

A tale of two emergencies

The interplay of sovereign debt and climate crises in the global south

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Executive summary

The climate emergency has become a wider focus of policy discussions around debt, as extreme climatic events and environmental hazards increase both the cost of borrowing and the risk of debt crises in countries in the global south that are often already bearing large external debt stocks. Similarly, unsustainable debt levels can mean less fiscal space and opportunities to face the challenges of adaptation and mitigation, as well as to recover from loss and damage after a climate disaster.

The overlap of the climate emergency and the Covid-19 health, social and economic crisis, poses enormous challenges for countries in the global south, aggravated by the unfurling debt crisis that many developing countries are facing. With increased debt vulnerabilities, fiscal pressures and the economic downturn, the capacity for many countries to invest in climate change mitigation and adaptation, as well as to face unexpected shocks such as those triggered by the climate emergency, the capacity is weakened even further. Furthermore, climate crisis can exacerbate debt vulnerabilities by increasing both debt levels and costs.

Alongside the costs of changes to the ecosystem, the human losses and impacts on the cultural heritage and livelihoods, material and monetary losses caused by the climate crisis are particularly acute after a catastrophe, which can be a driver of weakened debt sustainability. Both the World Bank (WB) and International Monetary Fund (IMF) have recognised that climate disasters can cause a significant deterioration of debt sustainability in the affected countries.

Special attention should be paid to Small Island Developing States (SIDS), which, while contributing less than 1 per cent to the world's greenhouse gas emissions, are amongst the most vulnerable countries to climate catastrophic events. Additionally, SIDS are amongst the countries that are most affected by increasing debt vulnerabilities. Furthermore, borrowing costs are higher for SIDS than for other developing countries with similar income levels and in general they have less access to concessional finance.

Recent cases such as Vanuatu, Grenada or Dominica show how climate extreme events have triggered further debt unsustainability, a situation that has been worsened by the economic impacts of the Covid-19 pandemic.

The economic downturn is hitting those economies that are dependent on tourism particularly hard, amongst which SIDS are the most vulnerable. The collapse in government revenue, when external debt payment levels were already high, has led these countries to increase their reliance on non-concessional loans, which worsens their debt vulnerabilities. Even when facing debt distress, some SIDS are not eligible for the Debt Service Suspension Initiative (DSSI) implemented by the G20 governments in the context of the Covid-19 crisis. As the United Nations (UN) Secretary-General António Guterres has stated, the debt and climate crisis constitute "piling injustice upon injustice" for SIDS.¹

As the experience in many SIDS and other impoverished countries shows, debt and climate crises have a feedback effect. The deterioration of the physical and economic situation in an overindebted country after a climate-related disaster not only makes it more difficult to face existing debt repayments in the immediate aftermath of the crisis, it also worsens the economic prospects for increasing revenues in the future, in order to be able to achieve debt sustainability. Furthermore, when the reconstruction and recovery is financed with more loans, it can be like throwing fuel onto the fire.

Climate vulnerabilities do not only have an impact on the countries' debt sustainability due to further borrowing for recovery and reconstruction, but also by influencing the costs of this borrowing. According to research sovereign debt interest rates for the climate most vulnerable countries are higher than they should be if only macroeconomic and fiscal indicators are considered. This is due to climate vulnerability. This situation leads to a vicious circle, since – as borrowing costs increase due to climate vulnerabilities – countries find themselves having to devote more resources to repay their debts and therefore these extra costs undermine their capacity to invest in climate mitigation and adaptation and to address loss and damage. As they can't invest enough in climate adaptation or mitigation, their climate vulnerabilities increase, and so do the borrowing costs.

While climate and debt vulnerabilities show multiple interlinkages, with an impact on the most vulnerable and particularly undermining gender justice, the public policy and market responses to both climate and debt crises have fallen short of the challenges and needs that the debt and climate emergencies pose. First of all, climate finance offered by Organisation for Economic Co-operation and Development (OECD) countries is largely in the form of loans. More than two thirds of the public climate finance delivered between 2013 and 2018 was delivered through debt-creating instruments.

Moreover, the mainstream approach by rich countries and development banks to address the financial challenges of climate catastrophes has been market-based. Emission trading and taxation, risk insurances, bond clauses and catastrophe or green bond emissions, among other innovative commercial financial instruments, have been key proposals to raise the resources to deal with, or cover the risks of, the climate emergency.

However, market mechanisms are generally not compliant with a human rights-centred approach and, contrary to their objectives, most of the market proposals end up being false solutions that put the financial burden back on developing countries, worsening the government's fiscal imbalances and even increasing debts. These market mechanisms also fail to enable transparency, accountability and participatory decision-making of those communities that are most impacted by the climate emergency.

Regarding proposals around debt for climate swaps, when well-designed they could provide resources for financing mitigation and adaptation investment, including a mild debt relief effect. However, past experiences have shown their capacity to significantly reduce debt burdens has been very limited. Debt swaps for development have also tended to be complex and long to negotiate, so they might not be adequate as a timely response to the debt distress that some countries are facing, nor to provide immediate post-disaster liquidity. Additionally, there are concerns around additionality, double overseas development assistance (ODA) counting and lack of country ownership risk. Progress on debt for climate swaps, although useful in certain contexts and forms, should not be seen as a solution for moments of profound debt crisis such as the one triggered by the Covid-19 economic downturn.

The interplay of the game-changing challenges that the climate emergency and the rise of new debt crises pose is cumulatively putting at risk the fulfilment of human rights and advancement towards the Sustainable Development Goals (SDGs), both globally and, in particular, in the global south. The social, economic, environmental and gender impacts of both debt and climate crises could be reduced if the right policy decisions were made, but action is urgently needed. In this context, the need to transition globally towards a more sustainable and equitable economy will not be possible without sustainable, responsible and fair climate finance, as well as finance for transition, that does not exacerbate debt vulnerabilities in the global south. In a nutshell, climate justice will not be possible without economic and debt justice.

A just, feminist and green recovery could lay the foundations to solve the debt and climate crises. But to make this recovery possible, we need rich countries to deliver fair, adequate and non-debt-creating climate finance, assuming the differentiated responsibilities that the most industrialised countries have in climate change, and to support impoverished countries dealing with adaptation, losses and damages, and mitigation to climate change. Rich countries should also stop blocking negotiations on finance to address loss and damage. In relation to which, they should support the civil society organisation (CSO) proposal to compensate for loss and damage in the aftermath of a climate-related disaster with debt payments suspension, restructuring and cancellation.

In summary, in order to deal with the interconnected impacts of sovereign debt and climate crises, governments and international financial institutions should implement the following recommendations:

1. Comply with committed funds for climate finance:

Assuming the differentiated responsibilities that the most industrialised countries have in climate change, they should offer affordable and responsible public financing options for adaptation and mitigation in the global south, as agreed in the Convention, the Kyoto Protocol and the Paris Agreement. Climate finance should be new and additional to existing finance commitments e.g. ODA, preferably in the form of grants, in order not to incur higher indebtedness, untied, unconditional and transparent, and following the international agreements on public procurement. Following the basic principles of effective development aid and introducing binding rules on responsible lending and borrowing would be key steps to make funds available for climate mitigation and adaptation, including Loss and Damage, that do not worsen debt vulnerabilities.

2. Providing finance to address loss and damage: Richer countries should stop blocking the negotiations and facilitate an agreement to provide sufficient finance to address loss and damage after a climate disaster in developing countries, favouring grants over loans, so this does not aggravate unsustainable debt levels. Funds should be disbursed to both governments and independent agencies, especially those locally-based and women-led that are best able to reach affected groups and/or contribute to lasting recovery and resilience.

3. Debt payments suspension and debt relief in the aftermath of climate disaster: As already argued, an interest-free moratorium on debt payments should be provided immediately after a climate disaster hits, as it has the potential to provide immediate access to resources that are already available. In addition to the moratorium, a pre-designed framework for restructuring the entire stock of existing public external debt, including debt cancellation if needed, would be required. Both the debt payments suspension and debt restructuring should be binding on official, private and multilateral creditors. This could be achieved through mechanisms such as Article VIII Section 2 (b) of the IMF. For newly contracted or restructured debt, governments and international financial institutions (IFIs) should include in their lending contracts, and promote among private lenders, state contingent clauses tied to both climate and other health and economic exogenous shocks.

4. Timely and sufficient debt relief: Creditors and IFIs should take action to agree and implement a post-Covid-19 debt relief and sustainability initiative under UN auspices to bring developing country debts down to sustainable levels, which considers countries' long-term financing needs to achieve the SDGs, climate goals and human rights and gender equality commitments. This debt relief process should involve all creditors and ensure that debt cancellation and restructuring in a timely, efficient and sufficient manner – especially to those countries at risk of – or already in, debt distress with high climate vulnerabilities. Easing debt levels will allow countries to become more climate resilient, by freeing up domestic resources to invest in adaptation and mitigation. Not taking sufficiently ambitious action in relation to debt relief, amidst a growing debt crisis in the global south, will leave developing countries even more ill-prepared to deal with the climate challenges they face.

5. Review debt sustainability: Governments at the IMF and World Bank should promote an open review of Debt Sustainability Analysis (DSA), with UN guidance and civil society participation, in order to evolve towards a more adequate debt sustainability concept, one that includes environmental and climate vulnerabilities, together with human rights and other social, gender and development considerations at its core.

6. Debt workout mechanism: Beyond debt relief to cope with the present debt crisis, governments and international organisations should support and work towards the creation of a permanent multilateral sovereign debt workout mechanism that, under the auspices of the UN, ensures the primacy of human rights over debt service and a rules-based approach to orderly, fair, transparent and durable debt crisis resolution, in a process convening all creditors.

7. Provide emergency additional finance: IFIs and rich governments should provide sufficient additional resources to support developing countries to tackle the health, social and economic crises, favouring grants over loans, so this does not aggravate unsustainable debt levels in the near future. Emergency finance for facing the health and social crisis and for funding a fair and sustainable recovery should not dent the previous ODA and climate finance commitments. These resources should be made available particularly to those countries where the effects of the crisis have been hard, both in terms of those countries where the health impacts of Covid-19 have been stronger, and of those where the economic impacts have been harder due to reliance on tourism, remittances and commodities. Efforts should also be stepped up to secure a new and large issuance of IMF Special Drawing Rights (SDR) to help alleviate liquidity pressures on developing countries in need.

Introduction

The climate emergency has become a wider focus of policy discussions around debt, as extreme climatic events and environmental hazards increase both the cost of borrowing and the risk of debt crises in countries in the global south that are often already bearing large external debt stocks. Similarly, unsustainable debt levels can mean less fiscal space and opportunities to face the challenges of adaptation and mitigation, as well as to recover from loss and damage after a climate disaster. In this context, the need to transition globally towards a more sustainable and equitable economy will not be possible without sustainable, responsible and fair climate finance, as well as finance for transition that does not exacerbate debt vulnerabilities in the global south. In a nutshell, climate justice will not be possible without economic and debt justice.

In a context where Covid-19 and the subsequent economic downturn have enormously intensified pre-existing debt vulnerabilities throughout the global south (as well as in the global north), the limitations of the existing international financial architecture to provide fair, timely, transparent and lasting solutions to debt crises have become more evident than ever before. The shortcomings of the Debt Service Suspension Initiative (DSSI) and the outdated approach of a new common framework for debt treatments² will result, if no further action is taken, in a full-blown debt crisis in the global south and a “lost decade” for development for millions of people, as well as a major step backwards in the developing countries’ capacity to tackle the climate challenges.

This briefing constitutes Eurodad’s first general approach to how sovereign debt dynamics interact with climate finance and climate crisis impacts in the global south and vice-versa. The main objective of this analysis is to support Eurodad members and partners in their strategies and actions both on debt and on climate, by providing a general overview of the interactions between both dynamics. The briefing not only looks at issues that are relevant to the interrelation between indebtedness and climate vulnerabilities in the global south, analysing how climate crises exacerbate debt vulnerabilities but also how existing debt vulnerabilities weaken countries’ capacity to deal with the climate emergency.

It also specifically looks at the cumulative impacts of climate and debt crises on women’s rights and gender justice. Finally, the briefing analyses the shortcomings of some of the current climate finance approaches and mechanisms in relation to the risks they pose to climate resilience and debt sustainability. The briefing also outlines some policy recommendations that could help countries in the global south deal with the interconnected impacts of sovereign debt and climate crises in a more fair and sustainable way.

1. The interplay between sovereign debt and the climate crisis

Climate and debt dynamics interact in several ways, mutually worsening the exogenous and internal vulnerabilities of developing countries.

