



Averting the crises

How a new approach to debt
could raise US\$400 billion
for climate and nature

Sejal Patel

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The Shaping Sustainable Markets group works to make sure that local and global markets are fair and can help poor people and nature thrive. Our research focuses on the mechanisms, structures and policies that lead to sustainable and inclusive economies. Our strength is in finding locally appropriate solutions to complex global and national problems.

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Sixty per cent of low-income countries are already in or at high risk of debt distress, while the global economic and debt sustainability outlook is quickly deteriorating due to higher interest rates, higher food prices and depreciating currencies. At the same time, macroeconomic risks caused by the crises of climate change and nature loss further undermine current siloed efforts to recover. Innovative climate and nature-linked debt instruments can help to address the current crises. This analysis estimates that these instruments could mobilise upwards of US\$105 billion from debt relief for climate and nature in the short term, and more than US\$329 billion in new debt issuances, with the possibility of even more in the medium and long term. Based on these findings, the paper recommends increased support for and promotion of these instruments, and a new architecture for international debt treatment.

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Acronyms, abbreviations and initials

AOSIS	Alliance of Small Island States
COP27	United Nations 27th Climate Change Conference, 2022
DSA	Debt Sustainability Analysis
DSF	Debt Sustainability Framework
DSSI	Debt Service Suspension Initiative
FCAS	Fragile and conflict-affected situations
G20	Group of Twenty countries
GDP	Gross domestic product
HIPC	Heavily Indebted Poor Countries (Initiative)
IFIs	International financial institutions
IMF	International Monetary Fund
KPIs	Key performance indicators
LDCs	Least developed countries
MDRI	Multilateral Debt Relief Initiative
NDC	Nationally Determined Contribution
PPG	Public and publicly guaranteed debt
RST	Resilience and Sustainability Trust
PRGT	Poverty Reduction and Growth Trust
PV	Present value
SDGs	Sustainable Development Goals
SIDS	Small island developing states
SLBs	Sustainability-linked bonds
TNC	The Nature Conservancy
UNCTAD	United Nations Conference on Trade and Development
V20	Vulnerable Twenty Group

Summary

Across low-income and emerging market economies, government debt rose by nine percentage points to 63% of gross domestic product (GDP) in 2020, the fastest one-year increase in the past 30 years. This sharp rise in debt levels and fall in growth results from the large external shocks of the COVID-19 pandemic and the Ukraine conflict and is exacerbating existing debt vulnerabilities. Now, 60% of low-income countries (LICs) are in, or at high risk of, debt distress and are finding it increasingly difficult to service their debts.

The international response has been highly lacking. The Debt Service Suspension Initiative (DSSI) that ran between May 2020 and December 2021 was an opt-in debt suspension scheme. Given the impact of the pandemic, this suspension represented a very short period of support, and it also did not address any of the structural issues building up due to the external shocks. The subsequent Common Framework for Debt Treatments beyond DSSI was supposed to address the gaps, but it has been very inaccessible: only three countries have requested to have their debt issues addressed under this framework – and their experience of this route appears to have been of a slow and difficult process.

Furthermore, both initiatives have represented highly siloed solutions. They seek to address debt in isolation. However, the climate, nature and debt crises are interlinked macroeconomic crises, and addressing one aspect without also addressing the others is unsustainable. Across many low-income and developing countries climate is adding to debt sustainability concerns, both from the economic impact of climate change and the financing required to adapt their economies to climate change. A coherent, integrated and quick-paced plan of action is needed.

The analysis presented in this paper gives an estimate of the scale of financing that could be mobilised for climate and nature through the restructuring of existing debt and from new debt issuances. The objective of estimating this figure is to show the potential for linking

such instruments to climate and nature priorities and to therefore highlight this form of innovative financing as an important mechanism for creditors, debtors and the climate and nature community to engage with in response to the interlinked debt, climate and nature crises. This analysis provides estimates for the volume of public and publicly guaranteed (PPG) external debt that could be restructured (for example, through debt for climate and nature swaps)¹ and for the amount of new PPG external debt that could be issued through climate and nature-linked debt instruments (such as sustainability-linked bonds or SLBs). An SLB is an instrument that provides general purpose finance linked to key performance indicators (KPIs). Through this instrument only a portion of the finance raised would go towards climate and nature to allow the country to support other priorities as well as climate and nature. While SLBs are very nascent instruments, they build upon previous sustainability instruments and mechanisms, and hold great potential within the current context of the triple crisis of debt, climate and nature.

In terms of the amount of debt that could be restructured, the Heavily Indebted Poor Countries Initiative (HIPC) and the Multilateral Debt Relief Initiative (MDRI) from the 1990s and early 2000s illustrated that even for countries in dire situations requiring substantial debt relief (outright debt write-off), it is still possible to direct (local currency equivalent) savings from debt relief towards key national development objectives, such as poverty reduction projects. In the current case, this should include climate and nature programmes that strengthen the economic resilience of those countries and therefore their future debt-carrying capacity. Under HIPC, the net present value of bilateral debt was reduced by 60%,² under MDRI, the net present value of multilateral debt was reduced by 100%, and under the Brady Plan,³ the value of commercial debt was reduced by 37%. The present analysis is based on the premise that a similar proportion of reduction in the net present value of debt could be possible again today.

¹ A debt for climate and nature swap is where a debtor country undertakes some form of restructuring of their existing debt obligations in order to free up or redirect funds towards climate and nature outcomes. For more detail, see Steele, P and Patel, S (2020) Tackling the triple crisis: Using debt swaps to address debt, climate and nature loss post-COVID-19. IIED, London. <http://pubs.iied.org/16674IIED>

² World Bank (2022a) Resolving high debt after the pandemic: lessons from past episodes of debt relief. Global Economic Prospects. <https://bit.ly/3y5EPUJ>

³ See Annex 1

The analysis identifies 55 Non-Annex I countries⁴ and three additional non-Non-Annex I fragile or conflict-affected states that might be included in an updated climate and nature-related HIPC-type initiative. From these countries, the analysis had data for 47 countries, and found total PPG external debt holdings of US\$403 billion (present value US\$262 billion).

