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THE CLIMATE IMPERATIVE IN A WORLD RIDDEN WITH DEBT

PROPOSALS FOR A SYSTEMIC RESPONSE

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Emerging coalitions aim to build political ownership around new rules and mechanisms to free up investment capacities in developing and emerging economies. A combination of those proposals is certainly needed for a comprehensive response to the debt and climate crisis.

Proposals addressing solvency issues	
Debt Restructuring	Debt restructuring processes currently take place under the Common Framework. They aim to reduce the interest rates on loans or extend the due dates for paying them back and are therefore used in case of solvency or liquidity issues. They allow for increased fiscal space for public investment ; however there have typically been no conditionalities on specific spending commitments associated with debt restructurings. Improving debt restructuring processes could include: - legislative reforms that compel private sector participation in debt relief initiatives[1] - clarity on the comparability of debt treatments[2] - the creation of an independent multilateral debt workout mechanism along 10 Civil Society Principles[3]. In July 2023, the UN officially announced its goal to create this independent mechanism[4]. - the addition of climate conditionalities (see below)

[1] Debt Justice, 2022, **Why climate justice must include debt justice**

[2] Think7, 2023, **Policy Actions for Alleviating Debt Distress and Debt Sustainability Risks in the Global South**

[3] Eurodad, 2019, **We can work it out**

[4] United Nations, 2023, **A World of Debt**

Climate-conditional debt restructuring	Comprehensive restructurings that are conditional on the same type of policy actions and spending commitments (e.g., on climate adaptation) that might be envisaged by debt–climate swaps. According to CEPR: “When debt is unsustainable and climate adaptation can materially lower debt risks, the right instrument is a comprehensive debt restructuring conditional on debtor climate action.”[5]
New Comprehensive Debt Relief Initiative (CDRI)	The CDRI would complement the G20 Common Framework and coordinate burden sharing among (i) bilateral creditors (ii) foreign commercial banks and (iii) private creditors. Each type of creditor would be expected to play a specific role and to suspend debt repayment for a 5 to 10 years period[2].
Debt Cancellation	International institutions like the IMF and World Bank, as well as governments from the G20, could provide debt cancellation to free up resources to invest in climate adaptation and mitigation. The rationale behind debt cancellation is that developing countries face the biggest consequences from climate change, while they contributed the least to global emissions[1] .
Proposals addressing liquidity issues	
Climate-resilient debt clauses (CRDCs)	In the wake of severe climate shocks, CRDCs aim to avoid service debt repayments crowding out vital spending. They allow for the suspension of debt repayments on a cost-neutral basis — helping borrowing countries experiencing the shock respond to the crisis as a priority, while lowering risks of default. CRDCs are being mainstreamed into the World Bank’s new loans. Going forward, they could be included in all new and existing loans from public institutions. Moreover, legislative reform could help mainstreaming those clauses into private loans.
Debt for Climate (Nature) Swaps	Debt swaps are typically associated with specific spending commitments. They may be agreed upon in debt relief contexts, but they might also be voluntary. According to CEPR research, dept swaps could make sense first, as a way to mobilize extra resources when a country cannot mobilize enough finance through conditional grants; second, to support specific public investments when debt risks are high, but debt remains sustainable, making a comprehensive debt restructuring process too heavy[5]. This is aligned with Debt Justice reporting that the amount of debt included in a swap is typically very small compared to the debt burden[1]. Therefore, debt for climate swaps could be used to generate extra-finance for climate

[5] CEPR, 2022, **Climate and Debt**

	mitigation and adaptation while slightly reducing debt risks but could not be thought of as the main tool for debt relief.
Redistribution of unused SDRs through the IMF or MDBs	Special drawing rights (SDR) are an international type of monetary reserve currency, created by the International Monetary Fund (IMF). In 2021, the IMF allocated $650 billion of SDRs to boost the post-pandemic recovery. Advanced economies received most of it but did not use it fully. There is currently a vivid debate about whether and how to reallocate those SDRs to developing countries. The IMF has set up the Resilience and Sustainability Fund, which allows member states to channel their SDRs in the form of low-interest and long-term loans. Debt Justice advocates for wealthy nations to channel their SDRs in the form of grants when legally possible[1]. Some advocate for a new allocation of SDRs[6], and a renewed IMF quota method[7]. In its 2023 report on debt, the UN also advocates for a "strengthened use of SDRs" and "increased quota-access windows" [4]. However, Rogoff argues that SDRs are not designed as a durable aid mechanism[8]. They can be used as such when urgent financing is needed and there is no other option, but they lack appropriate allocation (they are allocated based on IMF quota shares, hence mainly to advanced economies) and conditionalities.
Proposals addressing new financing beyond debt relief	
Scaling up grant-based financing for global public goods	Today's international aid comes mainly in the form of loans (72% of total public finance)[9]. Scaling up grant-financing will be essential for a successful financing strategy, according to Songwe and Stern. Rogoff puts forward the argument that "climate change and pandemics represent global public goods that are best dealt with through grants, not loans" [8]. He recognizes the limits for Bretton Woods Institutions (WB and IMF) to fulfill that role and suggests the creation of a World Carbon Bank to fill the gap: "Funds from the World Carbon Bank should be entirely in the form of outright transfers from rich countries to developing economies"[10].
Global market for carbon credits	CEPR suggests that a global market for carbon credits combined with mandatory net decarbonization would create high demand for offsets, where supply would largely come from the global South[5]
Reforming Debt Sustainability Assessments	Ball et al. suggest changing how we measure debt sustainability, making the Debt Sustainability Analysis framework about net worth public balance sheets. This would allow to differentiate investments spending from

[6] CEPR, 2022, **The Case for More Special Drawing Rights**

[7] Think7, 2023, **Policy Actions for Alleviating Debt Distress and Debt Sustainability Risks in the Global South**

[8] Rogoff, 2022, **Emerging Market Sovereign Debt in the Aftermath of the Pandemic**

[9] Songwe & Stern, 2022, **Finance for Climate Action**

[10] Rogoff, 2023, **The Case for a World Carbon Bank.**

	consumption spending and could allow long-term investment in climate infrastructures to be compatible with a sound DSA[11].
Borrower's Club	A strategic mechanism where African countries "club" together, taking loans together and using each other's growth prospects as collateral. With this mechanism, creditors could benefit from pooling their resources, hence lowering risks. This could unlock significant additional finance for developing countries. Additionally, it would provide them with more autonomy as borrowers would be themselves responsible for determining the prioritization of projects across members and would agree their own relevant thresholds or criteria for internal defaults[12]. The African-led and Woman-led development consultancy "Development Reimagined" has socialized this idea and the Sustainable Debt Coalition has picked it up and aims to build such a borrower's Club in the medium term.

About E3G

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

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

More information is available at **www.e3g.org**

[11] Ball et al., 2021, **Why Public Assets are Key to Debt Sustainability: A Moral Goal**

[12] Development reimagined, 2022, **Reimagining the international finance system for Africa**