Over recent years, many countries in the global south have been facing worsening public debt vulnerabilities³ – a growing crisis that has been exacerbated by the devastating global economic impact of the Covid-19 pandemic. Public and private debt levels had been growing at unprecedented speed and to unprecedented levels all around the world⁴ before the pandemic. The global economic downturn caused by Covid-19 has exacerbated the pre-existing debt vulnerabilities, pushing debt levels to new heights. According to the International Monetary Fund’s (IMF) projections⁵, average debt ratios will rise by ten per cent of Gross Domestic Product (GDP) in emerging market economies and about seven per cent in low-income countries.

A growth in debt levels that, despite the recent initiatives to provide temporal suspension of debt payments for a limited number of the world’s poorest countries,⁶ will be intensified by the increased primary fiscal deficits that developing countries will incur in order to tackle the health, social and economic crisis they are facing. Falls in commodity prices, export and tourism revenues and remittances have led to falls in government revenues that, together with sharp currency devaluations and an increase in borrowing costs for global south governments, is making it harder for governments to make their external sovereign debt payments.⁷ Additionally, we need to consider the fact that financial support for developing countries to tackle the pandemic is being provided principally in the form of new loans, which are enlarging already unsustainable debt levels in many countries in the global south. Along with increased debt vulnerabilities, fiscal pressures and the economic downturn, the capacity for many countries to absorb more loans is indeed weakening.

Before the Covid-19 pandemic hit, in many southern countries, an increasing portion of public budgets were being used to service external debts, affecting governments’ capacity to deliver basic public services,⁸ and leaving them particularly underprepared to deal with the current public health crisis, not to mention facing unexpected shocks such as those triggered by the climate crisis.

Countries struggling today with unsustainable debts tend to also be the most vulnerable countries to the impacts of climate change. As we know, those with less responsibility for contributing to the climate crisis – that is, countries with lower levels of greenhouse gas emissions per capita, and which tend to be global south countries – are those that are most vulnerable to climate risks and, thus far, have already been paying a higher price due to climate events over recent decades.⁹ According to Oxfam, the poorest half of the world's population – around 3.5 billion people – are responsible for only 10 per cent of the global emissions attributed to individual consumption, while around 50 per cent of these emissions can be attributed to the richest 10 per cent of people around the world.¹⁰

Although, in absolute monetary terms, the losses of richer countries due to climate events tend to be higher, economic losses relative to GDP – especially, loss of life, biodiversity, culture, heritage and livelihoods, human and animal displacement, personal hardship and existential threats – have been much more widespread in low-income countries.¹¹ The UN Special Rapporteur on extreme poverty and human rights, Phillip Alston, has added his voice to those highlighting the risks of the climate crisis exacerbating existing poverty and inequality in developing countries: “It will have the most severe impact in poor countries and regions, and the places poor people live and work. Developing countries will bear an estimated 75-80 per cent of the costs of climate change. Climate change threatens to undo the last fifty years of progress in development, global health, and poverty reduction.”¹²

Box 1: Climate Debt

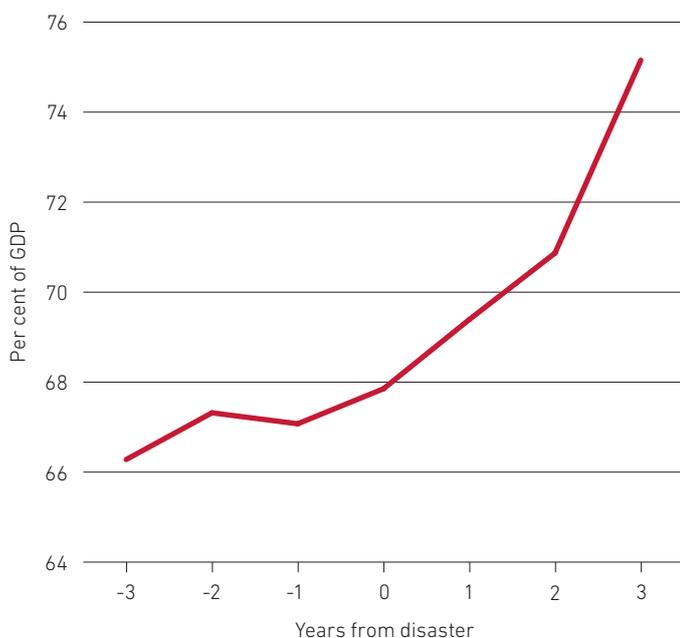
Social movements and academics, both in the global south and global north, have claimed for a long time that there is an “ecological debt” that rich countries and elites owe to impoverished countries due to the environmental impact and resource pillage that colonial and neo-colonial dynamics have inflicted on their territories and communities. The concept of ecological debt is based on the idea of environmental justice: “if all the inhabitants of the planet have the right to the same quantity of resources and equal proportion of environmental space, those who use more resources or occupy more space have a debt with the others”.¹³ This “ecological debt” has therefore been accumulated “on account of ecologically unequal exchange, biopiracy, damage from toxic exports, and the disproportionate use of carbon sinks and reservoirs”.¹⁴ It therefore contains what has been conceptualised as “climate debt” or “carbon debt” – a historical debt that most polluting economies have acquired due to their disproportionate contribution to carbon and other greenhouse emissions. The use of this concept brings a historical dimension to discussions of climate emergency and climate finance, arguing how present “challenges are derived from long-term processes of capital accumulation”¹⁵ and uneven environmental exploitation. Based on the climate debt concept, the contributions of industrialised countries to climate finance, in the form of new resources but also in the form of public debt cancellation, as the proponents of the ecological debt framework argue, would not be considered as charity or aid, but as a moral obligation and a repayment of an existing historical debt.

1.1 How climate crises exacerbate debt vulnerabilities

Alongside the costs of changes to the ecosystem, the human losses and impacts on the cultural heritage and livelihoods, material and monetary losses caused by the climate crisis are particularly acute after a catastrophe, which can be a driver of weakened debt sustainability. The World Bank (WB) recently recognised that “the experience of several economies in [Latin America and the Caribbean], in particular, shows that debt crises can be triggered by extreme climatic events and environmental hazards”.¹⁶ Furthermore, the Bank’s analysis acknowledges that the higher frequency and persistence of climate change impacts are “likely to increase macroeconomic volatility and reduce long-term growth prospects, posing a growing risk to debt sustainability”.

Similarly, the IMF recognised in a policy paper published in July 2019 that “large natural disasters causing significant damage can substantially setback output growth and contribute to a significant rise in public debt”.¹⁷ To reach this conclusion, the IMF analysed 11 cases of large “natural disasters” in developing countries producing damage of over 20 per cent of GDP between 1992 and 2016. The results show that public debt increased from an average 68 per cent of GDP in the year of the disaster to 75 per cent of GDP three years afterwards.

Figure 1: Public debt as percentage of GDP around large disasters 1992-2016 (damage > 20% of GDP)



Source: IMF staff estimates based on EM-DAT data from the International Disaster Database by the Centre for Research on the Epidemiology of Disasters (CRED).

The impact of the climate crisis on increasing debt levels had already been highlighted by civil society organisations (CSOs). In 2017, the Jubilee Debt Campaign UK (JDC) documented how, in several climate-related disasters, debt sustainability indicators worsened after the event. According to JDC’s calculations, from a list of 14 climate-related disasters with estimated costs of more than 10 per cent of GDP in their respective countries, government debt as a percentage of GDP was higher two years after the disaster in over 80 per cent of the cases.¹⁸

Special attention should be paid to Small Island Developing States (SIDS),¹⁹ which, while contributing less than 1 per cent to the world’s greenhouse gas emissions,²⁰ are amongst the most vulnerable countries to climate catastrophic events. Additionally, one-third of the population in SIDS live on land that is less than five metres below sea level. So, as well as suffering from hurricanes and cyclones, the threat of sea level rise poses existential risks to SIDS and their peoples. SIDS also suffer the highest economic losses in relation to their GDP. As we can see in Table 1, nine out of the ten climate-related disasters with higher losses as a percentage of GDP in the last two decades took place in SIDS.

Table 1: Top 10 climate-related disasters (losses as a percentage of GDP – 1998-2017)

Name and date	Countries/territories affected	Economic losses	
		Billion US\$	% GDP
Hurricane Irma Sep 2017	Saint Martin	2.50	797 %
Hurricane Irma Sep 2017	Saint Martin	4.10	584 %
Hurricane Irma Sep 2017	British Virgin Islands	3.00	309 %
Hurricane Maria Sep 2017	Dominica	1.46	259 %
Hurricane Ivan Sep 2004	Grenada	1.15	148 %
Hurricane Ivan Sep 2004	Cayman Islands	4.43	129 %
Hurricane Georges Sep 1998	Saint Kitts and Nevis	0.60	110 %
Hurricane Erika Aug 2015	Dominica	0.50	90 %
Hurricane Mitch Oct & Nov 1998	Honduras	5.68	73 %
Hurricane Maria Sep 2017	Puerto Rico	68.00	69 %

Source: Centre for Research on the Epidemiology of Disasters (CRED) – UN Office for Disaster Risk Reduction²¹

Furthermore, many SIDS not only face constraints from their exposure to climate-related disasters, but also due to the accumulation of unsustainable debts. According to UN Conference on Trade and Development (UNCTAD), total external debt stocks for SIDS more than doubled between 2008 and 2017, with their average debt-to-GDP ratios increasing from 28.3 per cent to 58.2 per cent, and well above 100 per cent in some cases.²² Latest data provided by UNCTAD situates external debt levels at 72.4 percent of GDP on average for SIDS, reaching up to 200 per cent in the Seychelles and the Bahamas, and over 100 per cent in Jamaica.²³ Borrowing costs are higher for SIDS than for other developing countries with similar income levels.²⁴ Graduating as middle-income countries (and even high-income countries), and therefore not being eligible for concessional finance, is also a factor for this debt cost and increase in debt vulnerabilities. Indeed, SIDS that are eligible for non-concessional finance only are precisely countries where debt problems have been prominent, such as Antigua and Barbuda, Belize, Jamaica, the Seychelles and St. Kitts and Nevis.

As we have argued, the already high debt levels worsen in the wake of a climate catastrophe. For instance, in the case of Vanuatu, and according to JDC's research, after the archipelago was devastated by cyclone Pam in 2015, government debt almost doubled, from 21 per cent of GDP before to 39 per cent afterwards.²⁵ Four years after that, government debt to GDP was over 50 per cent, mainly due to the reconstruction lending after Cyclone Pam, according to the IMF. The Fund also states in its last review of the country economic and financial prospects, made in 2019, that even when the country suffers from extreme weather events every year, "there is little fiscal space to address another natural disaster", mainly due to the high debt levels.²⁶

Jubilee Caribbean also reported that, "when category 5 Hurricane Ivan hit Grenada in 2004, the damages were estimated at 148% of GDP and the debt-to-GDP ratio jumped from 79% to 94%".²⁷ The devastation produced by Hurricane Ivan on Grenada was a key factor in the country's debt default in 2005.²⁸

Similarly, in Dominica, government debt, both domestic and external, was already as high as 71.7 per cent of GDP in 2016, when the country was still recovering from tropical storm Erika. On 18 September 2017, category 5 hurricane Maria devastated the island of Dominica, with damage estimated at US\$1.3 billion (226 per cent of GDP). Three years later, IMF projections show a government debt of 79.6 per cent of GDP in 2020, and Dominica has been assessed by the Fund as being in high risk of debt distress.²⁹

The economic downturn due to the Covid-19 crisis is hitting economies that are dependent on tourism particularly hard, amongst which SIDS are the most vulnerable. In addition, women represent the majority of low-skilled and casual workers living on SIDS in the most impacted sectors, such as accommodation, food provision³⁰ and the hospitality industry. On average, the tourism sector accounts for almost 30 per cent of GDP in SIDS, and over 50 per cent for the Maldives, Seychelles, St. Kitts and Nevis and Grenada. The collapse in government revenue, when external debt payment levels were already high, has led these countries to increase their reliance on non-concessional loans, which worsens their debt vulnerabilities. Even when facing debt distress, some SIDS are not eligible for the DSSI implemented by the G20 governments in the context of the Covid-19 crisis nor to access concessional lending, precisely due to being classified as middle- or high-income countries. As the UN points out, six middle-income SIDS that are not eligible for DSSI have debt service burdens at over 40 per cent of revenue on average.³¹