Based on this, the nominal value of total PPG external debt holdings for all 58 countries is estimated at US\$497 billion. This led to an estimate of the amount of debt that could be reduced of US\$397 billion (as modelled on the reductions achieved during the HIPC/MDRI initiatives). Of this amount, the analysis considers that 26.3% (again, based on the HIPC/MDRI experience), approximately US\$105 billion of these savings, could be channelled into climate and nature activities with the support of a HIPC-type climate and nature-linked debt reduction initiative.

This US\$105 billion mobilisation is considerably higher than the US\$16.7 billion of grant funding mobilised under the US\$100 billion climate finance mobilisation goal under the UNFCCC Paris Agreement. Debt mobilisation could be a significant contribution to nationally determined contribution (NDC) targets relative to other flows. Notably, it also has the potential to scale up and mobilise climate and nature funding annually.

In terms of the amount of new debt that could be issued through SLBs, the analysis finds that 99 Non-Annex I countries might be able to issue new climate and nature-linked debt. This analysis is based on data for 27 countries, for which it estimates that US\$706.9 billion could be issued as new debt. The analysis uses that to estimate that US\$2,499 billion could be issued from all 99 countries. Of this amount, the analysis considers the case where 50% of borrowing space is used, and of which 26.3% is directed to climate and nature. In this case, US\$329 billion could be mobilised for climate and nature.

Overall, this analysis therefore finds that US\$105 billion could be mobilised through a HIPC-type climate and nature-linked debt reduction initiative, and US\$329 billion could be mobilised through new issuances of SLB instruments.

This analysis draws out the following policy implications:

- There is potentially a significant amount of financing that can be mobilised for climate and nature while also supporting countries to deal with their debt burdens.
- The international system needs to provide better support for climate and nature-linked debt instruments.
- National governments can scope whether climate and nature-linked debt instruments are suitable for their contexts.

Based on these policy implications, the following next steps are proposed:

- Develop an international initiative to link debt with climate and nature
- Prioritise this agenda in climate and nature meetings in 2022 and raise it as a key outcome for the 27th United Nations Climate Change Conference (COP27) in November 2022. The UN is well positioned to play a key role in this process, despite carrying less weight than the international financial institutions (IFIs) on debt instruments.

⁴ Non-Annex I countries are a group of Parties to the United Nations Framework Convention on Climate Change (UNFCCC) that are outside the Annex 1 Parties (which are the group of industrialised countries)

Introduction



Low-income country debt rose by 12% to a record US\$860 billion⁵ in 2020 – the latest year for which global debt data are available. The rise in government debt in both low-income and also across developing and emerging market economies is of particular concern. Across these economies, government debt rose by nine percentage points to 63% of GDP in 2020, the fastest one-year increase in the past 30 years. The sharp rise in debt levels and fall in growth resulting from the external shocks of the COVID-19 pandemic and the Ukraine conflict has exacerbated and continues to exacerbate existing debt vulnerabilities.

Fiscal space was seriously undermined during the pandemic. This led to debt service difficulties with the urgent need to spend on health and other related areas, while repayments on existing debt also took an increasing share of scarce government revenues due to the economic slowdown.

As a result, several countries are already in debt distress⁶ and additional episodes of distress are to be expected in both low- and middle-income countries.⁷ As of April 2022, the International Monetary Fund (IMF) had found that 60% of low-income countries were already in, or at high risk of, debt distress and would find it increasingly difficult to service their debts.⁸

According to the World Bank,⁹ an encompassing approach to managing debt is needed to help low- and middle-income countries assess and curtail risks and achieve sustainable debt levels. Such an approach would need to include debt reduction, rapid debt restructuring and improved debt transparency. Many of these low- and middle-income countries that are facing growing debt challenges are also among the most climate-vulnerable and biodiversity-stressed countries in the world. They are facing a triple crisis of debt, climate and nature loss.¹⁰

The international community has brought in initiatives to support countries' debt situations. Among these are the Debt Service Suspension Initiative (DSSI), which was an opt-in debt suspension scheme running between May 2020 and December 2021; the Common Framework for Debt Treatments beyond the DSSI, through which the Group of Twenty (G20) countries are seeking to provide more comprehensive support to countries in debt distress, although only Chad, Ethiopia and Zambia have so far requested this support; and

the 2021 special drawing rights (SDRs) issuance, of which countries with higher drawing right allocations are seeking to redirect a portion of their drawing rights through the Resilience and Sustainability Trust (RST). Although the RST is a useful channel for opening up much needed long-term climate support while providing liquidity in times of need, it is not designed for managing short-term debt crises.

These solutions have so far provided too little support: the DSSI only suspended repayments for a short period and did not address any of the structural issues that had been building up through the external shocks, and the support under the Common Framework has been difficult and slow; they have been inaccessible to countries (as illustrated, for example, by the lack of take up of DSSI and the Common Framework, and also by the limited eligibility criteria); and they have sought to address crises in silos.¹¹ Instead, what is needed are integrated solutions that coherently respond to all three crises of debt, climate and nature to provide the most effective way forward.

One such integrated solution is in the form of climate and nature-linked debt financing – a type of innovative financial instrument that could be employed (as part of a broader toolbox) to coherently address the triple crisis.¹²

For countries in which there is rising debt, and where comprehensive debt relief and restructuring could significantly improve macroeconomic health, a comprehensive international debt relief programme, similar to – but learning from the lessons of – the HIPC, MDRI and Brady Plan programmes, could provide the much-needed large-scale support. A key lesson from the HIPC experience was that the recipients needed to ensure that the freed-up funding was channelled, in addition to poverty reduction activities, towards growth-enhancing activities (those that support low-carbon, climate resilient development pathways) as these would provide sustained growth to the economies and build resilience to climate and nature shocks.¹³ This is crucial to medium- and long-term macroeconomic health. The fiscal conditions of such a debt relief programme could therefore include commitments to achieving national climate and nature objectives, as laid out in NDCs, National Biodiversity Strategies and Action Plans (NBSAPs) and other relevant strategies.

