments and is expected to receive $31 billion in 2023.

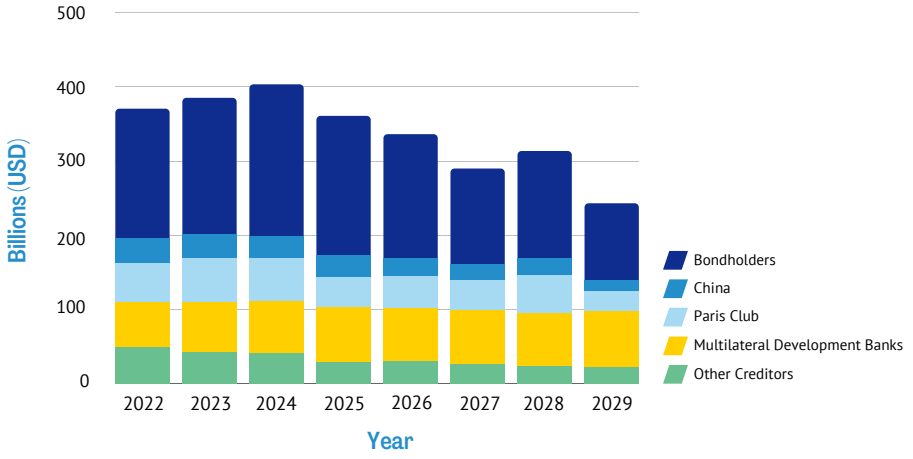
Figure 4: Estimated Debt Service Comparison, 2010-2023



Source: Compiled by authors using World Bank (2022).

EMDEs not only face escalating debt service payments but the cost of capital is also higher in light of multiple shocks, monetary tightening and increased uncertainty in the global economy. Figure 5 shows that debt service payments by EMDEs will continue to escalate with the peak expected in 2024. The largest fraction of the debt service payments is owed to private bondholders at 48 percent, and MDBs, Paris Club and China are owed 18 percent, 14 percent and 7 percent, respectively. Note that this does not include debt service payments owed to the IMF, meaning the actual external debt service payments owed are higher and may display considerable variation at the national level.

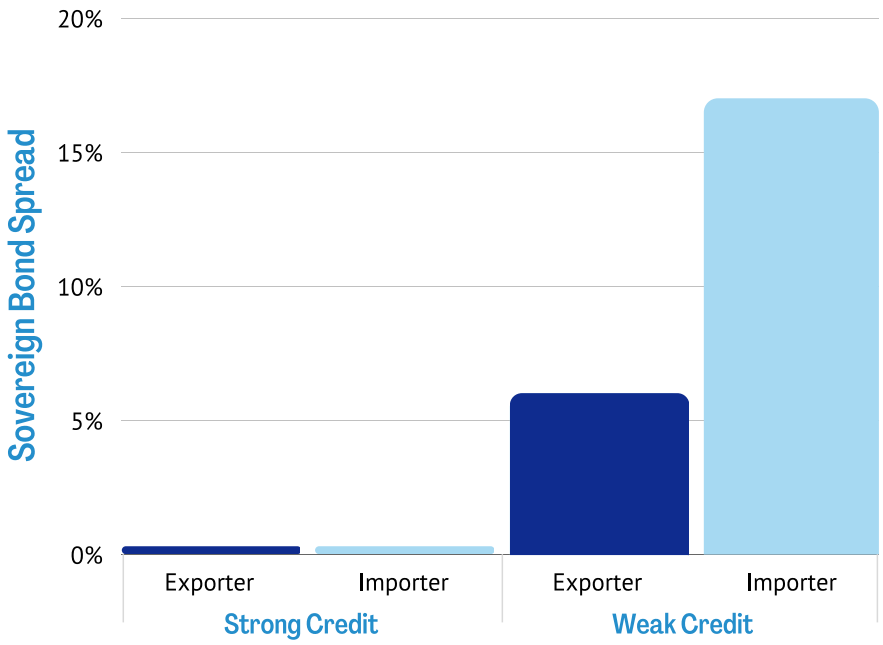
Figure 5: Debt Service Payments by Creditor, 2022-2029



Source: Compiled by authors using World Bank (2022).

The strong US dollar against depreciating currencies of EMDEs, climate shocks, geopolitical tensions and risk aversion have resulted in widespread capital outflows and a slowdown in bond issuance across EMDEs. Recent analysis shows exchange rate depreciation has been a major driver of public debt dynamics for African economies (AFDB 2023). Slowing and lower economic growth rates relative to the higher cost of capital is likely to cause a debt overhang that would lead to underinvestment in critical areas and render shared development and climate goals unachievable. These conditions have created a challenging environment for countries to maintain debt obligations, let alone take on new financing. Figure 6 shows the worsening financial context, particularly for less creditworthy EMDEs and energy importers (World Bank 2023). A higher interest rate environment has interacted with elevated energy prices to add further strain to energy importers. Figure 6 shows how energy importers with weak credit ratings (ratings Caa to Ca) have seen their sovereign spreads change by nearly 18 percent in 2022. It also highlights how essential sovereign credit is in coping with shocks, such as energy price rises. Energy exporters gain financially from the high energy prices but importers with strong credit have not registered a meaningful change in their credit ratings compared to exporters with strong credit either (World Bank 2023).

Figure 6: Rising Sovereign Bond Spreads for EMDE Energy Exporters and Importers, 2022

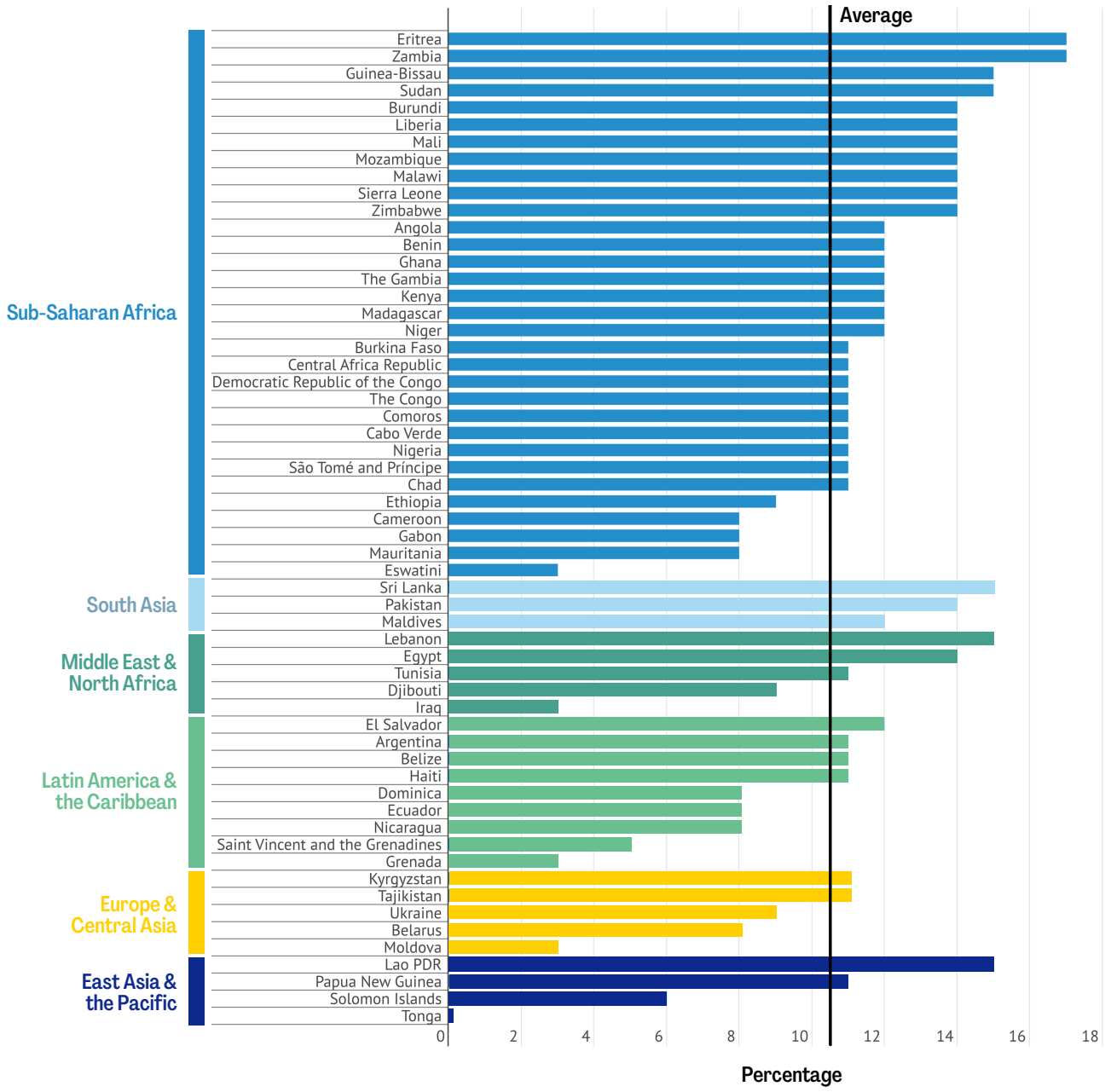


Source: World Bank (2023).

Note: This figure includes a sample of 46 EMDEs. The vertical axis shows percentage changes in sovereign bond spreads over January - December 2022.

These macroeconomic conditions elevate an already high cost of capital that EMDEs face. Climate vulnerable economies face a risk premium which increases their cost of capital (Volz et al. 2020). Figure 7 below shows that the average cost of capital—based on sovereign risk scores—is 10.5 percent for a select group of countries. Such a high cost of capital makes it very challenging for EMDEs to make new investments in capital stock to

Figure 7: Cost of Capital



Source: CountryRisk data and authors' calculations.

Note: The average cost of capital across the sample of 58 countries is 10.55 percent. The average sovereign bond yield over the last decade 2012-2023 was 7.58 percent for BB-. To arrive at the cost of capital for each country, 1.5 percent was added for every rating step below BB- and 1.5 was subtracted for each step above BB-.

generate growth. Moreover, the high cost of capital makes it all the more challenging for EMDEs to accelerate their recovery from the COVID-19 pandemic. The high cost of capital increases the debt servicing costs, thereby requiring a larger share of public finances to be spent on debt repayments. Advanced economies and EMDEs have shown divergent recovery paths (World Bank 2023).