The unsustainable and unjust situation that SIDS face due to the cumulative and interconnected impacts of debt and climate crisis are being increasingly recognised. In March 2018, Jubilee Caribbean launched a statement claiming for a debt relief mechanism in the wake of that year's hurricane season.³² In September 2019, UN Secretary-General António Guterres, at the high-level mid-term review of the SIDS Accelerated Modalities of Action (Samoa Pathway), reflected on how the debt and climate crisis was "piling injustice upon injustice" for SIDS: "Despite contributing very little, practically nothing, to global warming, small island developing States are paying the highest price. And because of their middle-income status, many are trapped in an accelerating and unsustainable cycle of disaster and debt. The world must step up and stop it".³³

The need for low-cost concessional financing for SIDS was also noted at the High-level political forum on sustainable development, convened under the auspices of the UN's Economic and Social Council (ECOSOC) in July 2019, while recognising that most of these countries "have limited fiscal space owing to the fact that debt servicing and rebuilding after disasters diverts resources from social investments".³⁴ For UNCTAD, in the wake of the Covid-19 downturn, "it is critical that SIDS have access to funding at zero interest rates and can suspend existing debt payments until they are financially ready to service their external debt obligations".³⁵

Despite the Paris Agreement acknowledging that climate finance efforts should pay specific attention to those that are particularly vulnerable to the adverse effects of climate change and have significant capacity constraints, such as SIDS and the least developed countries (LDC), recent data published by Oxfam International show how, on average, only 3 per cent of climate-related development finance reported to the OECD went to SIDS in 2017-2018, and around 20.5 per cent went to LDCs. Oxfam estimates that nearly half of this climate finance addressed to SIDS was in the form of loans and other non-grant instruments (and 20 per cent of the total was non-concessional). For LDCs, debt-creating instruments accounted for nearly 60 per cent of the climate finance received.³⁶

In the Covid-19 context, the states that constitute the Alliance of Small Island Developing States (AOSIS) released a statement on June 2020 alerting the world that “without systemic change and immediate and tailored policy action the risks for a protracted debt crisis in SIDS are all but certain”, and calling for actions that “include the design of new and the enhancement of existing financial instruments to provide debt relief including through debt cancellation, debt suspensions, debt rescheduling and restructuring, as well as other support measures”,³⁷ including a multilateral Debt Workout Mechanism.

As the experience in many SIDS and other impoverished countries shows, debt and climate crises have a feedback effect. The deterioration of the physical and economic situation in an overindebted country after a climate-related disaster not only makes it more difficult to face existing debt repayments in the immediate aftermath, but also worsens the economic prospects for increasing revenues in the future, in order to be able to achieve debt sustainability. Furthermore, when the reconstruction and recovery is financed with more loans, it can be like throwing fuel into the fire. Heron Belfon of Jubilee Caribbean makes it crystal-clear, “it’s the definition of a vicious circle”.³⁸

1.2 Lending to deal with climate disasters, fuelling the fire when it’s at its peak

Estimates indicate that, by 2030, the global loss and damage associated with climate change impacts will require financing for developing countries of at least US\$300 billion annually, and that this need will reach approximately US\$1.2 trillion per year by 2060.³⁹ According to a report by Civil Society Review, endorsed by 166 CSOs worldwide, some estimates situate annual financial loss and damage from 2030 onwards at a far higher amount, “with losses growing to USD\$ 400-430 billion per year for developing countries alone and total anticipated financial losses reaching USD\$ 600-700 billion”.⁴⁰

Countries affected by climate-related disasters normally face a lack of resources to address the costs of dealing with the emergency and reconstruction. Alongside a certain donor fatigue due to multiplying extreme climatic events and environmental hazards linked to the global climate emergency, there is currently no international mechanism under the United Nations Framework Convention on Climate Change (UNFCCC) framework to provide financial support to countries in the global south to pick up the pieces and recover after a climate-related disaster. The UNFCCC mandated in November 2013, during COP19, the establishment of the Warsaw International Mechanism (WIM) for Loss and Damage associated with Climate Change Impacts, to address loss and damage associated with impacts of climate change in developing countries.⁴¹ However, a final consensus on how to finance loss and damage after a disaster hasn’t been reached so far. As a result, countries are left with unfit and insufficient mechanisms such as insurance schemes funded by the World Bank (see section 2.1) or the IMF’s limited Catastrophe Containment and Relief Trust (see Box 4), and the also often insufficient and delayed support that might arrive from bilateral and multilateral donors, and that generally comes through loans, which actually increase the debt burden of impoverished countries.

This is especially worrying in those cases where the countries are already facing difficulties in meeting their debt payments. In summary, the lack of sufficient funding from the international community, the negative impact of climate disasters on government revenue – as the impacts on the economy are transferred to the public balances through diminishing tax collection – and the little fiscal space left after addressing debt service payments, leave governments with little option but to accept further lending offered by institutions like the IMF, the World Bank and regional development banks.

One striking example can be found in the case of Mozambique, where the destructive impact of climate events ended up tightening the debt trap in which the country was already caught. Mozambique’s sovereign debt started growing at a fast pace after debt cancellation was granted under the Multilateral Debt Relief Initiative (MDRI) in 2006. From 2014, the fall in global commodity prices impacted Mozambique’s revenue and in December 2015, the country requested financial support from the IMF in order to be able to repay its creditors. The already existing debt difficulties worsened when, in 2016, the scandal of illegal hidden debts came to light.⁴² Their exposure led the IMF to temporarily suspend its lending programme and the World Bank and other western creditors to suspend their loans and aid payments. Suspension of budget support, essential for sustaining public service provision, meant an unnecessary burden on the people of Mozambique who bore little responsibility for the hidden debts, yet Mozambique was being made to bear the burden of yet another debt crisis.⁴³

In this context, Cyclones Idai and Kenneth hit Mozambique in March and April 2019, causing over US\$873 million worth of damage, killing over 1,000 people, and virtually destroying the city of Beira and much of the country's crop harvest. The IMF answer to the situation was to agree to yet another US\$118.2 million emergency loan. More fuel onto the fire. Despite Mozambique already being in a situation of debt distress, the IMF assessed that the country did not qualify for its emergency debt relief from the Fund to free up existing resources to deal with the reconstruction. Although it recognised Mozambique as one of the most vulnerable countries to environmental hazards and the climate crisis, the IMF did not consider those climate vulnerabilities in the country debt sustainability analyses [DSAs]. The then UN Independent Expert on external debt and human rights, Juan Pablo Bohoslavsky, highlighted that both human rights and cyclone Idai's impacts should be considered in debt sustainability analysis, as debt servicing should not jeopardise the realisation of economic, social and cultural rights.⁴⁴

Mozambique is not a unique example. Nearby Comoros, also devastated by Cyclone Kenneth and reckoned to be at high risk of debt distress, also took an IMF loan for US\$12.3 million in order to face recovery, much of which will be charged at non-concessional interest rates. After the Philippines was impacted in 2013 by Typhoon Haiyan, with an estimated economic impact of around US\$5.8 billion, the World Bank and Asian Development Bank offered a US\$1 billion emergency loan for reconstruction and emergency response.⁴⁵

A decade ago, Pakistan suffered from an unusually strong and devastating monsoon season, causing rivers to overflow, dams to break and the flooding of more than 7 million hectares of arable land. More than 2,000 people lost their lives and more than 20 million were directly affected by the floods. Economic damage was calculated at more than US\$9.5 billion. Pakistan was struggling with high debt levels before the floods, an important part of which was qualified by Pakistan social movements as 'odious', as they were mostly inherited from the military regime. The IMF, World Bank and Asian Development Bank answered the needs for economic support to face the country's reconstruction with loans of US\$450 million, one billion and two billion dollars respectively.

Box 2: Extreme climatic events increasing debt distress risk assessment in Pacific Island Countries

World Bank and IMF assess the risk of debt distress for low-income countries through the joint Debt Sustainability Framework. Although climate vulnerabilities are not considered systematically as a factor for Debt Sustainability Analysis (DSA), the impact of environmental hazards in some countries' growth and debt level projections have been used as an argument to increase the level of debt distress risks. This is the case for several Pacific Island Countries (PIC), such as Vanuatu, Tonga or Samoa.

In 2012, Cyclone Evan caused significant damage in Samoa, in the worst climate event since 1991, causing damage and economic losses of around US\$210 million – equating to 30 per cent of the country's GDP. The DSA published by the IMF in 2013, together with the agreement to disburse a US\$8.6 million loan under the Rapid Credit Facility for reconstruction and recovery, raised the country's risk of debt distress from moderate to high. The main reason for that reassessment was the "sharp increases in external borrowings to deal with exogenous shocks"⁴⁶ (meaning, cyclone damages and economic losses). After its debt risk rating was lowered to moderate in 2015, Samoa saw how, after cyclone Winston caused even higher damages than Evan, the IMF increased the risk of debt distress to high again in 2017, "reflecting the potential impact of natural disasters on Samoa's fiscal position over the medium term".

Similarly, the IMF increased Tonga's risk of debt distress from moderate to high because of "potential costs of natural disasters" in 2017.⁴⁷ After cyclone Pam hit Vanuatu in 2015, causing the displacement of 25 per cent of the island's population and causing damage estimated at 64 per cent of GDP, the IMF also modified the risk assessment of debt distress for the country from low to moderate, arguing that "this escalation of debt distress risk largely reflects the expected high levels of fiscal deficits induced by post-cyclone reconstruction expenditures".⁴⁸ In these and other cases, increasing risks over debt sustainability are not only due to the (potential) impact of environmental hazards to economic growth and therefore the possibilities of facing previous debt commitments, but also due to increases in borrowing in order to finance recovery and reconstruction.

(continued on p10)

In fact, in the 2017 IMF *Review of the Debt Sustainability Framework for Low-income Countries*, tailored scenario stress tests were introduced in the DSA in order to evaluate specific risks of particular relevance to some countries, such as risks stemming from “natural disasters”. Vulnerability to climate change is also mentioned in the DSA review for Low-Income Countries (LICs) as a long-term factor to be considered while applying judgement by the staff in the analysis process.⁴⁹

However, Eurodad analysis of 80 IMF staff reports prepared as part of the process of approval for financial assistance between March and September of 2020 revealed that only 20 of those reports refer to climate change at some point, but just in one case, Samoa, climate change is included as a consideration in debt sustainability assessments.⁵⁰

1.3 Climate vulnerabilities make it costlier to borrow

Climate vulnerabilities do not only impact on the countries' debt sustainability due to further borrowing for recovery and reconstruction, but also by influencing the costs of this borrowing. According to research commissioned by UN Environment, public debt interest rates for the V20 group of systemically climate vulnerable countries⁵¹ are higher than they should be if only macroeconomic and fiscal indicators are considered, and this is due to climate vulnerability.⁵² The research estimates that exposure to climate risks has already increased the cost of debt for V20 countries by 117 basis points, on average, which can be “translated into more than 40 billion in additional interest payments over the past 10 years on government debt alone”. If we include also the private sector, the V20 economies would have been paying over US\$62 billion in higher interest payments. The projections made by the researchers set the additional costs over the next decade at between US\$ 146-168 billion.

The link between debt vulnerabilities and borrowing costs was also corroborated by a recent IMF working paper, which analyses the effects of climate change on sovereign risk as measured by government bond yields and spreads in 98 developed and developing countries during the period 1995–2017. The research concludes that “climate vulnerability has a highly significant effect on the cost of government borrowing, even after controlling for conventional macroeconomic and institutional determinants of sovereign risk”. The impact of climate vulnerabilities in borrowing costs is “greater in developing countries with weaker capacity to adapt to and mitigate the consequences of climate change” according to the paper's authors.⁵³

Similarly, a recent report prepared by the SOAS Centre for Sustainable Finance at SOAS University of London, the Asian Development Bank Institute, the World Wide Fund for Nature Singapore and Four Twenty Seven concludes that higher climate risk vulnerability leads to significant rises in the cost of sovereign borrowing particularly in the global south. According to this research, “premia on sovereign bond yields amount to around 275 basis points for economies highly exposed to climate risk”, but exposure to climate risks is not statistically significant for the group of advanced economies included in the study. Furthermore, the study signals six different transmission channels through which climate change “can amplify sovereign risk and worsen a sovereign's standing: the fiscal impacts of climate-related disasters; the fiscal consequences of adaptation and mitigation policies; the macroeconomic impacts of climate change; climate-related risks and financial sector stability; the impacts of climate change on international trade and capital flows; and the impacts of climate change on political stability”.⁵⁴

This situation leads to a vicious circle, since, as borrowing costs increase due to climate vulnerabilities, countries find themselves having to devote more resources to repay their debts and therefore these extra costs undermine their capacity to invest in climate mitigation and adaptation and to address loss and damage. As they can't invest enough in climate adaptation or mitigation, their climate vulnerabilities increase, and so do the borrowing costs.