⁵ World Bank (11 October 2021) Low-income country debt rises to record \$860 billion in 2020. Press release. <https://bit.ly/3mYoRFa>

⁶ IMF (2021a) provides a list of low-income countries' debt sustainability analysis (DSAs) for Poverty Reduction and Growth Trust (PRGT)-eligible countries. The list captures the risk of debt distress rating for each country. <https://www.imf.org/external/Pubs/ft/dsa/DSAlist.pdf>

⁷ From Special Focus, GEP, 2022

⁸ Georgieva K and Pazarbasiglu, C (2 December 2021) The G20 common framework for debt treatments must be stepped up. *IMF Blog*. <https://bit.ly/3mVtW1k>

⁹ World Bank (2022b) International debt statistics 2022 report. <https://bit.ly/39xEAbI>

¹⁰ Steele, P and Patel, S (2020) Tackling the triple crisis: using debt swaps to address debt, climate and nature loss post-COVID-19. IIED, London. <https://pubs.iied.org/16674iied>

¹¹ Nagle, P. (2022) 5 lessons from past episodes of debt relief. World Bank. <http://bitly.ws/sC7Y>

¹² Patel, S, Steele, P, Kelly, L and Adam, J (2021) Innovative financing for Africa: harnessing debt for climate and nature. IIED, London. <https://pubs.iied.org/20486iied>

¹³ Usereev, D (2021) Redesigning debt: lessons from HIPC for COVID, climate and nature. IIED, London. <http://pubs.iied.org/20276IIED>

Debt instruments for climate and nature



2.1 What are debt instruments for climate and nature?

Debt instruments for climate and nature are an innovative type of financial instrument that seeks to promote debt sustainability and climate and nature action. These instruments can offer substantial financial benefits for countries seeking to reduce their emissions, adapt to climate change and protect their natural environment, while also attempting to manage rising debt burdens. They have the potential to improve debt sustainability while mobilising new sources of capital with attractive terms.

The instruments would need to be employed as part of a broader toolbox of actions to address the triple crisis of debt, climate and nature. A country's debt management strategy could involve the use of a combination of instruments with different purposes to help improve the debt portfolio while addressing other key priorities.

Debt instruments for climate and nature can include a range of structures. For simplicity, the analysis in this paper focuses on the following two instruments, explored in more detail in previous IIED research:¹⁴

- **Debt swaps for climate and nature**¹⁵ where countries seek restructuring of their existing debt portfolios. This applies to countries which may or may not be in debt distress, as some countries have high but not necessarily unsustainable debt burdens. Transactions can be conducted as bilateral or multilateral agreements between the government and its creditors, where the creditors forgive the debt in exchange for a commitment by the debtor government to use the outstanding debt service payments for national climate and nature action. Alternatively, the restructuring can be facilitated as market transactions by a third party, such as an environmental nongovernmental organisation (NGO) that buys back the debt more cheaply on the secondary market for the country, with the savings for the debtor country going towards climate and nature financing. The underlying mechanism is to exchange debt service payments with an obligation to channel funds towards climate and nature outcomes.

While debt swaps can take many forms and structures, they are often associated with the 'debt for nature swap' transactions that were undertaken in the 1980s and 90s. The development of the HIPC/MDRI initiative reduced the need for these transactions, so there are few examples of debt swaps since then. These past swaps were also small in scale and limited in scope. Steele and Patel (2020) and IIED et al. (2021) discuss how these swaps can be updated and upscaled for the current context.

- **Sustainability-linked bonds**, where countries seek to raise discounted liquidity for any purpose, while simultaneously pursuing their own national sustainability goals. These bonds provide general purpose-use finance, meaning the use of the funds are unrestricted. These bonds are issuable by countries with market access and can be a preferable alternative to a debt swap as they would not affect their existing debt portfolios. They are designed to make use of coupon and/or principal adjustments that are dependent on the delivery of measurable climate and nature outcomes, captured as key performance indicators (KPIs). KPIs are pre-formulated metrics for measuring the issuer's progress towards one or more of the country's sustainability objectives. Each KPI would be formally evaluated by an outside party at a predetermined reference date, which would then trigger any previously agreed alterations to the financial structure of the bond.

SLBs are very nascent instruments, they build upon previous sustainability instruments and mechanisms, and have largely been used to date in the commercial sector. The first public sector SLB was issued by Chile in 2022. This is a new and innovative instrument that holds great potential to mobilise finance within the current context of the triple crisis of debt, climate and nature. It is therefore important that this instrument is adequately supported and scaled up.

Debt swaps for climate and nature and sustainability-linked bonds are related but are used for different purposes. Debt swaps are useful when high debt burdens and limited fiscal space prevent a country from being able to invest in climate and nature. By swapping their debt for investment in climate and nature, the instrument provides a way to address the three issues together. Doing so also strengthens their economy, as investing in climate and nature both builds resilience to future climate and nature shocks and represents 'productive investment', as it stimulates growth and productivity.

¹⁴ IIED, Potomac Group LLC, UNECA, UNESCWA and UNDP (2021) Linking sovereign debt to climate and nature outcomes: a guide for debt managers and environmental decision makers. IIED, London <https://pubs.iied.org/20651iied>

¹⁵ Steele, P and Patel, S (2020) Tackling the triple crisis: using debt swaps to address debt, climate and nature loss post-COVID-19. IIED, London. <https://pubs.iied.org/16674iied>

Sustainability-linked bonds are used in the context where a country has market access, and could involve that country reissuing or rolling over existing debt or issuing new debt. These bonds also feature a strong commitment to investing in climate and nature activities. This instrument may be less accessible for countries restructuring through debt swaps. However, as those countries' economies get stronger because of their debt swap operations – writing off bad debt and investing in growth-enhancing interventions – sustainability-linked bonds would be a useful instrument to transition towards. Given the general purpose-use finance that is raised through such bonds, and the need to mainstream climate and nature across economic decisions moving forward, these bonds could become a useful tool to support finance ministries with their debt management and financing operations. They could be particularly advantageous in comparison to green or blue bonds, which are 'use of proceeds' bonds (ie where the money raised through the bonds is already fully earmarked for particular activities; in the case of green or blue bonds, this would be for financing new and existing, but pre-agreed, projects or activities with positive environmental impacts).