Table 1 puts debt servicing costs in perspective. When examining external debt service as a share of government revenue, countries like Dominica reflect very high rates at 64 percent. Since external debt is denominated in foreign currency, they are sensitive to exchange rate fluctuations, which makes these countries vulnerable to market volatility. Table 1 lists the top 15 countries that overshoot the 14 percent threshold which is considered to be a marker of debt sustainability by the IMF (IMF and World Bank 2018). Moreover, most countries also have domestic debt that they are servicing from public revenue. With such a high percentage of government revenue going to service external debt, EMDEs face very tight budget constraints to fund new and productive investments that would put them on the path of achieving shared climate and development goals.

Table 1: Top 15 Countries Average External Debt Service and Government Revenue Ratio, Expected 2023-2027

Country	Average external debt service as a ratio of government revenue
Dominica	64%
Lao PDR	54%
Bhutan	35%
Angola	28%
Djibouti	28%
Zambia	26%
Benin	25%
Ghana	25%
Mauritania	24%
Cabo Verde	22%
Tunisia	21%
Jamaica	21%
Senegal	21%
Maldives	20%
Montenegro	20%

Source: Compiled by authors using World Bank (2022) and IMF (2022).

Alongside elevated debt servicing levels, local currency devaluation and higher capital costs, developing countries also face the prospect of a slowing global economy. In late 2022, the IMF lowered its growth forecast for EMDEs from 6 percent to 3.7 percent (IMF 2022b). Similarly, the World Bank estimates global growth in 2023 to be the third weakest in recent history with the two other periods being the 2008 global financial crisis and the onset of the COVID-19 pandemic in 2020 (World Bank 2023). The World Bank revised its economic growth forecast for EMDEs in early 2023 to 3.4 percent, 0.8 lower than an earlier estimate. If China is excluded from the forecast, the EMDE growth rate is expected to hit 2.7 percent in 2023, against 3.8 percent in 2022 (Ibid). As a result, higher financing costs and slowing demand will put many EMDEs in a very tight financial position, as these rates are lower than the cost of available capital.

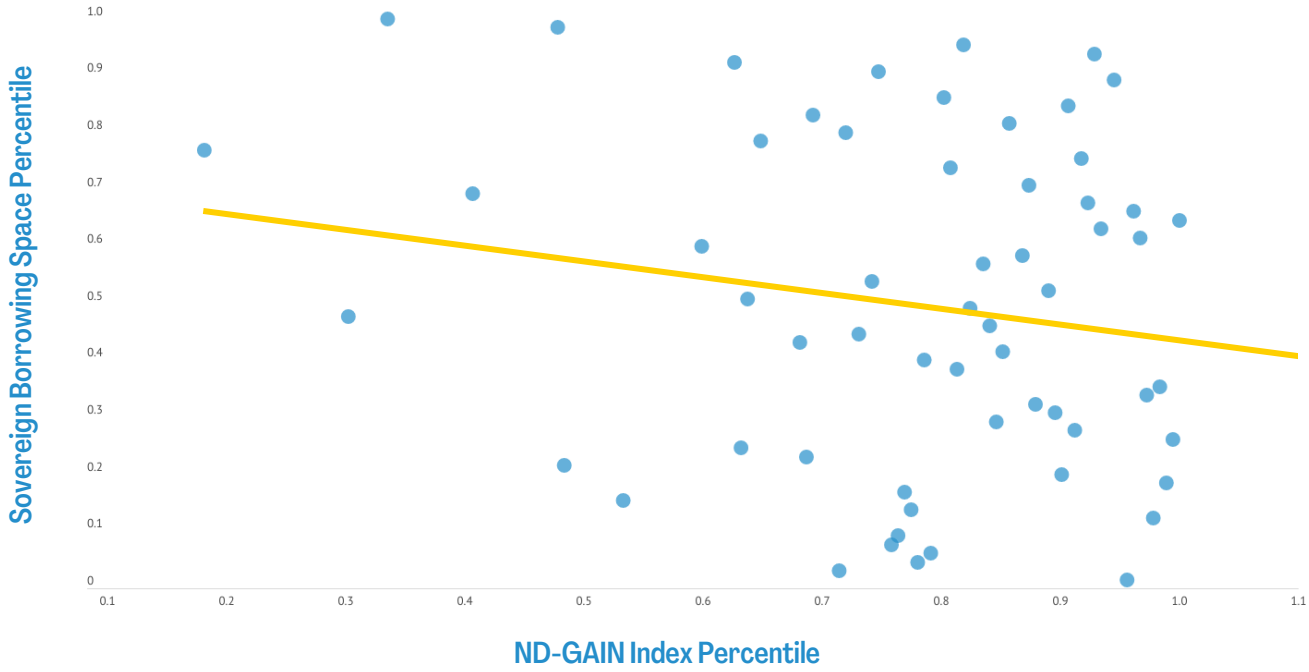
The most climate vulnerable developing countries are among those with the most significant debt distress. As climate hazards intensify and become more frequent, financial markets are increasingly factoring climate-related risks into their assessments, leading to a higher risk premium for climate vulnerable countries. This elevated risk premium could trap countries into a vicious cycle wherein higher climate vulnerability leads to higher debt costs and a decreased fiscal capacity to invest in climate resilience (Bühr et al. 2018; Volz et al. 2021).

Notre Dame-Global Adaptation Country Index (ND-GAIN) measures a country's vulnerability to climate change. It captures a country's exposure, sensitivity and capacity to adapt to the adverse effects of climate change by considering six life-supporting sectors: food, water, health, ecosystem service, human habitat and infrastructure (Chen et al. 2015). Countries that score high on the ND-GAIN index are more vulnerable to the impacts of climate change. Chamon et al. (2022) define borrowing space as the difference between the present value of debt as a ratio of GDP (end of 2021) and the country-specific present value debt ratio that would put the country at high risk of debt distress. Chamon et al. rely on the IMF-World Bank Low Income Country-Debt Sustainability Framework for thresholds and risks of debt distress.

As shown in Figure 8, a higher climate vulnerability correlates with a lower sovereign borrowing space. This illustrates a fundamental challenge facing climate vulnerable economies—their climate vulnerability necessitates greater adaptation investment. Yet, a tighter fiscal space constrains their ability to make the necessary investments.

The restricted fiscal space faced by climate vulnerable countries becomes apparent when examining available sovereign borrowing space against

Figure 8: Climate Vulnerability and Sovereign Borrowing Space

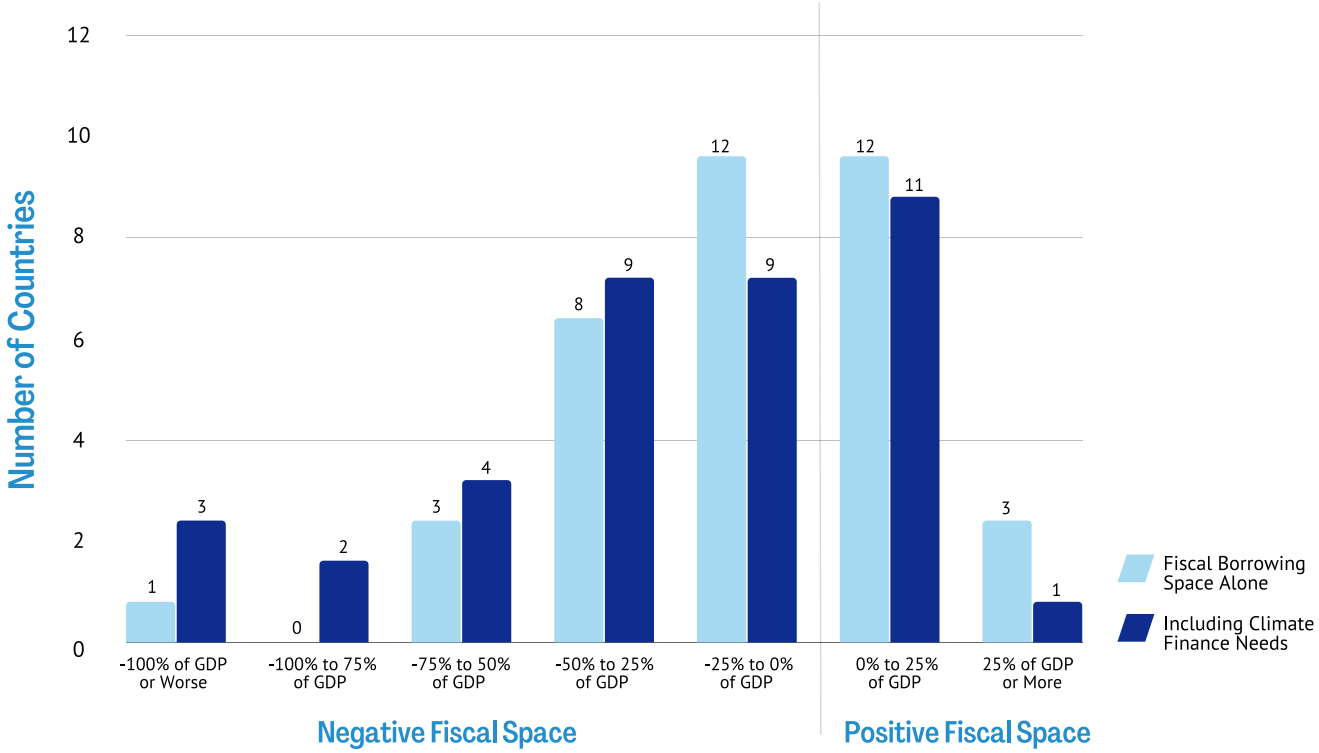


Source: Chamon et al (2022) and Chen et al. (2015).

climate finance needs. Figure 9 depicts climate finance investment needs for a subset of African countries against their borrowing space. Most countries already have negative borrowing space, that is, their debt levels already breach IMF thresholds for debt sustainability. Adding in the climate investment needs reveals that fiscal space is very limited. In Figure 9, countries to the left-hand side show negative borrowing space. Countries to the right-hand side have positive borrowing space. However, once climate finance needs are taken into account (the dark blue bars), more countries shift to the left and three countries face needs (negative fiscal borrowing space) of over 100 percent of GDP. The Chamon et al. (2022) study found that only seven of 29 low-income countries examined had the fiscal space to undertake the climate investments indicated in their national plans.