In fact, since 2014, rating agencies including Standard & Poor's, Moody's and Fitch Group have been considering debt vulnerabilities in their sovereign ratings. In 2014 already, Standard & Poor's identified climate change as one of the global mega-trends impacting negatively on sovereign creditworthiness.⁵⁵ Moody's has also stated that, although their “sovereign bond rating methodology does not account separately or explicitly for the credit risks posed by climate change, climate risks are already broadly captured in the four key risk factors we use in our analysis – economic strength, fiscal strength, institutional strength and susceptibility to event risk – either directly or indirectly through a variety of indicators”.⁵⁶ Climate vulnerabilities impact on sovereign's credit profiles, according to Moody's, through four channels:

- 1) the potential economic impact (for example, weaker activity due to a loss of agricultural production);
- 2) damage to infrastructure assets as a direct result of the physical destruction incurred from climate shocks;
- 3) rising social costs brought about, for example, by a health crisis or food security concerns;
- 4) population shifts due to forced displacements resulting from climate change.

As a consequence, Moody's analysis concludes that "sovereigns' ratings are quite strongly correlated with their susceptibility to climate change".⁵⁷ Moody's also recognises that, in a number of cases, they make explicit downward adjustments to their assessment for sovereign ratings "to account for sovereigns' vulnerability to environmental considerations and climate change". These cases include a number of small islands, such as the Maldives and the Solomon Islands, economies concentrated in sectors that are reliant on weather, like agriculture – examples include Ethiopia, Kenya, Rwanda, Cambodia – or tourism – such as the Maldives and Seychelles.⁵⁸

1.4 How debt vulnerabilities weaken countries' capacity to deal with climate emergencies

As Eurodad research⁵⁹ shows, public external debt service grew in low- and middle-income countries from an average of 6.71 per cent of government revenue in 2010 to an average of 12.56 per cent in 2018. The latest IMF estimates show that the ratio of public debt to tax revenue will increase for emerging economies and low-income countries. The percentage of low-income countries that will have a ratio of public debt service costs to government tax revenue over 30 per cent will increase from 28.57 per cent of countries in 2019 and 2020 to 33.33 per cent in 2021. In emerging markets, and according to the IMF, a 73.47 per cent of countries will have a ratio of public debt service costs to government tax revenue over 30 per cent in 2021, increasing from 71.43 per cent in 2020 and 57.43 per cent in 2019.⁶⁰

As a consequence, government spending on non-debt related expenditures – excluding interest payments – decreased by 13 per cent in sub-Saharan Africa between 2014 and 2018, and by 18.42 per cent in Latin America and the Caribbean. According to the latest IMF projections, the tendencies towards drops in government spending are set to deepen in the next few years (see Table 2).

Table 2: Government General Expenditure (per cent of GDP) 2020-25

	2020	2021	2022	2023	2024	2025
Emerging Market and Middle-Income Economies	35.0	34.1	33.3	32.7	32.1	31.5
Emerging and Middle-Income Latin America	37.0	32.2	31.6	31.4	31.3	31.1
Low-Income Countries (LIC)	19.2	18.9	18.7	18.5	18.3	18.2
LIC Sub-Saharan Africa	17.7	17.1	16.9	16.6	16.5	16.4

Source: IMF Fiscal Monitor, October 2020.

This means that governments in the global south will have decreasing domestic resources available to invest in climate mitigation and adaptation, and even less fiscal space to deal with unpredictable and extreme climate events without worsening their debt sustainability. In November 2020, the Global Development Policy Center, in partnership with the Heinrich Böll Stiftung and the Centre for Sustainable Finance at SOAS, University of London, launched the report and proposal *Debt Relief for a Green and Inclusive Recovery*. As this recent proposal states, "there is a danger that vulnerable developing countries will enter a vicious circle in which greater climate vulnerability raises the cost of debt and diminishes the fiscal space for investment in climate resilience".⁶¹ Furthermore, unsustainable debt levels also limit the capacity to borrow in the event of an extreme climatic event in order to finance reconstruction or recovery.⁶² This is because lenders and investors will be more reluctant to lend to a country that has difficulties in making the payments of their high debts and, if they do provide finance, it will be at higher costs. In the wake of a climate hazard, the risks for the lenders increase, so the access to new lending will be even further reduced and, as we have seen, will become more expensive.

Investing to face climate emergency challenges is not only a survival necessity, but according to different studies,⁶³ it can enable longer term economic growth. However, as recognised by the authors of the *Debt Relief for a Green and Inclusive Recovery* proposal, "unless the debt crisis is met with appropriate instruments at the multilateral level, policymakers will be forced to delay or cancel those investments, especially in developing countries".⁶⁴

Box 3: Debt crisis and Hurricane Maria – the perfect storm in Puerto Rico

From 1976, Puerto Rico's economy grew primarily due to investment driven by tax exemptions for US companies. However, in 2006, exemptions were cut and the Puerto Rican economy started a spiral of recession. To cover losses and the annual deficit, the Puerto Rican government stepped up its borrowing. Central government debt increased from 33.4 per cent of GDP in 2006 to 54.5 per cent in 2014. Most indebtedness at that time was simply a rolling-over of previous debts, so none of the money raised was actually being invested in infrastructure or public services.⁶⁵ After several partial defaults on debt payments from 2015, totalling US\$73 billion, Puerto Rico filed for bankruptcy in May 2017 and a long process of debt restructuring began. Meanwhile, a harsh austerity programme was put in place by the federally appointed financial management board that has run Puerto Rico's economy since its bankruptcy.

Just four months after declaring bankruptcy, Hurricane Maria hit Puerto Rico, causing major devastation and losses of US\$68 billion, around 69 per cent of the territory's GDP. But most importantly, 64 Puerto Ricans died during Maria and an estimated 2,975 people perished from hurricane-related problems in the following five months. Many of those who died after the hurricane had treatable chronic illnesses, but the cumulative impacts of austerity and of Maria on health service capacity, and

the destruction of roads and energy infrastructure by the hurricane, prevented many people from getting access to antibiotics, insulin and other vital medical care.

Despite the terrible human consequences of Maria, austerity didn't stop in Puerto Rico. Before the storm, 72 out of 78 of Puerto Rico's municipalities lacked adequate primary care services. A year afterwards, only 20 health centres in Puerto Rico provided primary and preventative care services. During summer 2018, Puerto Rico closed 283 schools, about a quarter of all public primary educational facilities, due to dropping enrolment. In fact, after Hurricane Maria, Puerto Rico has seen major migration towards the US.⁶⁶ Hurricane Maria also created many energy provision problems, and the difficulties of recovering from destruction were used by the Puerto Rican Governor to propose privatisation in the energy sector. Half of the Puerto Rico Electric Power Authority board members resigned in protest.⁶⁷ The cumulative impacts of climate and debt crisis in Puerto Rico were clear to the Special Rapporteur of the UN on Extreme Poverty and Human rights when he visited Puerto Rico: "these natural disasters are just the last in a series of bad news for Puerto Ricans, including an economic crisis, a debt crisis, an austerity crisis and, presumably, a structural political crisis".⁶⁸

1.5 The spiralling debt pressure over natural resources

We must also consider that debt unsustainability can also lead to greater exploitation of natural resources, including fossil fuels, fuelling climate change. Firstly, when countries face difficulties in repaying their debts, they turn towards their natural resources as a quick way to increase exports and, therefore, revenues in a foreign currency. In some cases, such as forest exploitation, this is possible without an extensive capital investment or skilled labour. Non-renewable forest products like timber or wood, as well as mineral wealth, are exploited in an effort to raise the needed funds, in too many cases generating or increasing deforestation, soil erosion, biodiversity loss and eco-system degradation, which leaves the country less prepared to deal with climate change events such as droughts and storms. Additionally, when countries turn to increased exploitation of natural resources, women tend to be more impacted, given the predominant role they play in firewood collection and engagement in forestry value chains as a supplement to their household income.⁶⁹ In other cases, the process requires further investment, like in fossil fuel exploitation, which is normally financed through further indebtedness and/or public-private-partnerships.

Intensifying the exploitation of natural resources to repay public debts, in some cases increasing climate vulnerabilities, also exacerbates developing countries' dependency on commodities, together with the additional debt vulnerabilities that this may bring. When relying on fluctuations of commodity prices and demand, governments face instability in revenue flows – needed to repay the existing debts – as well as in borrowing costs, as access to financial markets will become harder and more expensive when the country's export volume and prices fall. A recent IMF paper pointed out how the collapse in global oil prices is generating rising fiscal pressures in many oil-exporting countries, which is "likely to result in higher public debt" and could "affect investor confidence and increase the cost of borrowing due to higher risk premia, further limiting the fiscal space and potentially prompting concerns over debt sustainability for countries with already high debt".⁷⁰ Rather than promoting efforts to support countries moving up global value chains or moving away from fossil fuel exports, IFIs offer temporary financial support (further increasing debt vulnerabilities) hoping for higher prices and increasing demand for those natural resources in the future, and countries remain deeply exposed to external shocks.

1.6 Cumulative impacts of climate and debt crises on women's rights and gender justice

Women are not only more vulnerable than men to the impacts of debt crises, but also to the effects of the climate emergency.⁷¹ The two dynamics end up having cumulative impacts on women's rights and gender justice.

As the Women's Earth and Climate Action Network (WECAN) states "women from the Global South bear an even heavier burden from the impacts of climate change because of the historic and continuing impacts of colonialism, racism and inequality".⁷² Firstly, women tend to be more dependent for their livelihood on natural resources, which are threatened by the climate emergency. In least developed countries, 79 per cent of economically active women report agriculture as their primary source of livelihood (48 per cent of economically active women worldwide).⁷³

In the context of the climate emergency, women face a loss of income as well as harvests – often their sole sources of food and income. Food sources, even for urban women, become more unpredictable and scarcer due to increasing drought, flooding and unpredictable and extreme weather patterns, presenting life or death challenges for many women, who are most often the ones responsible for providing food for their families. Increases in food prices related to climate events make food inaccessible to poor people, in particular to women and girls whose health has been found to decline more than male health in times of food shortages.⁷⁴ Women and girls are also responsible for collecting water in almost two-thirds of households in developing countries, becoming a key agent to secure sustainable water resource management.⁷⁵ As a consequence, women tend to work longer hours than men, when we consider both paid work (formal or informal) and unpaid care and domestic work.⁷⁶ This is exacerbated in the wake of an extreme climatic event, as the need to invest more hours than usual in securing water, food and energy for cooking and heating the homes increases women's unpaid care work.⁷⁷

Debt crises can worsen this situation in various ways. As debt payments increase, public resources become scarcer and governments tend to accept the common IMF recommendation of cutting food subsidies – leading to food price increases – or subsidies on fertilisers, fuel and other aid to the agricultural sector, which impacts especially women as food and home energy providers. As public services are cut due to debt crises, and health centres, schools and water provision facilities are closed due to lack of funds, the distance women often have to walk, especially in rural areas, to access those basic public services increase. When an extreme climatic event or environmental hazard occurs and routes become impracticable, basic services can become simply inaccessible, particularly for women and dependent children and the elderly or disabled relatives they take care of.

Furthermore, the need for increasing resources to repay external debt often means a reinforcement of natural resource exploitation strategies in order to increase export revenue, which tends to imply land-grabbing⁷⁸ and, therefore, less access to land for the poor, especially women.⁷⁹

In post-climate disaster situations, women are usually at higher risk of being placed in unsafe, overcrowded shelters, due to lack of assets, such as savings, property or land, which makes them more vulnerable to gender violence.⁸⁰ Girls are also more prone to being taken out of school to help with the hardship of household management after the disaster, and risk being moved into domestic work for good. If the situation leads to food scarcity, some families might "feel they have no choice but to give their daughters away in early marriage, often resulting in early pregnancy".⁸¹ In fact, about 12 million more young girls are thought to have been married off after increasing extreme climatic events and environmental hazards have been shown to increase sex trafficking by 20-30 per cent.⁸² The lack of fiscal resources, due to debt crises, make governments less capable of providing adequate protection and shelter to women after an extreme climatic event or environmental hazard.