2.2 Where are these instruments being used?

These new innovative instruments have become increasingly relevant given the current context of external shocks leading to high debt levels and the need for high levels of climate and nature finance. As these instruments are still very nascent, concerted efforts are required at all levels and from all actors involved in the financing and investment ecosystem to support and build momentum in this space. Examples of where these and similar instruments are being used in practice include:

- Debt swaps for climate and nature:
 - The government of Jamaica engaged in a debt-for-nature swap in 2004 with the US government and The Nature Conservancy (TNC), mobilising US\$16 million over 20 years for forest conservation activities.¹⁶
 - The government of Seychelles developed an agreement with Paris Club members in 2016, also supported by TNC, which resulted in the creation of a US\$22 million investment in marine conservation.¹⁷
 - The government of Belize issued US\$364 million in blue bonds to buy back US\$550 million of commercial debt in September 2021, and is using the funds saved to support efforts to restore debt sustainability and finance marine conservation.¹⁸
- Sustainability-linked bonds:
 - The government of Chile issued a US\$2 billion sustainability-linked bond in March 2022 with two KPIs geared towards reducing emissions and increasing Chile's use of renewable energy.¹⁹
 - The government of Benin issued a €500 million 12.5-year Sustainable Development Goals (SDG) bond in July 2021. The bond is linked to Benin's SDG framework and based on the prioritisation of the most pressing targets and on the total cost to achieve them.²⁰
 - The government of Mexico issued a €750 million seven-year SDG bond in September 2020²¹ and issued a second €1,250 million 15-year SDG bond in July 2021. The approach emphasised Mexico's commitment to their Agenda 2030 for Sustainable Development objectives.²²

¹⁶ US Department of State (2004) Jamaica (04-0921) – Agreement Regarding a Debt-for-Nature Swap to Prepay or Cancel Certain Debt Owed by the Government of Jamaica to the Government of the United States. Office of Treaty Affairs. <https://www.state.gov/04-0921>

¹⁷ Seyccat (2019) Case study: Debt-for-Nature Finance Swap. The Commonwealth <http://bitly.ws/sC8a>

¹⁸ Owen, N. (2022) Belize: Swapping Debt for Nature. IMF <http://bitly.ws/sC8b>

¹⁹ BNP Paribas (2022) Chile sets a trend with first sovereign sustainability-linked bond. BNP Paribas <http://bitly.ws/sC8d>

²⁰ Caumes, A. and Merle, C. (2021) Republic of Benin's trailblazing €500m 12.5-Y inaugural issuance under its new SDG Bond Framework. Natixis Corporate and Investment Banking <http://bitly.ws/sC8e>

²¹ Quairet, A-L. (2021) The Federal Government of Mexico released its first SDG Bond Allocation and Impact report. Natixis Corporate and Investment Banking <http://bitly.ws/sC8m>

²² White, R. (2020) Mexico's € 750 7-year inaugural SDG Bond met strong investors' appetite. Natixis Corporate and Investment Banking <http://bitly.ws/sC8g>

The potential mobilisation from debt instruments for climate and nature

3

This analysis has developed an estimate of the scale of financing that could be mobilised for climate and nature through climate and nature-linked restructuring of existing debt and from new debt issuances. The objective of this estimate is to show the potential for linking such instruments to climate and nature priorities and to highlight this form of innovative financing as an important mechanism for creditors, debtors and the climate and nature community to engage with.

The estimate presented is broad, and it is acknowledged that further work would be needed to ensure greater accuracy of the estimated figure.

Countries that can afford to raise more sustainable financing would need to revisit their future borrowing plans so that environmental, social and governance (ESG) considerations are mainstreamed. Climate and nature financing should become part of the national financing framework. For debt-distressed countries, we continue to call upon the international community to come up with the right solutions to deal with the triple challenge of the onerous debt burden and climate and nature crises faced by an increasing number of countries.

3.1 Methodology

This paper reviews the volume of public and publicly guaranteed (PPG) external debt that could be restructured (for example, through debt for climate and nature swaps) and new PPG external debt that could be issued (for example, through sustainability-linked bonds) under a climate and nature-linked debt management approach.

This analysis is based on simplified calculations, as the purpose is to present an estimate that can illustrate the potential of this approach in terms of scale, rather than to provide a precise working of the amount of financing that could be mobilised by each country. Public data limitations would quickly limit closer scrutiny of existing debt stocks and financing plans. A more precise and detailed study would be better undertaken by country actors, led by national debt management offices, on a country-by-country basis.

The analysis uses the country's projected PPG external debt-to-GDP ratio as a measure of external debt sustainability. It does not consider the total debt of a country – that is, including domestic debt – as external

debt remains the largest component of total public debt in most LICs, and the most relevant at an international level, where international support is being provided overwhelmingly as loans²³ and where this support can be reassessed.

This ratio is compared to the Debt Sustainability Framework/Debt Sustainability Analysis (DSF/DSA) thresholds to determine whether there is fiscal space available.²⁴ The debt sustainability threshold varies by country depending on whether a country has weak composite index (CI) value or a strong CI value. This measure illustrates whether and how much borrowing space a country has available.

The paper then reviews the present value (PV) PPG external debt against the present value external debt sustainability thresholds. The DSF/DSA uses the PV of external debt to account for favourable concessional borrowing terms. Only the DSF/DSAs of Poverty Reduction and Growth Trust (PRGT)-eligible countries provide values for the PV of PPG external debt. For non-PRGT-eligible countries²⁵ the analysis adjusts the nominal external debt values to PV terms. According to the LIC DSF, debt is considered concessional when it includes a grant element of at least 35%. The grant element is the difference between the PV of debt and its nominal value expressed as a percentage of the nominal value of debt.

For simplicity, in this analysis it is assumed that the threshold of debt in PV terms therefore reflects 65% of the nominal value. The nominal debt values are therefore multiplied by 0.65 to be compared with the PV thresholds. Alternatively, the thresholds could be raised by a factor of 1.538462 ($1/65 \times 100$), in order to be comparable with the nominal debt values.

If the PV PPG external debt-to-GDP ratio is higher than the country specific 'high risk' PV threshold for PPG external debt-to-GDP ratio, then the analysis considers the difference as the amount of debt that must be reduced as a minimum.