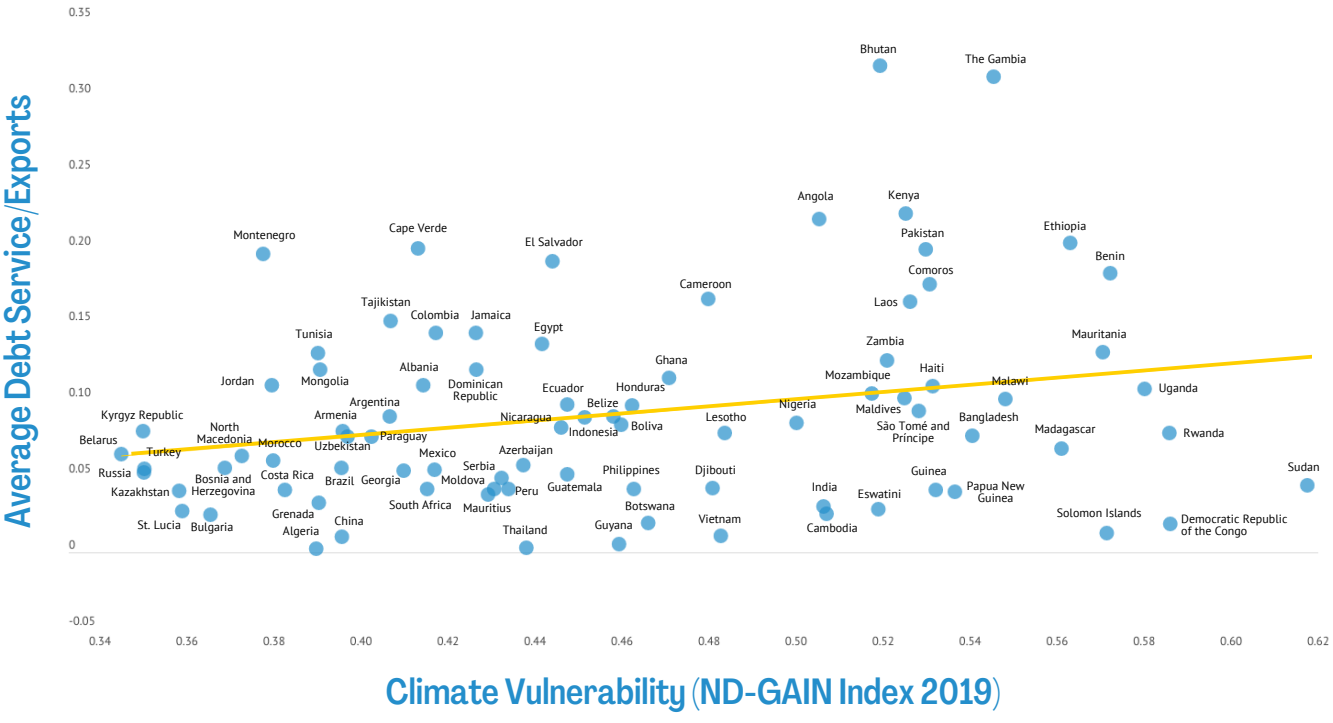
Figure 10 shows the ratio of debt service payments to exports against climate vulnerability using the ND-GAIN index as the indicator for climate vulnerability. As shown, climate vulnerability and high debt service payments are positively correlated. This is noteworthy, as exports generate foreign reserves, and if a large share of foreign reserves is going towards servicing payments on existing debt, fewer resources are available to pay for imports required for productive investments. With a strong US dollar and tightening interest rates, climate vulnerable countries are more likely to face foreign reserve balance challenges which restricts fiscal space.

Figure 9: Sovereign Borrowing Space and Climate Finance Needs, Subset of African Countries



Source: Chamon et al. (2022) and Meattle (2022).

Figure 10: Climate Vulnerability by Debt Service Payments and Exports



Source: Compiled by authors using Chen et al. (2015), and World Bank (2022).

Mexico City. Photo by Carlos Elizarrarás via Unsplash

COUNTRY-LEVEL ANALYSIS

In this section, analyses by two international institutions, the IMF and UNDP, are used to identify countries that need debt relief (Jensen 2022; IMF 2023). However, as underscored in earlier DRGR reports (Volz et al. 2020, 2021), eligibility should be based on debt sustainability analyses that incorporate investment needs related to the SDGs and climate change, while incorporating shocks.

Based on differing but strong methodologies, these institutions have identified a combined list of 69 countries that are in significant debt distress. Due to lack of data availability, our analysis includes 61 of these countries.

In its list of countries requiring debt relief, UNDP included all low- and middle-income countries that have a numeric credit rating under six. If there was no credit rating available, UNDP included countries "in distress" and "high risk of debt distress." The list also includes countries with sovereign bond spreads more than ten percentage points against US Treasury bonds. UNDP further identified nine countries as being at borderline risk, which are included in this analysis. Countries categorized by the IMF's recent Debt Sustainability Analyses as being in "high risk" of debt distress and low sovereign fiscal space are also included. This list is not exhaustive, and other countries may need debt relief according to different indicators and metrics. Still, we opted for two robust benchmarks to determine which countries require immediate action.

As we will argue that these countries must be eligible for a reformed G20 Common Framework, we refer to them as "New Common Framework" countries. Table 2 lists the 69 countries (See Appendix I for more information). As depicted in Figure 9, many countries do not have the necessary fiscal space to meet their climate adaptation needs, let alone investments needed for health, education and other government services or development aspirations (Chamon et al. 2022).

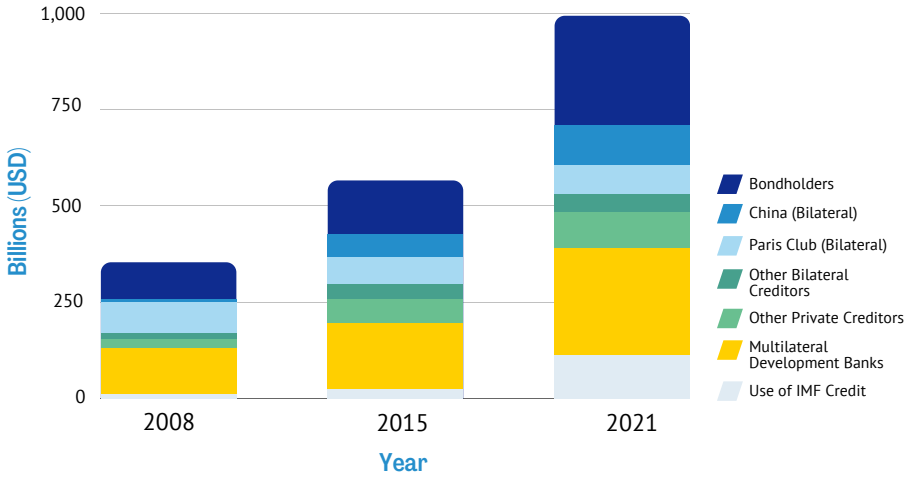
Table 2: New Common Framework Countries

Afghanistan	Ecuador	Liberia	Solomon Islands
Angola	Egypt	Madagascar	Somalia
Argentina	El Salvador	Marshall Islands**	Sri Lanka
Belarus	Eritrea	Malawi	St. Vincent and the Grenadines
Belize	Eswatini	Maldives	South Sudan**
Benin	Ethiopia	Mali	Sudan
Burkina Faso	Gabon	Mauritania	Suriname**
Burundi	Gambia	Micronesia**	Tajikistan
Cabo Verde	Ghana	Moldova	Tonga
Cameroon	Grenada	Mozambique	Tunisia
Central African Republic	Guinea-Bissau	Nicaragua	Tuvalu**
Chad	Haiti	Niger	Venezuela **
Comoros	Iraq	Nigeria	Ukraine
Congo, Dem. Rep.	Kenya	Pakistan	Zambia
Congo, Rep.	Kiribati**	Papua New Guinea	Zimbabwe
Cuba**	Kyrgyz Republic	Samoa	
Djibouti	Lao PDR	Sao Tome and Principe	
Dominica	Lebanon	Sierra Leone	

Source: Authors' elaboration.
Note: ** No International Debt Statistics data available.

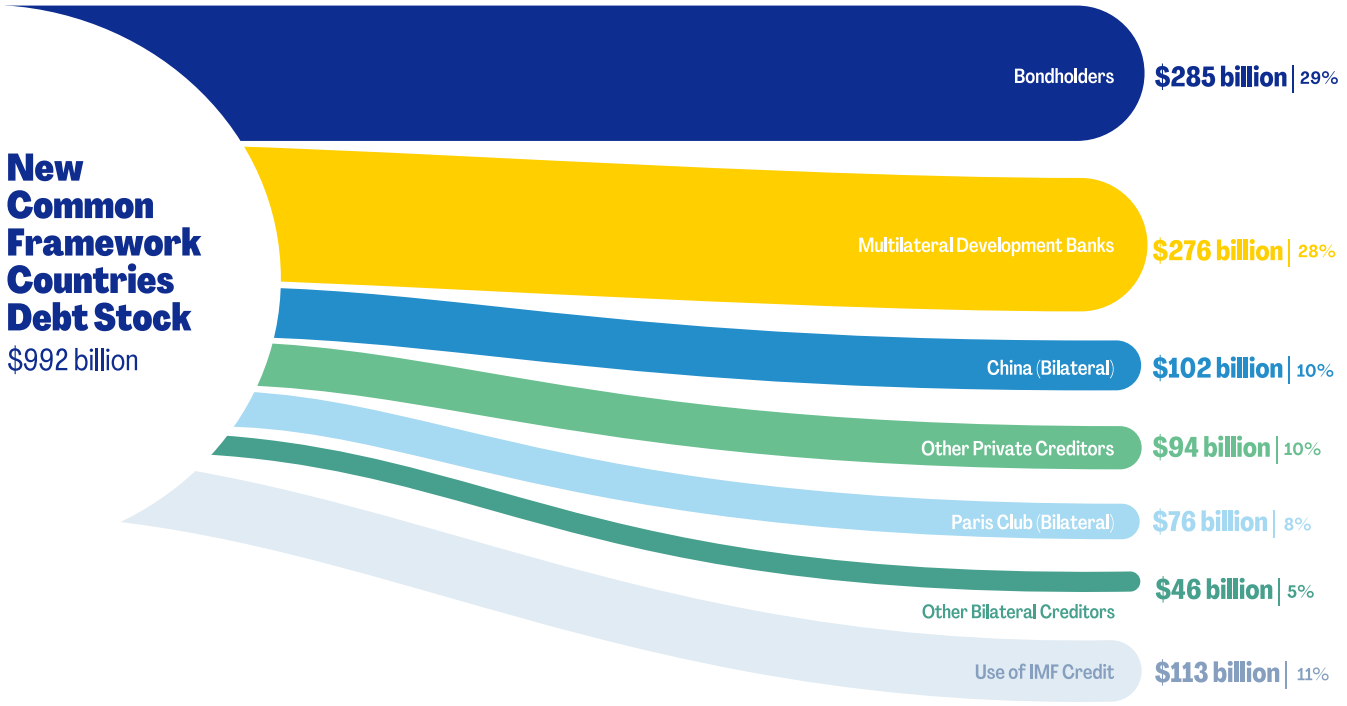
For the New Common Framework countries, debt stock has more than doubled over the last decade. In terms of creditor composition, Figure 12 shows bondholders hold 29 percent of their debt followed by MDBs at 28 percent, China at 10 percent and Paris Club members at 8 percent.