A recent report actually shows how "climate breakdown and the global crisis of environmental degradation are increasing violence against women and girls".⁸³ For instance, women and girls are more vulnerable to gender violence when having to walk longer distances to find water or firewood, as well as in temporary shelters. Furthermore, gender-based violence is increasingly being inflicted on female environmental rights defenders, and also on female climate refugees, as they face extortion and exploitation, rape, sexual harassment, survival sex, forced marriage, human trafficking or all types of humiliation in transit and in destination countries. Again, a government struggling with a debt crisis and implementing a neoliberal recipe of austerity, will have fewer resources to effectively fight to protect women from gender violence, especially after an extreme climatic event or environmental hazard.⁸⁴

Additionally, as the World Health Organization (WHO) warns, many of the health risks related to the climate crisis show gender differentials. Globally, extreme climatic events and environmental hazards such as droughts, floods and storms kill more women than men, and tend to kill women at a younger age, especially those amongst the poorest sectors of society. Other climate-sensitive health impacts, such as undernutrition and malaria, also show important gender differences.⁸⁵ This adds to the impacts of debt crises in public health systems and on women's health rights.

In at least 39 low- and middle-income countries, between 2014 and 2016, while debt service payments were increasing, health expenditure per capita was cut.⁸⁶ This is while at least half of the world's population are still without access to essential health services and only half of women in developing countries receive the recommended amount of maternal and reproductive healthcare.

When the concurrence of a debt crisis and climate catastrophe happen, women will suffer the cumulative impacts that both dynamics will have over the health systems in particular, and public services in general. It is mostly women who take on the extra burden that both cuts in public services and impact of a climate event creates in the form of increasing unpaid care and domestic work, as it is happening as a consequence of the Covid-19 crisis.⁸⁷

However, women are not just more vulnerable to the impacts of both debt and climate crises. The same way feminist economists and women's groups are joining forces with CSOs working on tackling debt crises from a feminist perspective,⁸⁸ women are also standing at the forefront of the action to address climate justice. Actually, women's involvement in decision-making has important implications for climate change, as countries with higher female parliamentary representation are more prone to ratify international environmental treaties⁸⁹ and to adopt more stringent climate policies, which can result in lower carbon dioxide emissions.⁹⁰ Women, especially indigenous and rural women, are also the main caretakers of water and land and, as such, are contributing to a more sustainable use of resources. In summary, women individually, and women's movements, are key to making the social, economic, political and ecological changes we need to tackle the climate emergency, including not only in lifestyle and consumption patterns, but also in macroeconomic policy and debt management.

2. Shortcomings of current approaches and mechanisms in climate finance

As we have seen, climate and debt vulnerabilities show multiple interlinkages, impacting the most vulnerable and particularly undermining gender justice. These interactions generate cumulative impacts and end up worsening both the climate emergency and the debt crisis. So far, the public policy and market responses to both issues have fallen short of the challenges and needs that the debt and climate emergencies pose. This section reviews some of the existing approaches and mechanisms in climate finance and points out their limitations in resolving the climate challenges and risks of worsening existing debt crises.

2.1 Climate finance mounting up debt

The UNFCCC agreed on several occasions that industrialised countries should provide finance to impoverished countries for adaptation (to help them become more resilient to climate change) and mitigation (to finance transition to low-emissions economy). The Convention, the Kyoto Protocol and the Paris Agreement recognise that capacity to mitigate and adapt to climate change differ between countries and call for provision of financial assistance from parties with more financial resources to provide finance to those more vulnerable. In 2009, at COP15 in Copenhagen, the most industrialised and polluting countries committed to deliver US\$30 billion for climate finance in 2010-2012 and scale up to US\$100 billion annually by 2020 – a goal that was extended to 2025 during COP21. This figure is widely considered to be a compromise figure meant to present COP15 as not being a failure, as opposed to being a figure based on current and future needs identified by developing countries. The 2015 Paris Agreement confirms that developed countries should take the lead in mobilising climate finance "from a wide variety of sources, instruments and channels" in a "progression beyond previous efforts".⁹¹ A new climate finance goal will be agreed before 2025, as mandated by Parties to COP21.

According to the most recent OECD progress report on climate finance,⁹² financing provided and mobilised by developed countries for climate action in developing countries reached US\$78.9 billion in 2018, still below the US\$100 billion commitment. This includes both public and private funds provided by developed countries and the part of multilateral funding attributed to developed countries. According to the OECD data, public climate finance totalled US\$62.2 billion in 2018.

Looking at the detail of that data, we see that borrowing is the main source for climate finance in general. Up to 74.4 per cent of this financing in 2018 was delivered in the form of loans and only 23.4 per cent was delivered through grants (the rest being equity, guarantees and non-specified instruments). Loans accounted for 60 per cent of bilateral and 88 per cent of multilateral finance. Between 2013 and 2018, the amount of grants available for developing countries has merely changed, from US\$10.3 billion to US\$12.3 billion. Considering the whole period (2013-2018), more than two-thirds of the public climate finance was delivered through debt creating instruments.

Table 3: Bilateral and multilateral public climate finance by OECD countries (2013-2018)

	2013	2014	2015	2016	2017	2018	Total
Public climate finance (US\$ Billions)	38	43.5	41.7	46.9	55.5	62.3	287.9
Total loans (US\$ Billions)	19.8	28.1	30.7	33.6	39.8	46.3	198.3
Per cent of loans	52.11%	64.60%	73.62%	71.64%	71.71%	74.32%	68.88%
Grants (US\$ Billions)	10.3	9.8	10.2	12	12.8	12.3	67.4
Per cent of grants	27.11%	22.53%	24.46%	25.59%	23.06%	19.74%	23.41%

Source: Eurodad calculations based in OECD data (2019)

However, and according to Oxfam International calculations, the total public climate finance provided could be much less than what is announced by the OECD. As the majority of finance is provided in the form of loans, it is important to look at the net value of the public climate specific assistance received by the developing countries. According to Oxfam research, "most loans continue to be counted at their full-face value, rather than as the amount of money given to a developing country once repayments, interest and other factors are accounted for (the grant equivalent)". Furthermore, there are "significant inaccuracies in how the climate component of broader development projects is counted". Considering these elements, Oxfam estimates that instead of US\$62.2 billion, public climate net assistance in 2018 could be as low as US\$19 to US\$22.5 billion.⁹³

According to the OECD report, the vast majority of bilateral loans (72 per cent) were concessional while the majority of multilateral loans (76 per cent) were non-concessional. The OECD report specifies that this non-concessional lending was, however, extended in "favourable terms and conditions compared to the capital market and/or are provided for activities in which the private sector may be reluctant to participate".⁹⁴ But the reality is that the grand majority of public finance is estimated to be provided in the form of loans, and on average, according to Oxfam International, an estimated 40 per cent of public climate finance is non-concessional (while non-concessional finance was only 30 per cent in 2015).

If we consider all aggregated public climate finance reported by developed countries and multilateral institutions between 2013 and 2018, the percentage of loans increased from 52.11 per cent in 2013 to 74.32 per cent in 2018. As Oxfam concludes, the announced "rising levels of public climate finance are largely the result of the increasing provision of non-concessional loans and other non-grant instruments".⁹⁵

Continued use of loans, especially on non-concessional terms, to fulfil climate finance obligations, sharply reduces a country's ability to achieve fiscal stability and debt sustainability, and contributes towards fuelling the unfolding debt crisis in the global south. This in turn impacts a country's ability to provide adequate public services during the ongoing health crisis and in the wake of an environmental hazard, public services that are greatly needed by marginalised groups including women, children, indigenous peoples and the transgender community. As Oxfam states, "the world's poorest countries and communities should not be forced to take out loans to protect themselves from the excess carbon emissions of rich countries".⁹⁶ Given the scale of the climate crisis, it's crucial to ensure that the US\$100 billion goal is met without further worsening the delicate debt situation in the global south, and, therefore, the amount of grants provided should significantly increase.

2.2 Absence of an accessible and effective debt relief framework after climate disasters

As we have seen, when a climate disaster happens, there is no international mechanism under the UNFCCC framework to enforce providing financial support to countries in the global south to cover for the loss and damage caused by the catastrophe. Countries impacted by a hurricane, floods or a severe drought are rarely in a position to mobilise resources and usually need to go through lengthy and not always successful processes of pledges for emergency finance and appeals for reconstruction funds, often resulting in loans. In a context where climate disasters are more frequent, donor fatigue also increases.⁹⁷ As we will see, in the case of climate risk insurance programmes or risk-sharing facilities, if the 'basis risk' is set too narrowly, it can result in reduced or no pay-outs from the insurer, which then decreases trust in the system and can lead to increased insurance premiums in the future.⁹⁸

In some cases, the situation worsens as the countries are expected to keep on servicing external debt, when they desperately need the resources to pay for the humanitarian emergency and reconstruction. In these situations, CSOs and occasionally governments have called for debt relief as a way of providing, in a fast and efficient way, the financial resources that the country needs and that are already available in their public budgets. An example is that of Hurricane Irma, which hit Antigua and Barbuda on 7 September 2017 and left damages valued at US\$152 million. The hurricane destroyed 90 per cent of the island's infrastructure and left 1,600 people, half of the island's population, homeless. Besides the devastation, Antigua and Barbuda had to deal with an almost US\$3 million debt payment due to the IMF on the day after Hurricane Irma hit the country.

Despite civil society calls for a moratorium on the debt payments, the IMF declared that they'd rather lend more money to the island than postpone the collection of the repayments.⁹⁹ The prime ministers of Antigua and Barbuda and of Grenada declared a few months later, in a joint public letter, that "in the absence of sufficient grants to support climate mitigation and adaptation and sustainable development, small islands have no choice but to resort to taking on more debt. Yet many already have large debts as a result of past disasters and injustices, loss of trade preferences, and exclusion from debt relief schemes, while our small size makes us more vulnerable to economic shocks such as global financial crises".¹⁰⁰ Similarly, Dominica had to pay several million dollars only days after it was devastated by hurricane Maria, and no debt relief or moratorium on the debt payments was made possible by international financial institutions nor creditors.¹⁰¹

Box 4: Catastrophe Containment and Relief Trust

The IMF actually did put in place one mechanism to provide debt relief in the case of a catastrophe, but it is so restricted that, in most recent cases related to climate disasters, it hasn't been triggered. The Catastrophe Containment and Relief Trust (CCRT) was established in 2015 in response to evidence that several impoverished countries were unable to deal both with reconstruction efforts after "catastrophic natural disasters or public health disasters", and debt payments. This mechanism was set up so the IMF could join debt relief efforts made by other creditors when impoverished countries are hit by a catastrophic "natural disaster" or a public health disaster (epidemic or infectious diseases). When countries qualify for CCRT, they are granted with debt relief in order "to free up resources to meet exceptional balance of payments needs created by the disaster rather than having to assign those resources to debt service."¹⁰²

However, the CCRT excludes most country debts – as it only pertains to IMF debt – and it is not applicable to most global south countries, due to narrow eligibility criteria on country per capita income and on population size for small states. Middle-income countries such as Mozambique, Dominica or Grenada, and small high-income countries such as Antigua and Barbuda, hit by devastating climate-related disasters, were denied IMF debt relief under this mechanism. In fact, before 2020, only three countries

affected by Ebola (Guinea, Liberia and Sierra Leone) received assistance from this trust. The CCRT is clearly insufficient to fulfil its aim to offer fiscal space for those countries affected by climate change related events or other natural catastrophes.

On 26 March 2020, the Executive Board of the IMF adopted a set of reforms to the CCRT to enable the fund to provide US\$251.24 million of debt service relief to a small group of 29 countries in the wake of the Covid-19 crisis.¹⁰³ On 2 October 2020, this initiative was extended for six months, providing an estimated additional US\$237.46 million of debt relief. The IMF has requested further contributions from donors to increase the capacity of the trust fund, up to US\$1.4 billion, in order to be able to extend debt relief until April 2022, but donors had only committed, by October 2020, to a third of it. Relief on debt service linked to the health emergency will exhaust most of the resources available at and contributed to the CCRT and, therefore, drain the capacity to provide further relief to countries that, meeting the restrictive criteria, will be impacted by extreme climatic events and environmental hazards. As such, it's imperative that more such schemes are developed, with broader eligibility criteria and lower threshold criteria on environmental hazards, in order to ensure that countries do not crumble under the weight of these dual crises.

2.3 Market-based approaches to climate finance and debt

The mainstream approach by rich countries and development banks to address the financial challenges of climate and other natural catastrophes, and the subsequent humanitarian crises, has been market-based. Emission trading and taxation, risk insurances, bond clauses and catastrophe or green bond emissions, among other innovative commercial financial instruments, have been key proposals from governments, international financial institutions and the private sector to raise the resources to deal with, or cover the risks of, the climate emergency.