Whether each debt is going to be put in the basket for securing debt relief or restructuring will depend on the type of debt and its terms – for example, whether the debt has a debt guarantee or not and whether it is concessional debt or non-concessional debt (see Section 4).

²³ More than 70% of climate finance is being delivered in the form of loans, which is increasing debt levels of already highly climate vulnerable countries. OECD (2020) Climate finance provided and mobilised by developed countries in 2013–18: key highlights. <https://bit.ly/3kOJ7sD>

²⁴ The Debt Sustainability Framework (DSF) is the main tool multilateral institutions and other creditors use to assess risks to debt sustainability in lower-income countries. The Debt Sustainability Analyses (DSAs) are structured examinations of developing country debt based on the DSF. See Annex 2 for more detail.

²⁵ IMF (2013) Staff guidance note for public debt sustainability analysis in market-access countries. <https://bit.ly/3mVoSK4>

3.2 Group of countries considered

This analysis looks at countries raising finance for climate and nature support. It considers the 154 Non-Annex I Parties to the Paris Agreement plus three additional non-overlapping fragile and conflict-affected situation (FCAS)-countries as the potential pool of countries that might either be part of an international debt relief initiative or that might issue new debt to raise finance for climate and nature actions. From this pool, 117 countries are classified as falling into one or more of the following categories:

- Low-income countries (27 countries)²⁶
- Least developed countries (LDCs) (46 countries)²⁷
- PRGT-eligible (70 countries)²⁸
- Small island developing states (SIDS) (38 countries)²⁹/Alliance of Small Island States (AOSIS) (39 members)³⁰
- Vulnerable Twenty Group (V20) members (48 countries)³¹
- FCAS³² (37 countries).³³

These countries are particularly vulnerable, have lower access to markets and are more likely to be eligible for concessional financing.

Attention to the particular vulnerabilities of different groups of countries is important in providing climate and concessional support. For example, some Caribbean SIDS have been disqualified from debt-relief initiatives in the past due to relatively high GDPs.³⁴ But these countries face existential threats from climate change and require special consideration. In response, AOSIS has proposed the use of a multi-dimensional vulnerability index, which would acknowledge the special circumstances and vulnerabilities of SIDS and not disqualify access to innovative financial instruments on the basis of GDP.³⁵

In previous studies IIED has analysed this pool of Non-Annex I countries against four criteria to identify countries for which a climate- and nature-linked debt management approach could be most suitable:³⁶

- Climate risk
- Nature risk
- Creditworthiness
- External debt stocks as a percentage of GDP.

This analysis categorises the pool of 157 countries into two groups (Group 1 and Group 2), based largely on the data for the PRGT-eligible group of countries, because these countries had detailed World Bank/IMF Article IV debt sustainability analysis information to draw on.³⁷ The analysis makes crude extrapolations of the calculations to include the countries in each group for which there is no data.

3.2.1 Group 1: Countries in or at high risk of debt distress

For countries that are in debt distress or at high risk of debt distress, debt relief is considered necessary to bring down their debt burden (to a level they can 'carry') and that a portion of this debt relief could be directed towards climate funding. Fifty-eight countries are included in this group, of which data was available for 47 countries.

For countries that are **in debt distress**, a significant portion of the debt holdings will need to be forgiven and extensively restructured. Climate and nature linkages could be some of the conditions of restructuring during such a process to promote future debt sustainability by making an economy more climate resilient or by contributing to a green and sustainable economy. Debt relief processes always seek to bring the levels of debt down to below 'high risk' to at least at or below 'medium risk'.

²⁶ World Bank (a), World Bank country and lending groups, <http://bitly.ws/sC8n>

²⁷ UNCTAD list of Least Developed Countries <https://unctad.org/topic/least-developed-countries/list>

²⁸ IMF (2021a) List of LIC DSAs for PRGT-eligible countries as of May 31, 2022. <https://www.imf.org/external/Pubs/ft/dsa/DSAlist.pdf>

²⁹ UNOHRLLS List of SIDS <https://www.un.org/ohrlls/content/list-sids>

³⁰ AOSIS Member States <https://www.aosis.org/about/member-states/>. The groupings of SIDS and AOSIS largely overlap, with three exceptions: Bahrain is included in the SIDS grouping but not the AOSIS grouping; and the Cook Islands and Niue are included in the AOSIS grouping but not the SIDS grouping.

³¹ V20 members <https://www.v-20.org/members>

³² The three FCAS countries that do not belong to the Non-Annex I Parties group are: Kosovo, Ukraine, and West Bank and Gaza. These countries have been kept in the analysis because although not part of the Non-Annex I Parties, the FCAS contexts make these countries vulnerable, and may be the case that they would receive greater access to concessional financing of some types to support their situations.

³³ World Bank (2022c) List of Fragile and Conflict Affected States <http://bitly.ws/sC8p>

³⁴ Fuller, F, Zamarioli, L, Kretschmer, B, Thomas, A and de Marez, L (2018) Debt for climate swaps: Caribbean outlook. Climate Analytics. <https://bit.ly/3mUvSqM>

³⁵ UN General Assembly (2020) A /74/943. <https://bit.ly/3xzF60j>

³⁶ Steele, P and Patel, S (2020) Tackling the triple crisis: using debt swaps to address debt, climate and nature loss post-COVID-19. IIED, London. <https://pubs.iied.org/16674iied>

³⁷ Please see Annex 2 for more detail on the data sources.

The countries currently classified as ‘in debt distress’ are:

- Chad
- Congo (Republic of)
- Grenada
- Mozambique
- São Tomé and Príncipe
- Somalia
- Sudan
- Zimbabwe

For the 32 countries that are currently classified as at **high risk** of debt distress, a reduction would be needed in the debt stock to return to at least medium risk, and it is expected that the remaining debt stock could be restructured to provide debt, climate and nature benefits.

Of these 32 countries at high risk of debt distress, 24 countries have some amount of borrowing space before breaching their sustainable PPG external debt-to-GDP ratio threshold. However, owing to other factors (such as their debt service to exports or debt service to revenues exceeding DSA thresholds)³⁸ they are considered to be at high risk of debt distress.