Figure 11: Debt Stock of New Common Framework Countries Over Time



Source: Compiled by authors using World Bank (2022).

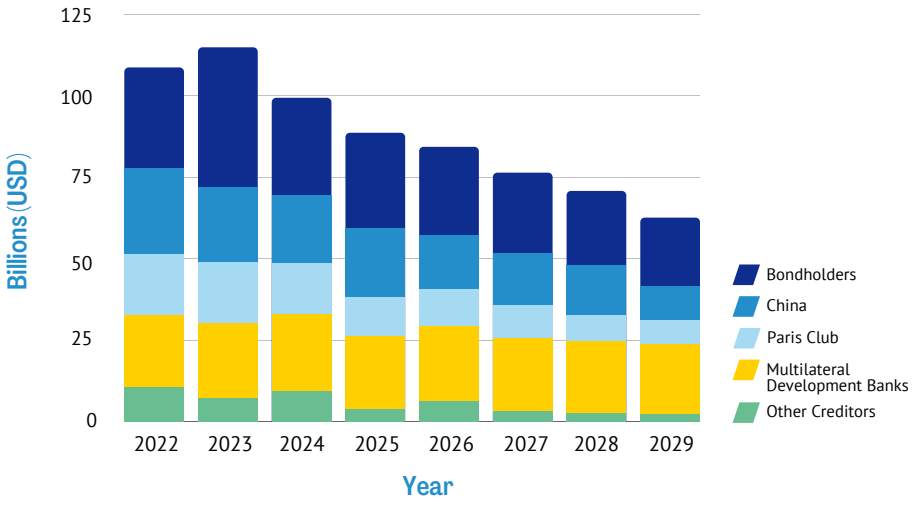
Figure 12: Debt Stock Disaggregation for New Common Framework Countries by Creditor in 2021, in Billions



Source: Compiled by authors using World Bank (2022).

An analysis of debt service payments (Figure 13) shows bondholders are the largest creditor group of New Common Framework countries, as they are projected to receive $228 billion (32 percent of the total debt payments from 2022-2029). Multilateral development banks are foreseen to secure

Figure 13: Debt Service Payments for New Common Framework Countries, by Creditor, 2022-2029



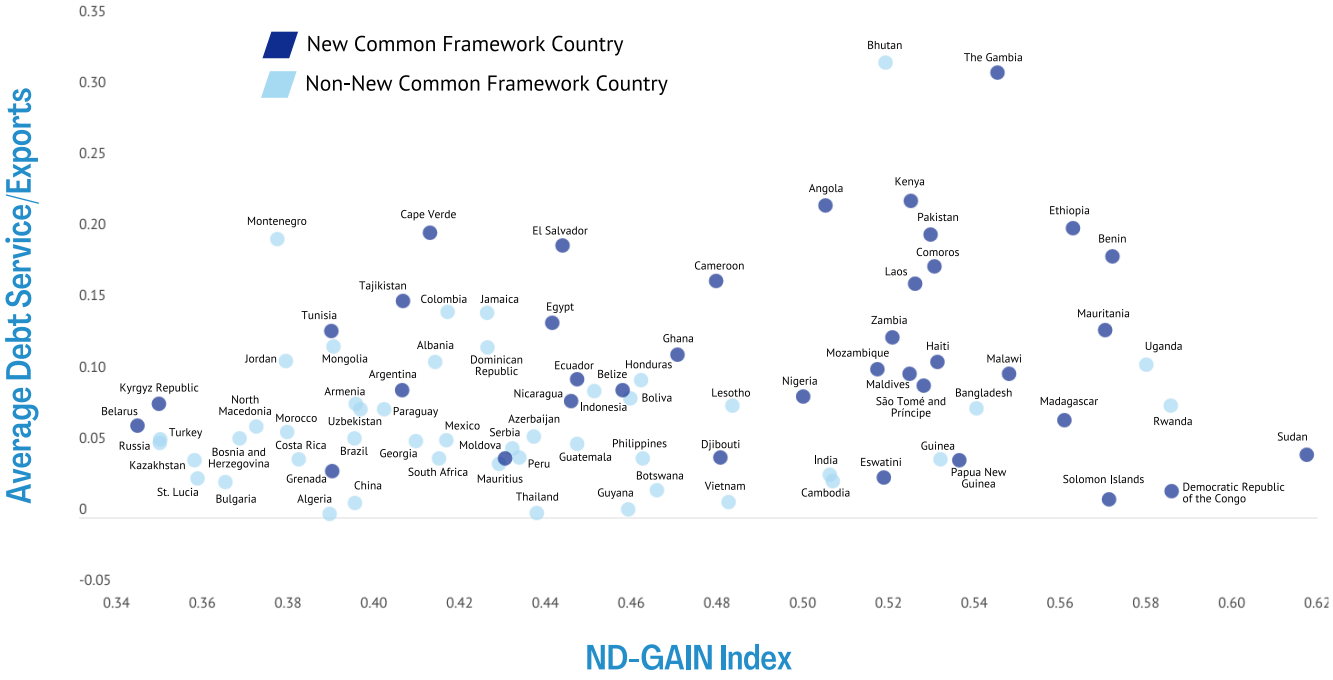
Source: Compiled by authors using World Bank (2022).

$180 billion (26 percent), while China and Paris Club members will receive 21 percent and 14 percent, respectively. We expect the debt service payments of New Common Framework countries to peak in 2023, primarily due to the short-term maturity of the loans they hold. Figure 13 displays the debt service schedule from 2022-2029. Of course, debt service costs are likely to increase over the course of the decade as countries increase their borrowing and higher interest rates are factored into borrowing or refinancing costs.

New Common Framework countries that are highly vulnerable to climate change are also likely to have a high ratio of expected debt service payments to exports. This means that these countries are allocating a larger portion of their foreign reserves to paying off debt, making their external financial position highly susceptible to fluctuations in macroeconomic variables, like exchange rates.

These 61 countries are projected to incur debt service expenses that often exceed the thresholds established by the IMF and World Bank Debt Sustainability Framework (DSF) to determine the sustainability for repayments by low-income countries. Figure 15 displays the aggregate debt service payments scheduled from 2023-2027, shown as a share of IMF projections for each countries' government revenues and exports, where projections are available. The DSF uses two thresholds of 10 percent of export revenue and

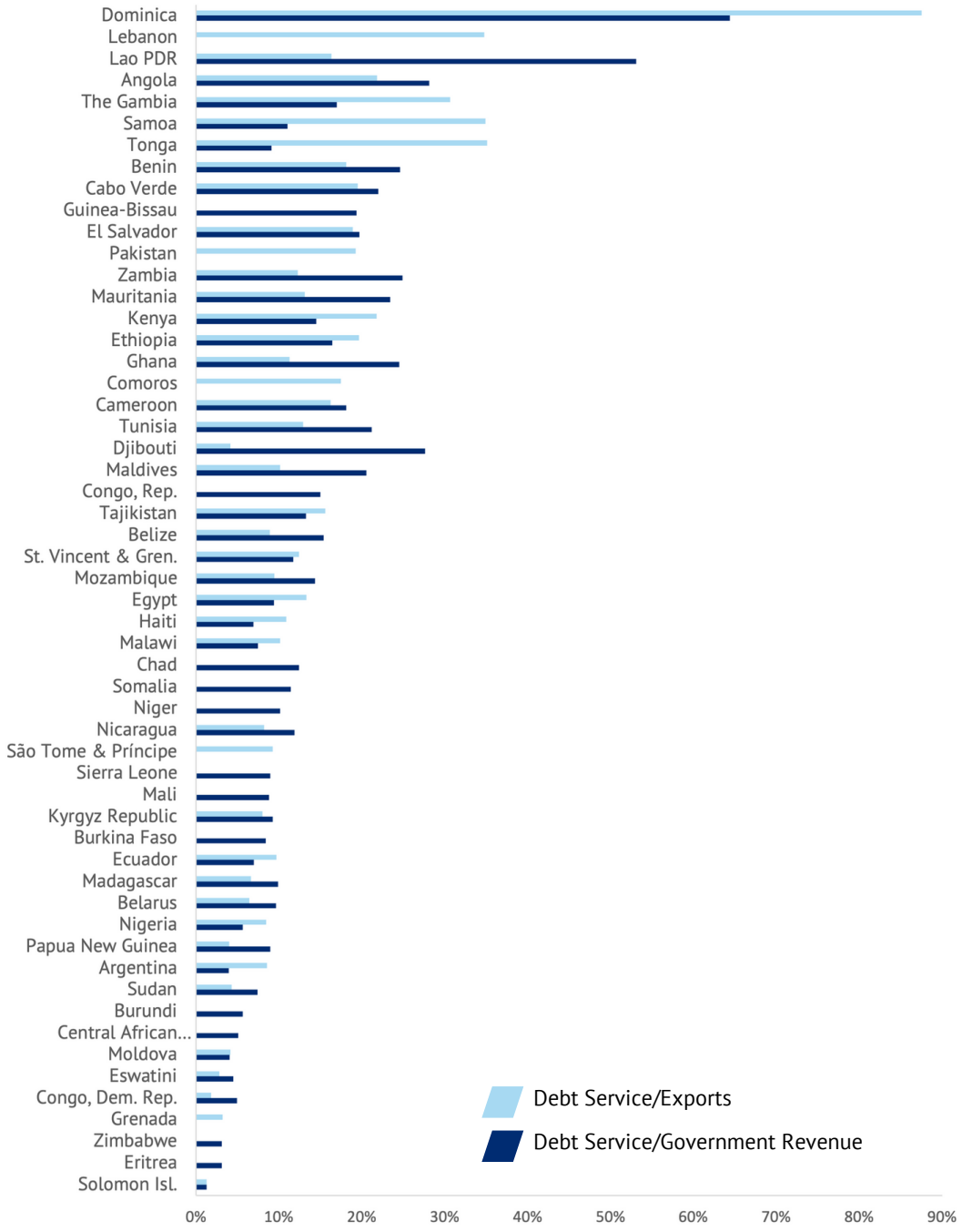
Figure 14: Climate Vulnerability, Debt Service and Government Revenue for New Common Framework Countries



Source: Compiled by authors using Chen et al. (2015) and World Bank (2022).