However, according to an ActionAid report, “no market mechanisms are compliant with a human rights-centred approach to achieving the financing needed to address loss and damage associated with the adverse impacts of climate change”.¹⁰⁴ Contrary to their objectives, most of the market proposals end up being false solutions that, according to ActionAid, put the financial burden back on developing countries, worsening the government’s fiscal imbalances and even increasing debts. These market mechanisms also fail to enable transparency, accountability and participatory decision-making of those most impacted by the climate emergency.

A diverse range of market-based mechanisms exists. The following sub-sections explore some that are relevant to this text due to the interlinks with debt dynamics.

Risk insurance

As a consequence of the unlikelihood that the private sector would provide risk insurance at affordable prices to those countries more vulnerable to climate-related catastrophes, the World Bank helped establish in 2007 the Caribbean Catastrophe Risk Insurance Facility (CCRIF), which in 2014 was rearranged as “a not-for-profit risk pooling facility”, that is, a segregated portfolio Company (SPC) owned by Caribbean and Central American countries.¹⁰⁵ The new CCRIF-SPC is available to all Caribbean and Central American Countries, which buy insurance policies from it to partly cover losses after a disaster. A multi-donor trust fund established by the World Bank provided US\$ 67.4 million to establish the facility.

Pay-outs are made quickly after catastrophic events, based on calculations analysing the severity of the event and not on the basis of actual losses. Yet this does not account for their losses, both in the immediate and long-term, and the value of so-called ‘non-economic losses and damages (NELD)’ (e.g. loss of culture and heritage, long-term impact on health, loss of ecosystem services), is often disputed or not fully recognised as part of such calculations.¹⁰⁶ As a result, the pay-outs tend to be too small in relation to the losses. For instance, as Jubilee Germany points out, Dominica only received US\$2.3 million after hurricane Erica, “which was certainly useful, but does not come anywhere near the financing needs”.¹⁰⁷ Jubilee Debt UK reported that, between 2008 and 2017, the CCRIF received US\$293 million in payments from the countries, but only paid out US\$131 million in insurance, and “\$105 million from the scheme has gone to private insurance companies as profit”. The proposal of insurance under market parameters to cover for the climate losses and damages will always fall short of the countries’ needs, and if it were to cover all the potential damage of the climate crisis, the premium payments would be unaffordable for many countries to pay. For JDC, this scheme is fundamentally unjust, as the cost is put on those who suffer the damage but did not cause the climate emergency.¹⁰⁸

Hurricane clauses

Another instrument used to allow countries to have resources in the event of a climate-related hazard are the hurricane or similar disaster-linked clauses in their loan agreements – these are types of state-contingent lending based on providing a borrower with breathing space on debt servicing in the event of a particular pre-defined event taking place. The so-called “hurricane clauses” are designed to provide cash flow relief right after an extreme climatic event happens. For instance, by embedding hurricane clauses in debt contracts, countries can be awarded extended maturity periods or defer either interest or principal payments – or both – for a defined period of time. Such clauses have been used, for instance, by Grenada and Barbados. The former with Taiwan, Paris Club and private creditors in a restructuring in 2014-2015, while the latter was able to successfully negotiate hurricane clauses in the debt restructuring process in 2018, which will allow for capitalisation of interest and postponement of scheduled amortisation falling due over a two-year period, following the incidence of an extreme climatic event.¹⁰⁹

According to the IMF, these clauses can provide “valuable insurance at low cost against exogenous risks”, but in reality, private creditors might only be willing to accept these clauses at the cost of higher interest payments – potentially implying an increase in overall debt stocks in the future.¹¹⁰ A recent study published by the Board of Governors of the US Federal Reserve concludes that, even when “disaster clauses” improve the government’s ability to borrow, “borrowing costs increase noticeably”, with spreads surging an average of 30 per cent. The study concludes, however, that “the expected cost of servicing debt declines, as governments expect to postpone repayments. Hence, with the introduction of disaster clauses, the government can tolerate higher spreads to the extent that they reflect delay-in-repayment risk”.¹¹¹ In any case, for the “Hurricane clauses” to effectively cover the risks in climate-vulnerable countries without increasing the borrowing costs, it is important that official lenders, both bilateral and multilateral, play a role in leading the way in developing such instruments, also by including these “disaster clauses” in their own lending without additional costs for the borrowing countries.

Catastrophe bonds

Catastrophe bonds, also known as “cat bonds”, also constitute a so-called “innovative source of finance” that allows governments to raise money from investors willing to bet against the likelihood of an extreme climatic event occurring in a particular place during a particular time period – usually three to five years. During that time, the issuer country pays the established interest to the investors, which tends to be high as the risk of losing part or all the investment is also high. When the period is over, if the extreme climatic event does not happen, the country issuing the bonds returns the initial investment. However, the issuer can keep the invested money upon the occurrence of a specified climate event, which typically involves a parametric trigger, such as a pre-defined hurricane wind speed or earthquake intensity.¹¹² The total invested in catastrophe bonds, since they were introduced in the 1990s up to beginning of 2020, has just passed US\$100 billion. However, not all the bonds in the market are issued by sovereigns. In fact, insurance and reinsurance companies currently dominate the issuance of “cat bonds”, but sovereign ones are increasing. It is worth saying that “cat bonds” are common in the global north, while only starting to grow in the global south. On the side of the investors, the interest in cat bonds is growing among large institutional investors, such as hedge funds and pension funds. For instance, investment bank Goldman Sachs is a leader in the development of cat bonds.¹¹³ The main interest for investors in this kind of financial product is the high-risk pay-out, and not ensuring that issuing countries, especially in the global south, are able to deal with the impacts of an extreme climatic event while retaining their ability to provide public services.

The World Bank has also issued catastrophe bonds under a programme with the Philippines. Within the “capital at risk” notes programme, the World Bank issued in November 2019 two tranches of cat bonds to provide “financial protection” up to US\$75 million of losses from earthquakes and US\$150 million against losses from tropical cyclones, for a period of three years.¹¹⁴ Under this scheme, the pay-outs to the Philippines would be triggered if an earthquake or tropical cyclone meets the predefined criteria (which does not seem to be public). These criteria are not based on actual losses, but on characteristics of the natural event, such as the magnitude of an earthquake or the intensity of a cyclone. This way, the payments in case of the disaster can apparently be made faster, as there’s no need to assess the losses. On 31 October 2020, Typhoon Goni, the strongest recorded tropical cyclone to ever make landfall anywhere in the world, hit the Philippines, with extreme winds and severe flooding reported. A few days later, on 6 November, while typhoon Vamco was causing massive flooding in the country, the government of the Philippines issued notice that it believes typhoon Goni would be an applicable event to trigger the pay-out of the World Bank catastrophe bond.¹¹⁵ At the time of writing (14 December 2020), there was still no news on whether the typhoon had made the cut to the parametric criteria.

The Asian Development Bank has also recently approved a similar programme, including both a pilot disaster insurance covering several cities in the country and a US\$500 million contingent disaster financing instrument, that, similar to the World Bank Cat Bond, provides financing in case of certain extreme climate events or a health emergency.

It’s worth noting that what is measured in these schemes is not the impact of the typhoon, or the cumulative destruction of having five tropical storms in one month – as has happened in the Philippines¹¹⁶ – but the intensity of one single one of those events. The human, material and immaterial losses that those events and their cumulative impacts have caused are irrelevant under these schemes when it comes to deciding whether the country deserves to get the pay-out linked to the catastrophe bonds. As the similar Pandemic Bonds showed during the Ebola outbreak in the Democratic Republic of Congo,¹¹⁷ the country might be facing a disastrous humanitarian crisis after a cyclone or a health catastrophe, but if the event does not meet the pre-established parametric criteria of number of human losses, wind speed or any other, the bonds will not pay out. The pandemic bonds showed, in the case of the Ebola, the utter inadequacy of the tool to support countries in preventing crises, demonstrating how such market-based solutions designed not to favour development needs but rather to favour investors who are willing to bet on human lives.

Green bonds

In the lack of public funding for climate-related investment, the World Bank and the European Investment Bank launched the so called “Green bonds” more than a decade ago. “Green bonds” are intended for issuers to raise financing for projects in renewable energy, energy efficiency and ecosystem protection and restoration, among other climate mitigation and adaptation projects. The Climate Bonds Initiative (CBI), a non-profit organisation that tracks and deems to ‘certify’ which “green bonds” are really going to be invested in “climate change solutions”, states in their last report that the cumulative issuance since 2007 until 2019 reached US\$754 billion.¹¹⁸ In 2019, green bond issuing hit a record high of over US\$250 billion. Both local and central governments, supranational institutions, as well as corporations can issue green bonds. In fact, corporate green bonds represent almost half of the market. Only 13 per cent are issued by central governments, 10 per cent by government-backed entities and 6 per cent by local governments (2018). It’s worth noticing that 24 per cent of green bonds are issued as asset-backed securities, that is, collateralised debt. The green bonds market is led by USA, followed by China and France. While emerging countries are increasingly issuing green bonds to finance adaptation and mitigation projects, most countries in the global south still face institutional and market barriers, including higher prices.

One of the main concerns around the issuance of green bonds is who decides whether a bond is green. Besides CBI, a slew of companies offer services to “independently” assess, verify or certify if the project or investment to be financed is green-worthy. They include rating agencies like Moody’s and specialised firms such as Paris-based Vigeo Eiris, Amsterdam-based Sustainalytics and Cicero Shades of Green. In parallel, many issuers state that they follow the “Green Bond Principles”, endorsed by the International Capital Market Association in 2014.¹¹⁹ The EU is also discussing the “EU Green Bond Standard”, which will also be voluntary. But the lack of globally accepted standards or real independent and consistent verification throws doubts on whether part of these bonds are actually “greenwashing” operations. In fact, recent research argues that “it is not yet clear whether green bonds can meaningfully contribute to addressing the environmental crisis”, mainly because it is not clear that they achieve additionality, as bonds are primarily used for refinancing existing projects.¹²⁰

According to the analysis of 249 green bonds issued in Asia in 2018 and 2019 by Oxfam Hong Kong, there is very little evidence of the environmental benefits of the investment. Only 26 per cent of the bonds analysed offered details on how environmental impact was identified in their project evaluation process, just 8 per cent offered details on how to manage environmental risks and only 3 per cent of issuers mentioned climate resilience measures in the green bond frameworks. Furthermore, “only 6% of issuers adopted a process to identify the social impact of their bonds and 4% embraced a process to manage social risks. Whilst 15% attempted to show some evidence of positive social impact, none has identified any action to prevent negative impact on the SDGs.”¹²¹

As for the specific challenges of green bond issuing in developing countries, besides the usual premium they pay for issuing bonds in financial markets, some authors also mention the higher transaction costs they face in the process of verification, monitoring and reporting.¹²² In addition, the issuing of sovereign green bonds by global south countries does not only contribute to increasing debt levels, but it also implies that these countries will be bearing the costs of mitigation and adaptation projects, with interests, instead of the economies that have contributed the most to causing the climate emergency.

2.4 Debt for climate swaps

One of the proposals to deal with both debt and climate vulnerabilities that is receiving growing attention is the debt for climate swaps. Evolving from previous debt for development and particularly from debt-for-nature swaps,¹²³ the initiative aims to provide a certain amount of debt relief while investing the liberated funds in local climate adaptation and mitigation programmes. The scheme is indeed not new, as since the late 1980s similar initiatives of debt for development, debt for health and debt for education, or debt for equity swaps, have been implemented, not without controversy.¹²⁴

There are different methodologies of debt swaps, but the usual structure would be that of the creditor cancelling a quantity of debt owed to them, in exchange for a commitment by the debtor to mobilise the equivalent of the reduced amount in local currency for a particular investment or any established purposes on agreed terms.