Some countries are only at moderate risk of debt distress, but are included in this group because their debt is close to breaching their country specific ‘high risk’ threshold for present value of PPG external debt-to-GDP ratio:

- Georgia
- Kyrgyzstan
- Lesotho
- Liberia
- Nicaragua
- Rwanda
- Senegal

Previous debt relief initiatives³⁹ have shown that even under debt relief (outright debt write-off), it is still possible to direct (local currency equivalent) savings from debt relief towards poverty reduction projects – and, in the current case, into climate and nature

programmes that strengthen the economic resilience of those countries and therefore their future debt-carrying capacity. Before the HIPC Initiative, eligible countries were, on average, spending slightly more on debt service than on health and education combined. With HIPC, they have increased markedly their spending on health, education and other social services. On average, such spending increased by about five times the amount of debt-service payments.⁴⁰ Under the HIPC initiative the net present value of bilateral debt was reduced by 60%,⁴¹ under MDRI the net present value of multilateral debt was reduced by 100%, and under the Brady Plan the value of commercial debt was reduced by 37%. This analysis is based on the assumption of a similar reduction in the net present value of debt today.

UNCTAD (2020) provides a breakdown of long-term public and publicly guaranteed external debt by creditor across developing countries. In low-income developing countries, official bilateral creditors hold 34% of debt, official multilateral creditors hold 55% of debt and private creditors (bond investors) hold 1.8% of debt. These proportions shift slightly in middle-income developing countries, with debt being held in more even proportions across the three creditor groups. Given these proportions, our analysis takes an average of the 60% bilateral debt forgiven under HIPC and the 100% multilateral debt forgiven under MDRI, simplifying the calculation to an overall 80% reduction in debt forgiven of the net present value of total debt.⁴²

The total present value PPG external debt holdings of the 47 countries in this group for which there is data is calculated. This estimate is then extrapolated to provide an estimate for all of the 58 countries included in this group. The 80% reduction in the present value of the debt is then calculated as an estimate of the amount of debt that could be reduced under an updated HIPC-type initiative.

In a 2016 report annex,⁴³ the UK government found that “overall, debt relief worth over [US]\$76 billion has been agreed under HIPC for 36 countries so far. This has reduced their debts, on average, by around two-thirds, and freed up roughly \$1 billion a year for

³⁸ The DSF/DSA helps to determine the risks of debt distress, taking account of a country’s capacity to carry debt and its projected debt burden under both baseline projections and shock scenarios. As part of this, the DSA considers a country’s overall debt sustainability position by looking at various factors related to public and external debt. As well as PPG external debt to GDP, the DSAs also calculate sustainability thresholds for debt service to export and debt service to revenues. See the LIC DSF guidance note – IMF (2018) Guidance note on the bank-fund debt sustainability framework for low-income countries. <https://bit.ly/39w1Fv8>

³⁹ This analysis draws on the experiences of previous umbrella initiatives which have sought to resolve debt distress through coordinating multiple creditors and debtor countries within common frameworks. These have included the Multilateral Debt Relief Initiative (MDRI) from 2005; the Heavily Indebted Poor Countries (HIPC) Initiative from 1996; the Brady Plan from 1989; and the Paris Club which was established in 1956. See Annex 1 for more detail on lessons from the HIPC initiative. See also Nagle, P. (2022) for more info lessons on these initiatives <https://blogs.worldbank.org/developmenttalk/5-lessons-past-episodes-debt-relief>

⁴⁰ IMF (2016) Debt Relief Under the Heavily Indebted Poor Countries Initiative <http://bitly.ws/sC8t>

⁴¹ World Bank (2022a) Resolving high debt after the pandemic: lessons from past episodes of debt relief. Global Economic Prospects. <https://bit.ly/3y5EPUJ>

⁴² UNCTAD (2020) From the Great Lockdown to the Great Meltdown: Developing Country Debt in the Time of Covid-19 https://unctad.org/en/PublicationsLibrary/gdsinf2020d3_en.pdf?user=1653

⁴³ UK Government (2016) Annex 3 – Debt Relief <http://bitly.ws/sC8v>

spending on poverty reduction". If an estimate of the period of debt relief across which the US\$76 billion was freed up was 20 years, this would mean that approximately 26.3% of the amount of funding freed up was being spent on poverty reduction. Following this example, this analysis takes 26.3% of the estimated debt reduction as an estimate of the amount of finance that could be channelled towards development and environment objectives. Given the interrelated activities between climate action, spending on nature, and for poverty reduction, there is likely to be significant overlap in spending towards these objectives, meaning 26.3% could give a reasonable estimate of the amount that could go towards supporting climate and nature activities as a result of debt relief.

The resulting value is then converted from present value to nominal terms, to help with comparability.

3.2.2 Group 2: Remaining countries

For all other countries in the pool, this analysis looks at the fiscal gap by calculating the difference between the PPG external debt-to-GDP levels against the country-specific PPG external debt sustainability thresholds to estimate how much more they can borrow. The analysis assumes that new borrowing will be through SLBs aimed at general purpose use, including a proportion going to climate and nature investment while the rest is used for other national financing priorities.

Countries can both restructure existing debt and issue new debt; these are not mutually exclusive strategies. Some countries can issue market instruments (such as bonds) even if they have not done so before.

In considering new issuances of climate and nature-related debt, the analysis looks at the amount of borrowing that is possible without breaching the debt sustainability level. The level of new finance that can be issued is considered to be the difference between the current debt level and the sustainable debt threshold.

Existing debt can also be restructured or reissued into climate and nature-linked instruments. This could be through buying out existing debt and reissuing through a new instrument, or if the country has existing loans or bonds that are due to mature soon, by rolling those into new instruments.

For Group 2 countries, the amount of new debt to be issued is calculated as the volume of new issuance that would bring the country's debt to half of their threshold volume of debt to GDP. For example, if a country's sustainable debt threshold was 30% debt to GDP, and the country currently has 3% debt to GDP, this leaves borrowing space of 27% to GDP, of which the analysis suggests that 13.5% of the space could be used. This calculation of using up half of the fiscal space is an arbitrary one – to ensure countries do not overburden their fiscal space with new borrowing, balancing the need to make new issuances and maintaining some fiscal space.