14 percent of government revenue as indicators of sustainability. Over half of these countries (35) are expected to have debt loads payments above the DSF thresholds for at least one year in the next five years, and 30 of them will be above the threshold for the entire five-year period. Although the DSF considers these thresholds appropriate only for countries with weak institutions, the thresholds were used for all countries analyzed for a consistent baseline.

Figure 15: Debt Service Payments Against Public Revenue and Exports for New Common Framework Countries



Source: Compiled by authors using World Bank (2022).

TOWARDS A NEW COMMON FRAMEWORK

The Common Framework must be immediately reformed to address debt distress of these 61 countries so that they can achieve debt sustainability and mobilize finance for achieving shared climate and development goals.

The Debt Relief for Green and Inclusive Recovery (DRGR) proposal can serve as the foundation for reform discussions. The proposal includes comprehensive debt relief across all creditor classes, with private and commercial creditors enticed through a Brady bond-like guarantee facility, a payments standstill to expedite the negotiations and participation by international organizations through measures that would not jeopardize their preferred creditor status and AAA credit ratings.

Under our analysis, a New Common Framework would need to:

1. Facilitate the restructuring of $812 billion (present value) of debt owed by 61 debt distressed countries. Using a range of historical precedents for the size of relief needed, we estimate that public and private creditors will have to grant haircuts between $317 billion to $520 billion in debt relief;

2. Compel all creditors to participate in debt restructuring with a guarantee facility of $37.1 billion to $61.9 billion to provide enhancement for newly issued 'green and inclusive recovery' bonds that private and commercial creditors can swap with a significant haircut against old debt;

3. Suspend debt payments totaling to $30 billion to incentivize rapid resolution of debt restructuring negotiations and keep countries afloat amid negotiations. Building on analyses by the IMF and UNDP, this report estimates that 55 of the most debt distressed countries in the world need around $30 billion in debt suspension to reach the sub-optimal levels of fiscal outlays they had before 2020. We restrict the suspension calculation to 55 countries only due to data availability. This debt suspension estimate illustrates the scale of suspension potentially needed

to provide debt distressed countries breathing room while negotiating a larger and more ambitious restructuring effort.

4. Support EMDES in using the fiscal and borrowing space gained from immediate debt relief efforts to pursue a low carbon, socially inclusive and resilient future.

In the 1990s, several developing nations faced default on their foreign debts as they strived to reach the UN 2015 Millennium Development Goals. To address this, the Brady scheme was implemented, allowing a large number of these countries to reorganize their debts with private lenders, followed by the Heavily Indebted Poor Countries (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI). Today, many EMDEs face a similarly pressing issue, grappling with severe debt distress while striving to meet the SDGs and fulfill the commitments made in the Paris Climate Agreement.

The DRGR proposal is in many ways a modern-day version of the Brady plan and the HIPC Initiative of the 1990s combined (Volz et al. 2021; Qian 2021; V20 2021). While the G20 Common Framework has been a step in the right direction, it has yet to deliver meaningful debt relief. The DRGR proposal offers a set of incentives and sticks to ensure that the widest possible section of creditors participate in the restructuring and relief process. Furthermore, it also addresses the hesitation that many debtor governments have in seeking restructuring by providing a clear and predictable roadmap of the steps involved and ensuring haircuts are sufficient for countries to meaningfully invest in their national plans on sustainable development.

The DRGR proposal is depicted in Figure 16. The DRGR proposal comprises three pillars. In the initial proposal, we predicated relief on the need for the IMF to conduct comprehensive DSAs that incorporate true resource mobilization needs and potential climate shocks. While we still see this as an essential reform, we anchor the need for immediate relief on the more than 60 countries already identified by the IMF and UNDP. The first two components (pillars) focus on debt restructuring for public and private creditors. In the first pillar, debt relief by official creditors is provided following historical and HIPC-like haircut scenarios. To protect the privileged status of multilateral institutions as creditors, MDBs' losses should be financed through bilateral contributions, sales of gold or the creation or reallocation of new SDRs (Volz et al. 2020). In the second pillar, old private and Chinese commercial debt are exchanged for newly issued "green and inclusive recovery" bonds, which are partially guaranteed through a new facility. This proposal may be particularly interesting to Chinese creditors given that, like in the original Brady scheme, their finance is in the form of bank loans and could be converted to bonds, which could be sold on secondary markets.

Figure 16: Three Pillars for Debt Relief for a Green and Inclusive Recovery

Source: Authors' elaboration.
Note: The ranges of the haircuts mentioned in the figure are in net present value terms.

A guarantee facility administered by the World Bank with a capitalization range of $37.1 billion to $61.9 billion would be required to incentivize participation. Pillar 3 offers credit enhancement to countries that are not in debt distress and do not need restructuring but lack the fiscal space to mobilize the resources to recover from these multiple crises and harness the investments needed to achieve shared climate and development goals.

As shown in Figure 16, New Common Framework countries would undergo a comprehensive process reflecting the same core principles but reflecting national circumstances. One of the benefits of the HIPC Initiative was the transparency in the organizing framework for debt relief.

The cornerstone of the DRGR and V20 proposals is to directly link the outcomes of restructuring to national climate and development goals. Country-ownership is a core principle of DRGR and countries must be able to chart out their own vision and implementation plan. In this proposal, in exchange for the restructuring across creditor classes, debtor governments

develop their own Green and Inclusive Recovery Strategies that are aligned with their climate and development goals (Volz et al. 2021). V20 countries have "Climate Prosperity Plans" that could be enshrined in such agreements, for other countries it could be certain aspects of a country's Nationally Determined Contributions under the Paris Climate Agreement, or another plan specific to the restructuring. Furthermore, where new bonds are issued in Pillar 2, they should come with natural disaster clauses to ensure recipient countries do not fall back into a debt trap amidst a future climate event. The bonds could also be explicitly sustainability-linked, where payments are tied to the key performance indicators.

Our proposal is an attempt to advance a comprehensive debt restructuring solution that moves away from the ad hoc approach currently employed by the G20 Common Framework. The DRGR proposal could also serve as a stepping stone to an international sovereign debt resolution mechanism under the auspices of the UN.

The following section details the debt reduction necessary under historical and HIPC-like scenarios. The subsequent two sections outline the design of the guarantee facility and advocate a temporary suspension of debt payments to promote widespread creditor participation.

THE NEW COMMON FRAMEWORK NEEDS TO PROVIDE $317 BILLION TO $520 BILLION IN DEBT RESTRUCTURING

The amount of debt relief for countries in the New Common Framework under Pillars 1 and 2 would range from $317 billion to $520 billion in present value terms, based on two precedents: the historical level of haircuts in the "modern era" (1980s-2016), and the level of debt reduction provided under the HIPC Initiative and MDRI. As of 2021, the present value of the total debt stock is $812 billion. According to a comprehensive study of past sovereign debt restructuring, the average haircut on sovereign bonds in the "modern era" was 39 percent (Meyer, Reinhart and Trebesch, 2022). Under the HIPC Initiative, debt restructuring reached up to 64 percent of the present value of the debt for participating countries.

Table 3 shows the levels of debt reduction for New Common Framework countries under Pillars 1 and 2, respectively, using these historical benchmarks. Under the historical scenario, the total debt reduction amounts to $317 billion (39 percent of the total present value). Under a HIPC-like scenario with a benchmark of 64 percent, the total debt reduction would be $520 billion. In these scenarios, the Pillar 1 multilateral and bilateral

creditors would supply 45 percent of the haircuts, amounting to $143.7 and $235.8 billion in the two scenarios, respectively. In 2021, the private sector, bondholders, Chinese actors and other commercial creditors held 55 percent of the New Common Framework countries' debt stock. Using this proportion as a proxy, the total present value of debt that needs restructuring is between $173.3 billion and $284.4 billion, respectively, in the historical and HIPC-like scenarios. See Appendix 2 for haircuts by creditor classes.

Table 3: Haircut levels by scenario and Pillars 1 and 2[1]

	Present value debt	Historical scenario	HIPC-like scenario
New Common Framework	812	317	520.2
Pillar 1: Publicly held debt	368.4	143.7	235.8
Pillar 2: Privately held debt	444.5	173.3	284.4

Source: Author calculations based on World Bank data (2022).

Note: Historical scenario refers to a 39 percent reduction in debt while the HIPC-like scenario refers to a 64 percent reduction.

APPROXIMATELY $37.1 BILLION TO $61.9 BILLION IS NEEDED TO FUND THE PILLAR 2 GUARANTEE FACILITY

The linchpin of the DRGR proposal is the creation of the Facility for Green and Inclusive Recovery, designed to entice the commercial sector to engage in the restructuring. This new guarantee facility could be administered by the World Bank, which not only has the expertise to manage, but would also offer a diverse range of capitalization options. For example, as a prescribed holder of SDRs, the World Bank would be able to use SDRs towards this facility. Private creditors would swap old debt for new bonds at one of these haircut levels—accepting the same haircut as public creditors. The Facility would provide credit enhancements for new sustainability-linked 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 Facility. The Facility will back up 80 percent of the principal and total interest payments in the first 18 months (Volz et al. 2021). Figure 17 exhibits the design of the Facility.