In debt-for-nature swaps, the scheme can also include an international non-governmental organisation (NGO) that purchases external debt from a creditor and offers the debt for cancellation to the borrower in exchange for a conservation commitment. In some cases, the amount cancelled is exchanged for local currency, that local conservation groups, government agencies or/and an ad hoc trust fund would use to fund projects in the debtor country. In other cases, what is available for the conservation projects is not the full amount of debt bought by the private non-profit entity, but a partial amount (a cut in the debt stock) or the savings from a discount in the coupon or interest rates. This is the case of the debt-for-nature swap in the Seychelles, where the government agreed in 2016 a debt swap with Nature Conservancy and a number of private investors (including other non-profit foundations), who bought a portion of the country's sovereign debt, around 5 per cent of the total, worth US\$21 million, from European governments, including UK and France. The debt obligations were then transferred to a trust, the Seychelles Conservation and Climate Adaptation Trust, which offers the country lower interest rates on its repayments. The over US\$8 million savings are invested in projects designed to protect marine life.¹²⁵

Some institutions, such as the Commonwealth Secretariat,¹²⁶ the World Bank and the Economic Commission for Latin America and the Caribbean (ECLAC),¹²⁷ have been discussing and promoting debt for climate swaps as a possible alternative or innovative source of climate finance.¹²⁸ In the wake of a new debt crisis in the global south, triggered by Covid-19 and the economic downturn, the proposal has gained new impetus and support from CSOs, academics, governments and international institutions.¹²⁹ For instance, President Pedro Sánchez of Spain, President Hage Geingob of Namibia and Prime Minister Imran Khan of Pakistan included climate-based debt swaps in their remarks at the UN high-level event, Financing for Development in the Era of COVID-19 and Beyond,¹³⁰ and the UN Secretary-General included Debt Swaps as an option to “to transform public debt into sustainable investments” in his letter to G20 leaders ahead of the Summit in November 2020.¹³¹

Among the supports and proposals on the table, the ECLAC proposal for the Caribbean is probably the most detailed and most advanced one. In the ECLAC scheme, the Green Climate Fund (GCF) would buy up some of the external private debt of participating countries at a discount. The participating Caribbean countries, instead of making debt-service payments to their initial lenders, would make payments into the Caribbean Resilience Fund, created for this purpose, which would finance “green investments”. So far, three countries – Antigua and Barbuda, Saint Lucia and Saint Vincent and the Grenadines – are participating in a first pilot phase. Antigua and Barbuda has proposed the use of its Paris Club debt to pilot the scheme, which collectively totals over US\$130 million in debt.¹³² Besides these pilots and the case of the Seychelles, Caribbean countries such as Jamaica, Haiti and Grenada have been negotiating swaps with different outcomes.

The recently presented *Debt Relief for a Green and Inclusive Recovery* proposal, which aims to provide ambitious and comprehensive debt relief at the same time as it “frees up resources to support recoveries in a sustainable way, boosts economies’ resilience, and fosters a just transition to a low-carbon economy”, is structured around three pillars. The third pillar explicitly proposes debt-for-climate swaps for countries that are not heavily indebted, but have reduced fiscal space due to Covid-19. The debt swaps under this scheme, are designed to facilitate investments in climate adaptation or mitigation, and propose “an independent third party [that] would need to oversee the implementation and monitor the fulfilment of the government’s obligations under the arrangement and measure their impact”.

Debt swaps, however, have some limitations. The experiences in the past haven’t been successful at significantly reducing debt burdens, as they generally cover too little debt relief.¹³³ The *UN Financing for Sustainable Development Report 2020* acknowledges in this direction that “debt swaps generally do not reduce a country’s debt burden; rather they swap a country’s debt-servicing payments for investments in sustainable development”.¹³⁴ Debt swaps for development also tend to be complex and lengthy to negotiate, so they might not be adequate as a timely response to the debt distress that some countries are facing, nor to provide immediate post-disaster liquidity.

However, well-designed debt for climate swaps could indeed provide resources for financing mitigation and adaptation investment, including a mild debt relief effect. But progress on debt swaps should not be seen as a solution for moments of profound debt crisis such as the one triggered by the Covid-19 economic downturn, nor as an alternative to moving forward the fundamental reform of the international architecture towards a new fair and transparent debt resolution framework.

One of the main concerns around debt swaps in general is also additionality, as there's a risk that the funding provided through this mechanism would not be additional to existing ODA and climate finance commitments. The resources would come from the developing countries' domestic resources (that instead of being directed towards debt payments would be diverted towards climate investments), but in this sense the scheme does not provide countries in the global south with additional means to tackle climate change beyond their existing capacities. We also need to consider that, when involving concessional debt, a part of the loan to be relieved (its grant equivalent) would have been already reported as ODA in the first place, and the subsequent debt swap thus risks leading to double counting.¹³⁵

Finally, a key concern with climate debt swaps is the lack of country ownership risk. In previous debt swap experiences, particularly in debt-for-equity swaps, the interests of the creditor country had been imposed over the needs of the debtor country.¹³⁶ In fact, debt-for-equity swaps have been used as a tool of support for the internationalisation of companies from the lender country, which would qualify as tied aid, and therefore should be avoided. This is the case in one of the latest debt swap operations between Spain and Cuba, where the debt cancellation provided by the Spanish government was to be converted into infrastructure investment conditional to the involvement and to the benefit of Spanish companies.¹³⁷ Any debt swap scheme should be prevented from being used as a push for wider economic reform to promote public-private partnerships or to drive the sale and privatisation of public assets, potentially undermining states' abilities to deliver quality public services. Moreover, the design of debt swap processes should not be used to influence investment decisions by the public sector that would automatically exclude areas with low financial returns regardless of the social returns and positive externalities associated with them.

2.5 Fossil-fuel lending: Undoing with one hand what you're trying to do with the other

Efforts towards building a zero-emissions economy, society, and technology are advancing, although at a much slower pace than needed to avoid a temperature increase of over 1.5°C. As we have seen, in many cases this process of investing in mitigation (as well as adaptation) is being done at the cost of undermining debt sustainability. Meanwhile, funding from both public and private financial institutions for fossil-fuel projects has continued, neutralising the efforts of climate finance and potentially worsening the debt crisis, as it is normally in the form of lending and, therefore, further indebtedness.

On the one hand, private banks have been, and still are, key allies of fossil-fuel companies, as lending from 35 US, Canadian, Chinese, European and Japanese private banks¹³⁸ to fossil fuel companies has reached US\$2.7 trillion since the Paris Agreement was adopted (2016-2019), with financing on the rise each year.¹³⁹

On the other hand, as for public lending to the fossil fuel sector, activists have for many years focused on multilateral development and investment banks phasing out fossil fuels. For instance, the European Investment Bank (EIB) awarded the fossil fuel industry €13.5 billion between 2013 and 2018.¹⁴⁰ In November 2019, after tireless advocacy and campaigning by civil society organisations such as those in the coalition Counter Balance,¹⁴¹ the EIB adopted a new Energy Lending Policy, committing to ending financing for most fossil fuel projects by 2021.¹⁴²

The World Bank has also been, and still is, an important lender for the fossil fuel industry. Since the signing of the Paris Agreement in 2015 to August 2020, the World Bank Group has at least provided US\$12.1 billion of public assistance to 38 countries in fossil fuel-related projects, including US\$10.5 billion in direct finance to fossil fuel projects, and the rest as technical assistance and pre-existing equity investments. Additionally, and according to the study by Urgewald, "billions more flow to fossil fuel through World Bank Group (WBG) mixed operations and indirect funding".¹⁴³ After much civil society advocacy, the World Bank pledged in 2018 to cease funding for upstream oil and gas after 2019, but they haven't set a deadline yet for ending all fossil fuel lending.

Beyond the EIB and the World Bank, the nine multilateral development banks announced in December 2017 that they would work to develop a joint approach to Paris Agreement alignment. Two years later, at COP25 in Madrid, the group of public banks, including the World Bank, Asian Development Bank, African Development Bank and Inter-American Development Bank, among others, indicated that full implementation of their framework to align their financial flows with a 1.5°C pathway will not occur until 2023-2024.¹⁴⁴ In November 2020, the first Finance in Common Summit (FiC) – which brought together 450 Public Development Banks (PDB) – concluded without a clear agreement on a timeline to end fossil fuel investment once and for all.¹⁴⁵ So even when PDBs are slowly responding to the claim of ending fossil fuel financing, they fail in taking a clear and definite decision with the urgency that the planet needs.

Box 5: Stranded fossil fuel assets

Reaching the emissions' reduction goals to avoid temperatures increase over 1.5°C or 2°C will require keeping large proportion of existing fossil fuel reserves in the ground. According to a 2015 article in *Nature*, an estimated third of oil reserves, half of gas reserves and more than 80 per cent of known coal reserves should remain unused in order to meet global temperature targets under the Paris Agreement.¹⁴⁶ As a consequence, the value of public and private fossil fuel companies might not be fully reflecting the real value of these "stranded assets". Similarly, states that rely heavily on revenues from fossil fuel exploitation could be affected by a sudden drop if the stranded asset risks were priced in.¹⁴⁷ The magnitude of the loss from stranded fossil fuel assets may amount to a discounted global wealth loss of US\$1 to 4 trillion.¹⁴⁸

Developing countries that are particularly dependent upon revenue from fossil fuel exploitation risk losing massive amounts of revenue¹⁴⁹ due to assets being stranded by a potentially rapid onset of divestment and global transition to cleaner energy; by a reduction of government revenue from fossil fuel taxes and profits from state-owned fossil fuel resources companies;¹⁵⁰ through the need to compensate investors when domestic assets are stranded to comply with climate goals; and through debt repayment difficulties on loans collateralised against fossil fuel assets and revenue.

All these fiscal revenues become even more vital in a context of rising debt levels, and losses will indeed increase public debt vulnerabilities. Additionally, as markets become aware of the risks related to stranded fossil fuel assets, a loss of confidence could be reflected in higher costs for sovereign bond issuing. Moreover, if the local private sector is dependent on fossil fuel exploitation and indebted, a collapse in the latter due to assets being stranded could result in a public bailout of the former, including the assumption of the existing private debts by the public administration.

Additionally, also bilateral official development finance agencies have been pointed out as responsible for maintaining support for fossil fuels. The OECD reported that, on average, at least US\$3.9 billion in official development finance annually went on supporting fossil fuel activity in 2016 and 2017.

In general, this lending to the fossil fuel sector, coming both from private and public sources, besides undermining efforts to fight the climate emergency, can also impact negatively on debt vulnerabilities, as it mounts up on private debt – the main recipients are private fossil fuel companies – but it can also increase public debt, as some of the recipient companies are public enterprises or the investments are publicly guaranteed. It is also worth noting the risks of elevated corporate debt, since, as has happened many times in the past, when the private sector encounters difficulties in repaying its debts, it looks towards the state for a bail-out. As a recent IMF working paper actually demonstrates, excess private debt systematically turns into higher public debt.¹⁵¹ This is particularly relevant when we take into account the risks of stranded assets for fossil fuel corporations.

The IMF does not provide lending for specific projects, nor for specific fossil fuel industry development, but in their surveillance work the Fund has on occasions recommended intensifying fossil fuel exploitation in order to boost economic growth. This is the case for Mozambique. Struggling with a debt crisis and the losses and damage caused by a climate disaster, the IMF praised the significant contributions to the country's economic growth and government revenues of promoting coal and, especially, the gas extractive sector. Among their arguments, the IMF emphasised how Mozambique is poised to become a major exporter of liquified natural gas (LNG), and that LNG fiscal revenues could contribute to a more sustainable debt path. Gas has in fact been promoted as a cleaner fuel, due to its lower carbon emissions when compared to coal. But, additional to the impacts of extractives in local communities and ecosystems, it is still a fossil fuel with significant greenhouse gas emissions, especially due to leakages of methane, a far more potent greenhouse gas than CO₂.¹⁵²

Beyond the Mozambique case, a recent report by Recourse showed how the IMF's most recent economic policy advice to countries like India, Indonesia, Philippines and South Africa, with ongoing coal sector expansions, is green-lighting fossil fuel expansion. According to the report, "not only does the IMF fail to adequately identify climate change as an economic risk in three out of these five countries, it is also supportive of tax incentives for new coal and fossil fuel infrastructure, and even encourages government spending on mega fossil fuel projects in Indonesia, India, and Mozambique". As the report states, the IMF urges the five countries in the study to improve the management of public debt, while ignoring how the public debt distress situation might be linked to the coal power sector.¹⁵³

3. How to deal with the interconnected impacts of sovereign debt and climate crises

The world today faces several game-changing challenges, among which the climate emergency and the rise of new debt crises stand out. The interplay of these phenomena is cumulatively putting at risk the fulfilment of human rights and advancement towards the SDGs, both globally and, in particular, in the global south. The social, economic, environmental and gender impacts of both debt and climate crises could be lessened if the right policy decisions were made, but action is urgent.