With the use of the SLBs, which provide general purpose financing, as with the estimates for debt swaps – where the assumption is made that 26.3% of finance could be mobilised, drawing from the HIPC experience – this analysis also considers the scenario where 26.3% of financing is channelled to climate and nature.

Caveats and assumptions



There are a number of assumptions made in the analysis and a number of conditions that need to be in place in each eligible country for successful transactions of this nature.

4.1 Overarching assumptions

Overall, the analysis in the paper assumes that:

Finance mobilisation for climate and nature is a priority in national plans

Undertaking debt restructuring, refinancing or new issuances would strongly depend on national interest and ownership. If a country has integrated climate and nature planning into development planning and has a well-defined viable climate and nature investment strategy (co-developed and validated among national stakeholders through a whole-of-society approach using an inclusive and participatory process) and is seeking sources of finance to support initiatives under the strategy, this would help drive the momentum of the country to refinance or issue this type of debt, and also ensure that the conditions of such instruments are met. These strategies should integrate other cross-cutting priorities including gender equity. Demonstrating national interest and ownership would provide a strong indication to the market that the country is serious about meeting the conditions of the instrument, which would make the instrument more viable.

The success of issuing climate and nature-linked debt instruments therefore depends on appetite and progress that the country has made in terms of mainstreaming the climate and nature agenda across the national development agenda.

The country is undertaking active national debt management

This approach also builds in an assumption that countries are managing their debt well and will manage their debt well after debt refinancing, restructuring and/or new issuances. This also requires coordination between the country's ministry of finance and the ministries in charge of climate and nature responses.

This analysis has not looked at countries' future financing (and borrowing) plans in calculating the total amount available for climate and nature interventions. This would help understand where countries are planning to prioritise financing in the near future. For effective climate and nature-linked debt management, climate and nature would need to be mainstreamed into countries' future financing and borrowing plans.

A portion of the transaction is channelled to climate and nature

Another assumption made in the analysis is that around 26.3% of the finance mobilised from a transaction would be channelled to climate or nature action. This assumption is made as countries have multiple priorities, and climate and nature action is only one of many priority areas. Experience from national climate and nature financing indicates that these areas are receiving around 26.3% of the budget.

Further assumptions for group 1 and group 2 countries are as follows:

4.2 Group 1 countries

Overarching assumption: Group 1 countries could achieve large-scale debt relief and restructure agreements with their creditors

This analysis makes the assumption that Group 1 countries (countries in or at high risk of debt distress) could achieve large-scale debt relief and restructuring agreements with their creditors. Some considerations for this are outlined below.

80% of the present value of debt can and will be reduced

This figure is based on the HIPC and MDRI experience, where the net present value of debt was reduced by 60% and 100% respectively.⁴⁴ The HIPC and MDRI experiences show that this level of reduction is possible, but it required an overarching international initiative that outlined eligibility, scope and other factors, and charted out a process that all countries could follow. More details on learnings from HIPC and MDRI are outlined in Annex 1. The call for such an initiative is outlined in Section 6.

Most, if not all, creditors of a country would need to engage in the process to enable this level of net present value reduction. As well as public creditors, this includes private sector creditors, who have held an increasing amount of developing country debt in recent decades. Private sector creditors have participated in previous debt relief and restructuring efforts. For example, ten LDCs benefited from commercial debt reduction through the IDA Debt Reduction Facility.⁴⁵ This is an important consideration in a context where commercial actors are more reluctant to engage.

⁴⁴ World Bank (2022a) Resolving high debt after the pandemic: lessons from past episodes of debt relief. Global Economic Prospects. <https://bit.ly/3y5EPUJ>

The international community will provide timely and adequate debt support

There has been a persistent tendency by the international community to underestimate the scale of what has been needed, which has in itself contributed to the build-up of debt.⁴⁶ The Paris and London Club of private creditors' rescheduling through most of the 1980s were on non-concessional 'standard terms' with relatively short grace periods (five years) and maturity (ten years), and market-related interest rates. This inevitably led to repeated rescheduling and growth of the stock of debt.⁴⁷ Nagle (2022) notes that this delaying had severe economic consequences for the debtor countries. For example, in the countries under the Brady Plan, and notably those in Latin America and the Caribbean, there was a 'lost decade' of growth, with GDP per capita only recovering to its pre-crisis level by 1993.⁴⁸ This analysis considers the situation where debt relief and restructuring operations can help to reduce debt burdens for countries in debt distress and at risk of debt distress to a level they can carry.⁴⁹

Profiling debt stock

The profile and timeline of the country's debt stock will be important to consider. Not all debt would be eligible to restructure or write off. Nor might that be necessary.

For example, Bhutan has a high level of debt-to-GDP ratio. The World Bank/IMF DSA⁵⁰ finds that 77% of Bhutan's debt is from India for hydropower projects in Bhutan, and that this debt is closer in nature to foreign direct investment (FDI).⁵¹ The finance from India is under an intergovernmental agreement where the construction and financial risks are borne by the government of India, and surplus electricity is sold to India at cost plus 15% net return. So even though the external debt is high (98.8%) and breeches the DSA's sustainable debt thresholds for a country in Bhutan's position, because of the 'unique mitigating factors' of the hydropower debt, DSA does not conclude that Bhutan is at high risk of debt distress.⁵²

Previous debt finance restructuring

If a country has previously restructured debt finance, it will be important to consider the profile and timeline of that debt. Not all debt would be eligible for restructuring.

4.3 Group 2 countries

Overarching assumption: Group 2 countries would be able to roll over existing debt and/or issue new debt in the form of sustainability-linked bonds.

This analysis makes the assumption that the Group 2 countries could reissue existing debt and/or issue new debt in the form of sustainability-linked bonds, and that a proportion of the proceeds of the new finance raised would be directed to climate and nature. For a country to issue new bonds, the right macroeconomic and policy conditions would need to be in place. Some considerations are outlined below.

Market access

In considering the issuance of bonds, whether a country has market access is an important factor.

Some low- and middle-income countries may have already been accessing the market, but the pandemic and other shocks (climate, nature) are exacerbating debt problems and limiting their market access. These types of shocks can reduce access at times when it is most needed.