[1] The public debt estimate is an underestimate as there lacks transparent data on the net present value of IMF loans. The private debt estimate will be a slight overestimate because the World Bank IDS data does not differentiate between publicly guaranteed debt from China and Chinese commercial debt.

Figure 17: Design of the Guarantee Facility for Green and Inclusive Recovery

Source: Authors' elaboration.

Table 4 exhibits the size of the capital required to guarantee the new Brady-like bonds. These bonds would be sustainability-linked with key performance indicators rooted in country-owned plans. As in the case of the original Brady bonds, we assume a ten-year maturity for the new bonds and a Secured Overnight Financing Rate +3.5 percent cost (Qian 2021; Buchheit and Lerrick 2023). We estimate a partial guarantee of the principal (80 percent portion) plus 18 months of interest payments fully guaranteed. We also assumed a 1:4 leverage ratio, meaning $1 in available capital could guarantee up to $4 in new sustainability-linked bonds in the guarantee facility. Each institution has a leverage level for guarantees determined by its internal rules. For this Facility, a 1:4 leverage ratio is assumed, which the World Bank has allowed on policy-based guarantees (World Bank 2016).

Table 4 shows haircut ranges for two classes of creditors. Paris Club bilateral creditors, other bilaterals and MDBs would need to provide a haircut of between $143.7 billion to $235.8 billion depending on the historical or HIPC-like scenarios. Bondholders, other private creditors and bilateral Chinese

Table 4: Debt Relief, Guarantee Facility and Debt Service Suspension under the New Common Framework (in US$ billions)

	Debt Relief		Guarantee Facility		Debt Service Suspension
	Historical Scenario	HIPC Scenario	Historical Scenario	HIPC Scenario	
Bondholders					
Other Private Creditors	173.3	284.4	271.1	160	
China Bilateral					30
MDBs					
Paris Club Bilateral	143	235.8	61.9*	37.1*	
Other Bilateral					

Source: Authors' analysis of World Bank data (2022).
Note: $37.1-61.9 billion reflects the size of the guarantee facility hosted at an MDB.

creditors would have to provide a haircut ranging from $173.3 billion to $284.4 billion for historical and HIPC-like scenarios, respectively.

As shown in Table 4, the level of new bonds issued by the private sector and Chinese entities would range from $160 billion to $271.1 billion under the two scenarios. What follows then, is that the size of the guarantee facility would be $37.1 billion to $61.9 billion, depending on the level of ambition in the haircuts. Since the guarantee facility is an incentive to private creditors and Chinese bilaterals, the size of the guarantee facility is based solely on the new bonds issued by these actors, rather than the entire set of creditors.

As noted in the 2021 DRGR report, the guarantee facility could be financed through unused SDRs or through the World Bank's existing balance sheet (Volz et al., 2021). A number of studies have shown that the World Bank and other regional MDBs have not been optimizing their balance sheets and could lend upwards of at least $200 billion without jeopardizing their AAA ratings (G20 Expert Panel 2022; Munir and Gallagher 2020).

A NEW DEBT STANDSTILL OF UP TO $30 BILLION IS REQUIRED TO FACILITATE THE NEGOTIATIONS UNTIL RESTRUCTURING IS FINALIZED

Given the urgency of the matter, we propose a partial standstill on debt payments that would suspend $30 billion for 55 countries needing immediate relief in order to provide a "stick" to participating creditors and to reduce short-term debt payment stress to the sub-optimal levels of fiscal outlays before 2020. Due to data availability, the suspension calculation covers 55 of the 61 countries identified as needing immediate debt relief.

By delaying full payments until debt restructuring has been agreed, the New Common Framework proposal incentivizes all creditors to participate in renegotiations. Furthermore, the New Common Framework directs the strongest incentives toward those creditors who are receiving the bulk of near-term repayments, which are those with higher interest rates and shorter maturities. Applying the same percentage cut to all debt service payments across all creditor classes produces a stronger incentive for bondholders and China to participate, as their interest rates tend to be higher than multilateral creditors, meaning they would make up a larger share of near-term repayments.

To calculate the level of debt service suspension, this proposal takes as a given that LICs whose debt burdens are above their DSF thresholds for debt service sustainability should see their payments reduced to those threshold levels during negotiations. (DSF thresholds vary among nations, from 10 percent to 21 percent of export revenue, and from 14 percent to 23 percent

of government revenue, depending on national institutional strength.) This reduction would total $8.8 billion if the negotiation period—during which the partial suspension will be active—lasts through 2027. 11 LICs do not breach the threshold. For these countries, we apply a 5 percent discount. Even though these countries do not breach the DSF debt sustainability thresholds, since they have been identified by UNDP and/or IMF as requiring immediate restructuring, we include them in the debt service suspension. A nominal debt service suspension can be helpful for a speedy resolution for these countries so we apply 5 percent which yields a total of 0.73 billion for 11 LICs.

MICs do not have IMF debt service sustainability thresholds identified by the IMF. For MICs, we use 30 percent as the threshold – 30 percent of debt service to projected government revenue, debt service to export revenue or both. This threshold is well above any threshold used in DSFs for LICs. It must be emphasized that threshold is for illustrative purposes. 10 MICs are above the threshold of 30 percent. These countries will require debt relief totaling to $9.5 billion. An additional 27 MICs do not breach the threshold. Like for LICs, these countries receive a nominal 5 percent suspension. (For more information on this methodology, see Appendix 4.)

In addition to this debt service suspension, a number of other "sticks" could be used to compel creditor participation.

During the debt restructurings of the 1990s, the IMF threatened to hold emergency financing until a restructuring was underway and to be the first to disburse upon a successful restructuring. This move provided an incentive for private creditors who were holding out to participate in the restructuring process. In tandem, the United States Federal Reserve threatened that commercial banks could be required to increase their reserves if they did not participate (Qian 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, Volz and Gallagher 2021). More recently, the United Kingdom ruled in 2010 in a manner that prevented creditors from acting against nations participating in the HIPC Initiative, and the US has issued executive orders to deal with potential litigation deriving from the restructuring of Iraqi war debt in 2002 (Buchheit and Gulati 2019; Hagan 2020). Additionally, the G20 could publish a list of non-participating creditors to spotlight on their inaction.

Marrakesh, Morocco.
Photo by Annie Spratt via Unsplash.

CONCLUSION

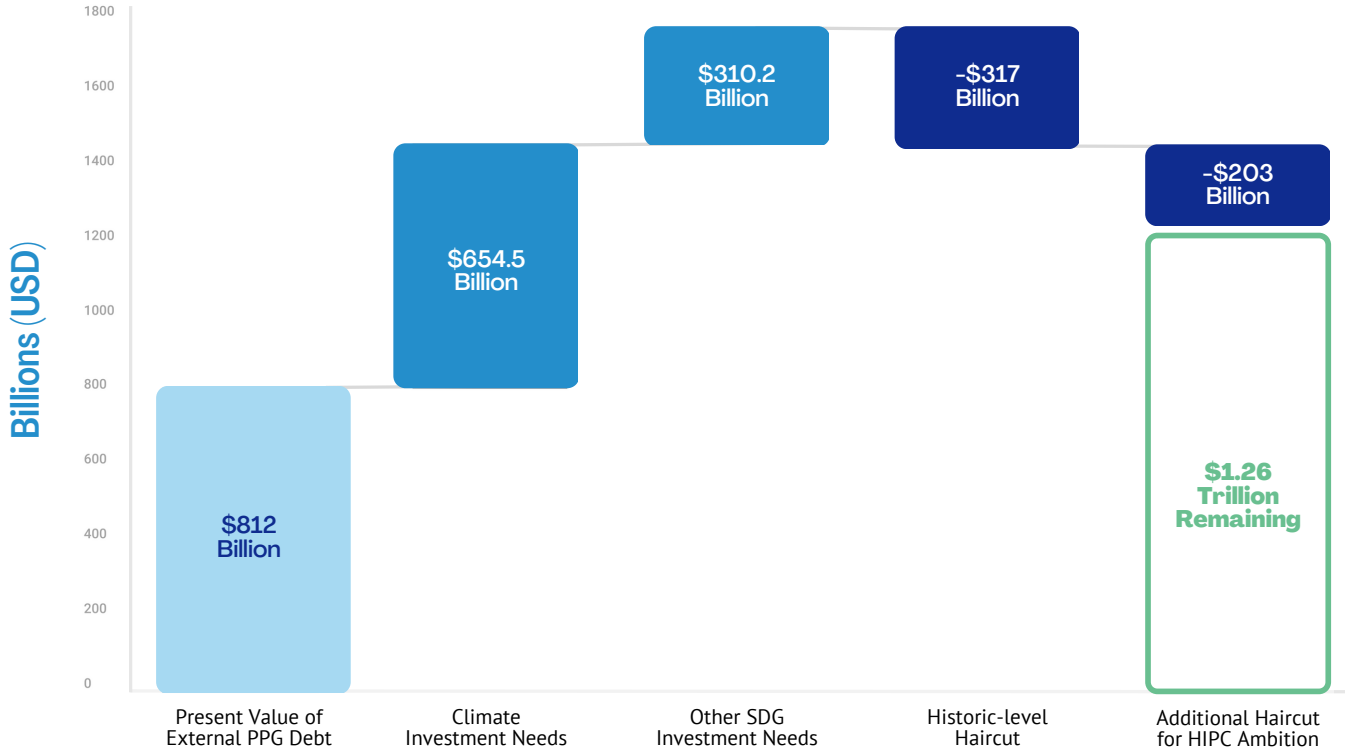
Urgent action is needed to immediately help EMDEs restore debt sustainability and mobilize resources to achieve shared development and climate change goals. The report also further illustrates how our proposal to reform the G20 Common Framework would work, and provides approximate ranges of the levels of potential haircuts based on historical precedent, and the size of a guarantee facility and level of a payments standstill to compel creditors to come to the table and negotiate.