3.1 A just, feminist and green recovery that lays the foundations for resolving the debt and climate crises

A fundamental shift in the global economy towards a new model that puts people's needs and rights at the centre, respecting the material and natural limits of the planet and atmosphere is imperative to avoid further global temperature increase. Furthermore, the relentless pursuit of economic growth based on resource extraction is still fuelling climate change dynamics, dwindling natural resources, changing ecosystems and environmental hazards. Maintaining the current dynamics, especially fossil fuel dependency and exploitation, is in fact a recipe for long-term economic catastrophe, along with social and environmental hazards, exacerbating existing poverty and inequality.¹⁵⁴

Some of the current policy strategies to face both the environmental and economic challenges of the climate emergency, are framed within the rhetoric of a "Green New Deal". Recalling the 1930s New Deal in the US, proposals variously promote a wave of green investment as a source of income and employment growth, contributing to global macroeconomic recovery. The EU has already committed to such an initiative, although uncertainty remains about its potential impact outside European borders, particularly in the global south.¹⁵⁵

The Covid-19 economic downturn has fired up the calls around a green and sustainable recovery. The IMF, for instance, is calling for "greening the recovery", that is, "green measures that both boost aggregate demand and employment".¹⁵⁶ According to the OECD estimates, "green" recovery measures by many governments could already be around US\$312 billion, including "grants, loans and tax reliefs directed towards green transport, circular economy and clean energy research, development and deployment". However, so far, the balance between green and non-green spending in the recovery packages still favours the latter.¹⁵⁷

The challenges for this transition into a greener economy are gigantic, and particularly acute for countries in the global south. And among those challenges, one of the key questions is how this transition will be financed without increasing already historically high debt levels. As we have seen, up to now, most climate finance has been deployed through debt-creating instruments, and with the unfurling debt crisis in the global south, developing countries have little or no fiscal space at all to promote such green recovery programmes. In fact, debt cancellation and restructuring will undoubtedly be necessary for countries in the global south to be able to face any recovery at all, but especially if investments in a transition towards a greener economy are to be made. For the authors of the *Debt Relief for a Green and Inclusive Recovery* proposal, this debt relief "should be coupled with a new and ambitious allocation of SDRs and significant new capital mobilized from development finance institutions".¹⁵⁸ Only through both reducing the debt burden and increasing the resources available will countries in the global south be able to adopt sustained counter-cyclical responses to the crisis.

Furthermore, as the 2019 UNCTAD Trade and Development report, entitled *Financing a Global Green New Deal*, already pointed out in pre-Covid times, there is also a risk of increasing reliance on private capital for development financing, which "will not only fail to generate the resources required for the investment push needed to deliver the 2030 Agenda but, in all likelihood, will further exacerbate the inequalities and imbalances that the Agenda is designed to eradicate". For UNCTAD, a global green new deal, would need a rebuilding of the rules of the global economy, as well as the financial system, with a stronger role for public development banks.¹⁵⁹

For feminist economist Diane Elson, additional to a Green Deal, a new Care Deal should be promoted, investing in social as well as physical infrastructure for the care economy and climate resilience, and with the objective, not to restore growth, but to transform growth.¹⁶⁰ Indeed, from a feminist perspective, and according to the US feminist organisations that have promoted a *Feminist Agenda for a Green New Deal*, "to truly address the root causes, as well as the scope and scale of the climate crisis, the Green New Deal must be cross-cutting in its approach, steadfast in feminist principles, and strive to combat historical oppressions".¹⁶¹ The proposal should therefore help end oppression against, as well as be led and defined by frontline, impacted communities, especially women from the global south, migrant and refugee communities, indigenous, transgender and racialised women. It should also address not only the need for a just environmental and economic transition, but also economic, social and gender inequalities, including a "shift from the privatisation and commodification of resources toward regenerative, sustainable, cooperative, and collective models". A feminist and green new deal should also address the gender gap in unpaid care work, by redistributing it.

3.2 Fair, sufficient and non-debt creating climate finance

In addition to increasing investment and promoting massive economic and social changes to effectively reduce greenhouse gas emissions and promoting a just, green and feminist recovery, rich countries should recognise that they have an ecological and climate debt to the peoples in the global south, and honour their commitments on climate finance. Assuming the differentiated responsibilities that the most industrialised countries have in climate change means that the rich countries have to contribute to support impoverished countries dealing with adaptation, losses and damages, and mitigation to climate change. In line with this commitment, rich countries should also stop blocking negotiations on finance to address loss and damage.

In all cases, finance for mitigation, adaptation and loss and damage for impoverished countries, as well as finance for Green and Care Deal proposals, should be not only made more accessible, but should also be designed in a way that does not increase the risks of debt vulnerability, prioritising grants over loans, and public over private finance. As such, funds should be disbursed to both governments, including regional and local governments, and local/community-led non-governmental organisations, especially those locally based and women-led that are best able to reach affected groups and/or contribute to lasting recovery and climate resilience.

This non-debt creating financing should also be at the centre of the financial support for global south countries as a response to the Covid-19 health, social and economic crisis. The international community should support and provide affordable and responsible public financing options for recovery from the global downturn, and for investment in care economy, gender-sensitive public services and climate resilience. This includes concessional loans by public financial institutions, but also fulfilling the donors' commitment to devote 0.7 per cent of national income as ODA, together with the additional commitments for climate finance. 2020 is in fact the delivery year for the first phase of the US\$100 billion climate finance goal. Aid and climate finance should be untied, unconditional and transparent, and following the international agreements on public procurement. Following the basic principles of effective development aid and introducing binding rules on responsible lending and borrowing would also be key steps.

3.3 Debt cancellation in the aftermath of a climate hazard

Numerous CSOs¹⁶² and governments, particularly from SIDS,¹⁶³ have been calling for some years for a debt relief initiative to compensate for loss and damage after a climate-related hazard hits a developing country. Debt relief, including an immediate debt payments moratorium after the climate event and a pre-designed debt restructuring process, including debt cancellation, as soon as the damages and losses are evaluated, constitutes one of the most efficient and fast mechanisms at hand to provide support when it's most needed. For Jubilee Caribbean and Erlassjahr.de (Jubilee Germany),¹⁶⁴ both of them CSOs that have been advocating for such a solution, the proposal would involve two steps:

- An interest-free moratorium on debt payments immediately after a climate disaster hits. Debt payments suspension has the potential to provide immediate access to resources that are already in the hands of the authorities and thus do not have to be mobilised through lengthy pledging exercises. Resources earmarked for debt service in national budgets can be put to work immediately for emergency relief and reconstruction. The country affected by a climate-related disaster should be able to apply to a previously identified international institution for a moratorium. This institution should consider the application on the basis of objective information available related to the amount of damage incurred (following a previously defined critical threshold) and give a "yes or no" answer within a period of two to maximum seven days. The moratorium should be limited to a given period (could be around six months), during which all payment obligations to all external creditors are suspended and no legal action can be taken against the borrowing country to enforce debt service.
- In addition to the moratorium, a pre-designed framework for restructuring the entire stock of existing public external debt in the impacted country, including debt cancellation if needed, would be required. To be effective, the scope of the debt relief must be comprehensive, covering both private and official creditors. In this regard, a creditors' committee involving all private and public claim holders vis-à-vis the country concerned would be organised within the granted moratorium period and start a discussion on the restructuring process, including the level of debt cancellation needed for the country to be able to recover from the disaster. Restructuring processes need to follow principles of the rule of law - such as those established in the UNCTAD Roadmap and Guide to a Sovereign Debt Workout¹⁶⁵ - and those set out by civil society in their calls for a multilateral sovereign debt workout mechanism that, under the auspices of the UN, ensures the primacy of human rights over debt service and a rules-based approach to orderly, fair, transparent and durable debt crisis resolution.¹⁶⁶

For newly contracted or restructured debt, governments and IFIs should include in their lending contracts, and promote among private lenders, state contingent clauses tied to both climate and other health and economic exogenous shocks – such as a drop in commodity prices. These clauses would trigger debt relief and could be tied to future official sector debt suspensions.

Beyond the above proposals, which would help deal with debt resolution in the aftermath of a climate disaster, an established multilateral fair and timely debt resolution framework would help countries face the debt and climate emergency challenges in general with better chances. Governments and international organisations should therefore support and work towards the creation of a multilateral sovereign debt workout mechanism¹⁶⁷ that, under the auspices of the UN, ensures the primacy of human rights, including women's rights and gender equality, over debt service and a rules-based approach to orderly, fair, transparent and durable debt crisis resolution. We need to evolve towards policy responses to debt crisis that consider environmental and climate vulnerabilities, together with human rights and other social, gender and development considerations at their core. To be able to increase the resources available for investment in climate resilience and guaranteeing women's rights, there is also a need to increase revenue, including through progressive taxation and fighting tax dodging and other innovative sources of climate finance.

We need to put in place a response to the economic, social and environmental challenges that the world and, particularly, the countries in the global south face, that tackles the multiplicity of interconnected crises. And only if we address at the same time the debt and climate crises, from a comprehensive, systemic and eco-feminist approach, will we be able to tackle the cumulative impacts of debt and the climate emergency. The Covid-19 economic downturn, its economic, social and gender inequality impacts, and the aggravation of the debt crisis, make it even more urgent than ever to design and implement eco-feminist responses that will allow a fundamental shift in the global economy and the financial system.

3.4 Policy recommendations to deal with the interplay of the debt and climate crises

In summary, in order to deal with the interconnected impacts of sovereign debt and climate crises, governments and international financial institutions should implement the following recommendations:

1. Comply with committed funds for climate finance:

Assuming the differentiated responsibilities that the most industrialised countries have in climate change, they should offer affordable and responsible public financing options for adaptation and mitigation in the global south, as agreed in the Convention, the Kyoto Protocol and the Paris Agreement. Climate finance should be new and additional to existing finance commitments e.g. ODA, preferably in the form of grants, in order to not incur higher indebtedness, untied, unconditional and transparent, and following the international agreements on public procurement. Following the basic principles of effective development aid and introducing binding rules on responsible lending and borrowing would be key steps to making funds available for climate mitigation and adaptation, including loss and damage, that do not worsen debt vulnerabilities.

2. Providing finance to address loss and damage: Richer countries should stop blocking the negotiations and facilitate an agreement to provide sufficient finance to address loss and damage after a climate disaster in developing countries, favouring grants over loans, so this does not aggravate unsustainable debt levels. Funds should be disbursed to both governments and independent agencies, especially those that are locally based and women-led that are best able to reach affected groups and/or contribute to lasting recovery and resilience.

3. Debt payments suspension and debt relief in the aftermath of climate disaster:

As argued, an interest-free moratorium on debt payments should be provided immediately after a climate disaster hits, as it has the potential to provide immediate access to resources that are already available. In addition to the moratorium, a pre-designed framework for restructuring the entire stock of existing public external debt, including debt cancellation if needed, would be required. Both the debt payments suspension and debt restructuring should be binding on official, private and multilateral creditors. This could be achieved through mechanisms such as Article VIII Section 2 (b) of the IMF. For newly contracted or restructured debt, governments and IFIs should include in their lending contracts, and promote among private lenders, state contingent clauses tied to both climate and other health and economic exogenous shocks.

- 4. Timely and sufficient debt relief:** Creditors and IFIs should take action to agree and implement a post-Covid-19 debt relief and sustainability initiative under UN auspices to bring developing country debts down to sustainable levels, which considers countries' long-term financing needs to pursue the SDGs, climate goals and human rights and gender equality commitments. This debt relief process should involve all creditors and ensure debt cancellation and restructuring in a timely, efficient and sufficient manner, especially to those countries at risk of, or already in, debt distress with high climate vulnerabilities. Easing debt levels will allow countries to become more climate resilient, by freeing domestic resources to invest in adaptation and mitigation. Not taking sufficiently ambitious action in relation to debt relief, amidst a growing debt crisis in the global south, will leave developing countries even more ill-prepared to deal with the climate challenges they face.
- 5. Review debt sustainability:** Governments at the IMF and World Bank should promote an open review of Debt Sustainability Analysis (DSA), with UN guidance and civil society participation, in order to evolve towards a more adequate debt sustainability concept, one that includes environmental and climate vulnerabilities, together with human rights and other social, gender and development considerations at its core.
- 6. Debt workout mechanism:** Beyond debt relief to cope with the present debt crisis, governments and international organisations should support and work towards the creation of a permanent multilateral sovereign debt workout mechanism that, under the auspices of the UN, ensures the primacy of human rights over debt service and a rules-based approach to orderly, fair, transparent, and durable debt crisis resolution, in a process convening all creditors.
- 7. Provide emergency additional finance:** IFIs and rich governments should provide sufficient additional resources to support developing countries to tackle the health, social and economic crises, favouring grants over loans, so this does not aggravate unsustainable debt levels in the near future. Emergency finance for facing the health and social crisis and fund a fair and sustainable recovery should not dent the previous ODA and climate finance commitments. These resources should be made available particularly to those countries where the effects of the crisis have been especially hard, both in terms of those countries where the health impacts of the Covid-19 have been stronger, and of those where the economic impacts have been harder due to reliance on tourism, remittances and commodities. Efforts should also be stepped up to secure a new and large issuance of IMF SDR to help alleviate liquidity pressures on developing countries in need.

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