Debt relief alone cannot solve the immediate crises at hand, nor is the DRGR proposal a substitute for the more fundamental reforms called for by the United Nations, the Bridgetown Initiative, the United States and a growing number of actors and analysts around the world (Gallagher and Kozul-Wright 2022). Figure 18 illustrates that $1.3 trillion would be needed to meet shared development and climate change goals even by reducing the debt burden through ambitious debt relief. Much of that finance would have to be in the form of new liquidity through SDR issuances and rechanneling, concessional finance and grants and a return to capital markets at an affordable cost (Truman 2022).

To arrive at the estimates in Figure 18, we draw from Songwe et al. (2022), who calculate the annual resource needs for climate and other SDG investment for EMDEs other than China to be in the range of $1.3 trillion per year: $889 billion in climate investment and $421 billion in other SDG investments. We estimate the aggregate five-year resource mobilization needs for this group of 61 countries by weighting the investment needs identified in Songwe et al. (2022) by a share of GDP for EMDEs other than China. This amounts to $547.1 billion in climate investment and $259.3 in additional SDG investment for a total of $806.3 billion in additional resources. (See Appendix 5 for detailed methodology.)

Extrapolating from Songwe et al. (2022), the New Common Framework countries face an additional $547.1 billion in climate finance needs over the

Figure 18: Debt Relief and Remaining Resource Mobilization Needs for New Common Framework Countries



Source: World Bank (2022), Songwe et al. (2022) and authors' calculations.

next half decade and $259.3 billion in financing to meet the SDGs—on top of the $812 billion in public external debt (see Appendix 4 for methods). Figure 18 shows how the two debt relief scenarios profiled would help make resource mobilization goals more realistic. Of course, new investments will not be equal to the full size of the haircuts, as the haircuts are needed to restore solvency in the first place. (Panizza, Sturzenegger and Zettelmeyer 2009). With these haircuts, however, New Common Framework countries would be able to return to capital markets (see Patel 2022) and stand with more capacity to absorb SDRs, new concessional loans and grants to close the finance gap.

The G20 Common Framework were emergency measures applied amid the shock of the COVID-19 pandemic, and are no substitute for comprehensive reform. Given the multiplicity of shocks now facing the international community, DRGR proposes a framework for reforming the Common Framework to return countries to capital markets and mobilize resources to meet shared climate and development goals. This proposal is but a first step toward comprehensive reform.

To conclude with words from the UN Secretary General, Antonio Guterres, "It is time for a new Bretton Woods moment. A new commitment to place the dramatic needs of developing countries at the center of every decision and mechanism of the global financial system. A new resolve to address the appalling inequalities and injustices laid bare once again by the pandemic and the response. A new determination to ensure developing countries have a far greater voice in global financial institutions. And a new debt architecture that encompasses debt relief and restructuring to vulnerable countries, including middle-income ones in need—building on the momentum of the Bridgetown Agenda" (UN 2023).

Chefchaouen, Morocco.
Photo by Mohammed Iak via Unsplash.

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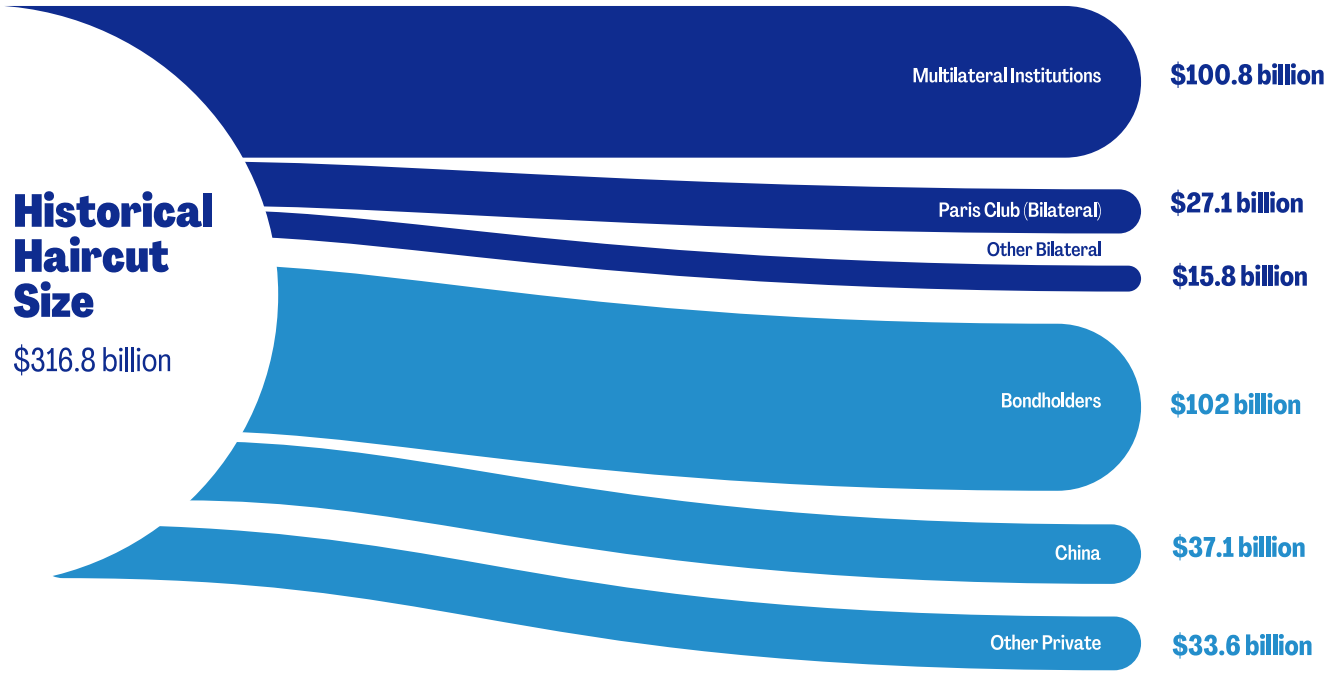
APPENDIX

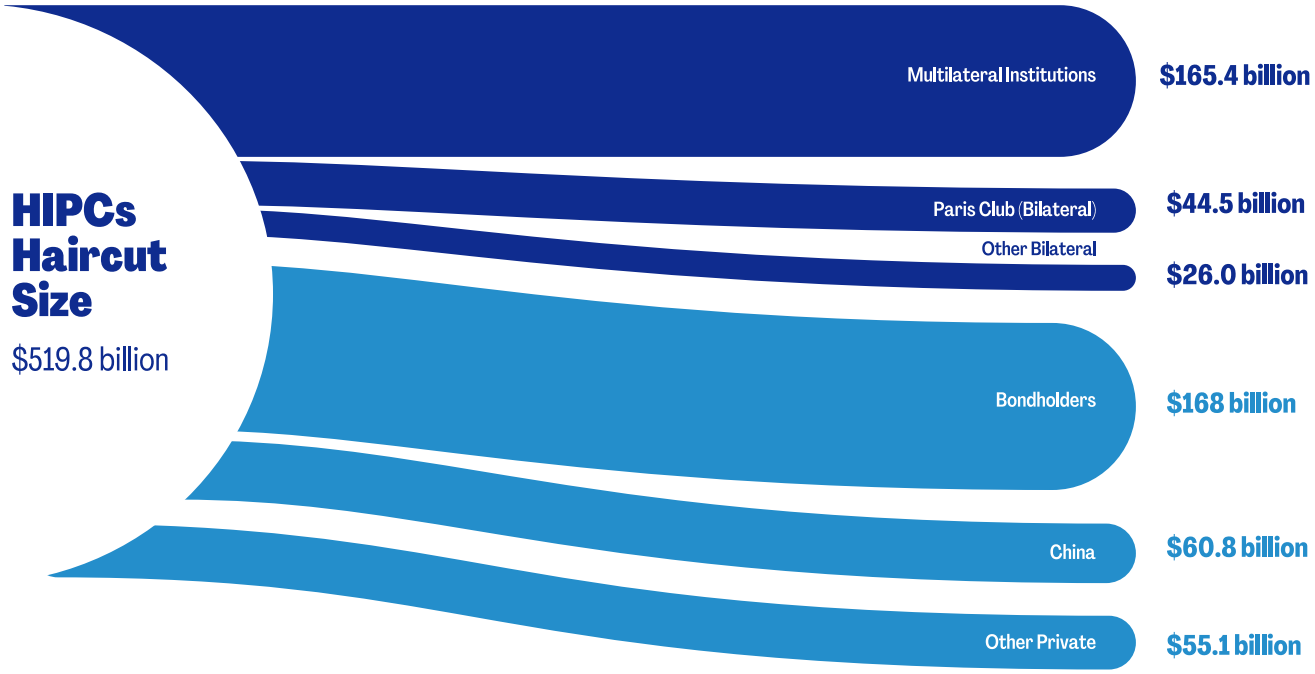
APPENDIX 1
CREDITOR CLASSES AND HAIRCUT SCENARIOS

Figure A1: Haircut size – Historical



Source: Authors' calculations using World Bank data (2022).

Figure A2: Haircut size – HIPC



Source: Authors' calculations using World Bank data (2022).

APPENDIX 2
METHODOLOGY FOR DATA COLLECTION

This report features data collected from the World Bank International Debt Statistics database. We examine external public and publicly guaranteed debt. External private data appears in selected figures and analysis and is framed properly.

This report targets the most relevant creditors for a group of countries, and we discussed only external debt. Domestic debt is a key component of debt sustainability. However, we do not examine domestic debt here.

All amounts are estimated. The current values may differ due to new debt issuances and interest and exchange rate fluctuations.

Debt stock information refers to public and publicly guaranteed (PPG) debt outstanding to bilateral, multilateral and private creditors. Country counterparty data for China and Paris Club are PPG bilateral loans. Paris Club refers to Austria, Australia, Belgium, Brazil, Denmark, Canada, Finland, France, Germany, Ireland, Israel, Italy, Japan, Netherlands, Norway, Russia, Spain, Sweden, Switzerland, USA, UK and South Korea. We calculated private loans as bonds or other private (the difference between total private debt and bonds).

This report also includes IMF liabilities. Following International Debt Statistics (IDS) methodology, the 'Use of IMF Credit' series converted amounts from SDRs into dollars using end-of-period exchange rates for stocks and average-over-the-period exchange rates for flows. IMF trust fund operations under the Enhanced Structural Adjustment Facility, Extended Fund Facility, Poverty Reduction and Growth Facility and Structural Adjustment Facility (Enhanced Structural Adjustment Facility in 1999) are presented together with all of the IMF's special facilities (buffer stock, supplemental reserve, compensatory and contingency facilities, oil facilities, and other facilities). IMF liabilities here are the balance of 'use of IMF credit (DOD, current US$)' and 'use of IMF credit, SDR allocations (DOD, current US$)'.

Besides total debt stocks, we create a representative portfolio of developing countries to analyze creditor composition and how the composition has shifted over the decade. First, for each country in the sample, we calculated each creditor's share of debt stock. We then calculated the median share for each of the creditors across all the group countries. We call this the representative portfolio in the sample below. Given the varying debt magnitudes across developing countries, computing the median share provides a better

picture than the overall debt basket. The overall debt basket does not represent a typical debtor country's experience. We also compare the representative portfolio for 2008 and 2021 to understand how creditor composition has shifted.

For debt service, we used debt service on external debt (public and publicly guaranteed (PPG)) for the period 2022-2028. This is the TDS series in the current US$. Debt service (PPG) is the sum of principal repayments and interest paid in currency, goods or services on long-term obligations of public debtors and long-term private obligations guaranteed by a public entity.

APPENDIX 3
METHODOLOGY FOR ESTIMATES OF NEEDED DEBT SERVICE RELIEF

This report estimates debt service sustainability in accordance with methodology developed jointly by the World Bank and IMF, in the Debt Sustainability Framework (DSF) (IMF 2021). DSF defines sustainable debt service payments as no greater than of 14 percent of general government revenue or 10 percent of the value of exports of goods and services. These debt service sustainability thresholds are calculated for each country for the years 2023 through 2027 using a variety of IMF projections for each country, as described below.

Government revenue projections are estimated using the IMF Fiscal Monitor (FM) and World Economic Outlook (WEO) databases. The October 2022 edition of the FM dataset provides projections of the general government for the years 2023-2027, expressed as percentages of projected GDP (IMF 2022a). These percentage values are applied to projected GDP levels for the same year, reported through the October 2022 WEO database (IMF 2022b).

Projections for the values of exports of goods and services estimated using the IMF's International Financial Statistics (IFS) and WEO databases. The October 2022 WEO database reports projected rates of annual growth in the value of exports of goods and services for the years 2022-2027 (IMF 2022b). These growth rates are applied to the most recent values of actual exports of goods and services (for 2021), as reported in the January 2023 edition of the IFS database (IMF 2023) to create estimated projections for the value of exports for the years 2023 through 2027.

From these projections for government revenue and exports, sustainable debt service thresholds are calculated. For each country and year through

2027, either 14 percent of projected government revenue or 10 percent of projected exports is used, whichever is lower. According to the DSF, these thresholds can vary by national institutional strength, and the 14 percent and 10 percent thresholds correspond to weak institutions. However, this analysis relies on these thresholds for all countries to compensate for the fact that the thresholds are just one of many factors taken into account by the IMF in national debt sustainability analysis.

Projected debt service payments for 2023-2027 are accessed through the World Bank International Debt Statistics database, updated in December 2022 (World Bank 2022b). This analysis uses debt service on PPG external debt, expressed in current USD (series DT.TDS.DPPG.CD). Creditors are sorted into five categories: China, Paris Club, multilateral creditors, bondholders and other creditors. Official and private creditors (other than bondholders) are aggregated by nationality.

Needed debt service relief is calculated as the difference between projected debt service payments and the sustainable threshold for each country and year. Calculating needed debt service relief on an annual basis prior to aggregating across the entire 2023-2027 period allows for the inclusion of countries who rise above sustainable debt service thresholds for one or more years but not for the entire five-year period. For example, Argentina's debt service payments are projected to be $21 billion in 2023, or 23 percent of the value of exports that year. To reach the sustainability threshold of 10 percent of projected exports ($9 billion), Argentina will need $12 billion in relief. However, Argentina's projected debt service payments for subsequent years, and for the 2023-2027 period as a whole, do not rise above sustainability thresholds. Nevertheless, for the year of 2023, Argentina will find itself significantly above IMF debt thresholds and therefore in need of debt service relief.

These estimates of needed debt service relief are divided among creditors on a pari passu basis, in proportion to each creditor's share of a given debtor's service payments in a given year. For example, Angola owes 51 percent of its 2023 debt service payments to China, 36 percent to Paris Club creditors, 7 percent to bondholders, and 3 percent each to multilateral and other creditors. These percentages are applied to the $6 billion in needed debt service relief for 2023 to yield creditor specific amounts: $3 billion from China, $2 billion from Paris Club creditors and $0.2 billion each from multilateral and other lenders. These values are then aggregated across the entire 2023-2027 period to create estimates of total needed debt service relief by creditor.

Finally, estimated debt relief needs are aggregated across borrower country groups. The entire group of countries in this study is taken from UNDP and IMF estimates, as noted. That list is further disaggregated by income levels: low- and middle-income countries are defined according to the World Bank's June 2022 country income classification (World Bank 2022). Beyond the high-risk group of countries, other country groups are considered regardless of their inclusion in published lists of high-risk groups, due to shared climate or regional interests: members of the Climate Vulnerable Forum (also known as the V20), the Alliance of Small Island States (AOSIS), Sub-Saharan Africa and the Amazon. V20 and AOSIS member lists are taken from their respective websites (AOSIS 2022, CVF 2022). Sub-Saharan African countries are classified according to World Bank definitions (World Bank 2022c). Amazon countries are classified as those containing territory in the Amazon basin, biome or both.

APPENDIX 4
METHODOLOGY FOR ESTIMATING CLIMATE AND OTHER SDG INVESTMENT NEEDS

This report estimates climate and other SDG investment needs for the years 2023-2027 by applying projections for the year 2025 to each year in this interval. We approach this task first on an aggregate level for all EMDEs other than China, and then on a national level for those countries.

The 2022 International High-Level Expert Group on Climate Finance report (Songwe et al. 2022) finds that EMDEs other than China will need to ramp up climate investment and other SDG investments by 2030 as shown in Table A4.1

Table A4.1: IHLEG Estimates of Climate and Other SDG Investment Needs, 2030

	2019, actual	2030, needed	New annual inv. by 2030
Climate investment	450	2,250	1,800
Other SDG investment	1,935	3,630	1,695
Total SDG investment	2,385	5,880	3,495

Source: Songwe et al. (2022), Table 3.1.

However, it is not appropriate to simply apply the 2030 "new investment" levels to the years between 2019 and 2030. HLEG explain that this investment trajectory entails growth each year, so the years between 2019-2030

will have lower values than 2030. Nevertheless, we can estimate a reasonable value for 2025 investment needs. IHLEG draw these projections from Bhattacharya et al. (2022), who give more detail on the pace of increased investment and provide estimates for 2025 spending needs, as shown in Table A4.2.

Table A4.2: IHLEG Estimates of Climate and Other SDG Investment , 2025 and 2023

	2019 actual	2025 needed	2030 needed	New annual inv. by 2025	New annual inv. by 2030
AFOLU (agric., food, land use)	150	355	650	205	500
A&R (adaptation & resilience)	35	180	325	145	290
Sustainable Infrastructure	730	1,160	1,840	430	1,110
Human capital	1,470	2,000	3,065	530	1,595
TOTAL	2,385	3,695	5,880	1,310	3,495

Source: Bhattacharya et al. (2022), Table 2.2.

Thus, Bhattacharya et al. (2022) give an explicit estimate of new investment in 2025 needed for total SDG achievement ($1,310 billion) although they do not specify the portion of this value that corresponds to the "climate investment" discussed by IHLEG. Nevertheless, we can estimate climate investment needs based on this information, according to the following method.

Songwe et al. (2022) explain that "Climate Investment" is the sum of three categories: AFOLU, A&R, and the "Energy Transition" (which is an unspecified portion of "Sustainable Infrastructure"). Combining data from IHLEG and Bhattacharya et al, we can calculate that for 2030, "Energy Transition" is the difference between "Climate Investment" and the sum of AFOLU and A&R, or $1,275 billion. As a share of Sustainable Infrastructure investment in 2030, Energy Transition investment is 1,275 / 2,250 = 69.3 percent. Bhattacharya et al emphasize the urgency of frontloading energy transition investment, so it is reasonable to expect the "Energy Transition" category to being a higher share of "Sustainable Infrastructure" in 2025 than in 2030. So a conservative estimate for Energy Transition investment needs for 2025 is 69.3 percent of the 2025 Sustainable Infrastructure investment needs, or 69.3% * $1,160 = $803.8 billion.

Thus, total climate investment needs for 2025 can be calculated as the 2025 sums of AFOLU, A&R, and our estimate for Energy Transition investment needs: $650 + $325 + $803.8 = $1,338.8. Subtracting the actual 2019 values for climate investment from IHLEG yields new climate investment needs for 2025: $1,338.8 – $450 = $888.8 billion annually, which we can apply for the intervening years of 2023-2027 in the debt relief analysis.

As neither Songwe et al. (2022) nor Bhattacharya et al. (2022) disaggregate investment needs by country, we estimate national investment needs using the simplest possible method: each country's share of total EMDE GDP in 2019, excluding China. The group of high-risk countries identified by UNDP and IMF as most in need of debt relief does not include all EMDEs, and in fact excludes the ten largest EMDEs other than China (Brazil, India, Indonesia, Iran, Mexico, Poland, Russia, Saudi Arabia, Turkey and Thailand) which together comprise over half of the group's total GDP). Thus, the resulting total climate investment need estimates shown in the analysis sum to only a fraction of the $1,338.8 billion estimated for total EMDE climate investment in 2025.

This approach to estimating national-level investment needs admittedly introduces a downward bias for the lowest-income countries, whose actual human capital investment needs doubtless represent a higher share of their GDP than their higher-income counterparts. However, we opted for this approach to avoid introducing additional complications to this estimate.

Aceh, Indonesia. Photo by Sandy Zebua via Unsplash.

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