Involvement in debt management initiatives like the Debt Service Suspension Initiative (DSSI) or undertaking other debt management operations can result in a lower credit rating for the country. This will limit some countries' abilities to issue new debt on the market.

Previous debt finance issuances

If a country has raised debt finance on the market before, it will be important to consider the profile and timeline of that debt. New debt issuances would need to be considered in the context of the existing debt portfolio.

⁴⁵ UNCTAD (2000) The least developed countries report, 2000. Aid, private capital flows and external debt: the challenge of financing development in the LDCs. <https://bit.ly/3b3Ydbg>

⁴⁶ UNCTAD (2000) The least developed countries report, 2000. Aid, private capital flows and external debt: the challenge of financing development in the LDCs. <https://bit.ly/3b3Ydbg>

⁴⁷ 188 restructuring episodes were taken under the Paris Club, excluding the debt restructurings under the 'classic' terms (which did not offer debt relief) Nagle, P. (2022) 5 lessons from past episodes of debt relief. World Bank. <http://bitly.ws/sC7Y>

⁴⁸ Nagle (2022) also finds that among low-income countries, GDP per capita fell by an average of 0.2% per year between 1980-99, due to weak economic growth and high population growth. However, in the decade after debt relief, GDP per capita growth in the low-income countries of 2001 averaged 2.9% a year between 2001 and 2011. Nagle, P. (2022) 5 lessons from past episodes of debt relief. World Bank. <http://bitly.ws/sC7Y>

⁴⁹ UNCTAD (2000) The least developed countries report, 2000. Aid, private capital flows and external debt: the challenge of financing development in the LDCs. <https://bit.ly/3b3Ydbg>

⁵⁰ IMF and World Bank DSA (2018) Bhutan debt sustainability analysis <http://bitly.ws/sC8w>

⁵¹ IDA and IMF (2018) Joint bank-fund debt sustainability analysis – 2018 update. <https://bit.ly/3b7RMUV>

⁵² World Bank (25 July 2017) How much should Bhutan worry about its public debt? World Bank brief. <https://bit.ly/3zGvNhS>

Also, experience with previous debt finance issuances can be very advantageous in relation to capacity of the country's debt management team, including their familiarity with the process and their network of technical support and advisers.

The appetite of the market

The market situation is also an important factor. For example, if interest rates are high there might not be much to gain from a refinancing operation.

Similarly, whether there is appetite from investors for investing in a bond from a specific country may depend on market conditions and signals, which determine how risk averse the market is at any specific time.

Existing IMF programmes

If the country has an existing IMF programme, this may affect the operations it can undertake. IMF programmes usually require that the country does not borrow any more non-concessional debt and would require special permission therefore to issue a bond.

New debt terms

The analysis also makes the assumption that new instruments would be issued with debt terms that will support debt sustainability in the debtor countries, such as the inclusion of state-contingent debt clauses, which mean that in the event of a natural disaster debt service payments are paused.

Findings

5

5.1 Findings for Group 1 countries

For the first group of countries – debt distressed and at high risk of debt distress – the analysis finds that US\$262 billion in present value debt could have been eligible for debt relief for the 47 countries as of 31 January 2022. This amount could increase further as many more countries’ debt burdens are becoming unsustainable. Of this amount, the analysis finds these savings could represent US\$70 billion of present value financing – US\$105 billion in nominal terms – going to climate and nature priorities.

Table 1 shows the debt distress risk and present value of PPG external debt of the 47 Group 1 countries with data, and Figure 1 shows the average PPG external debt holdings per country by classification of risk of debt distress. Figure 2 shows the total present value PPG external debt held by the 47 countries in Group 1 for which there is data (blue and dotted areas combined). The bar chart in Figure 2 also shows the amount that could be reduced (dotted area) and the amount that could be redirected to climate and nature spending (area outlined in red).

Figure 1. Average PPG external debt holdings per country by classification of risk of debt distress

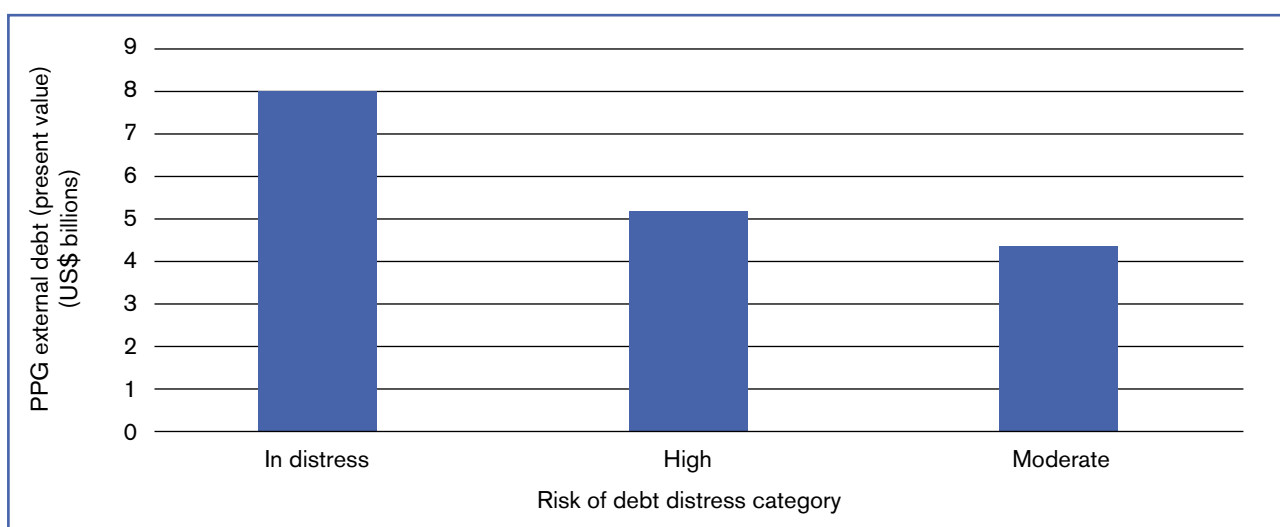


Figure 2. PPG external debt held by 47 countries in Group 1

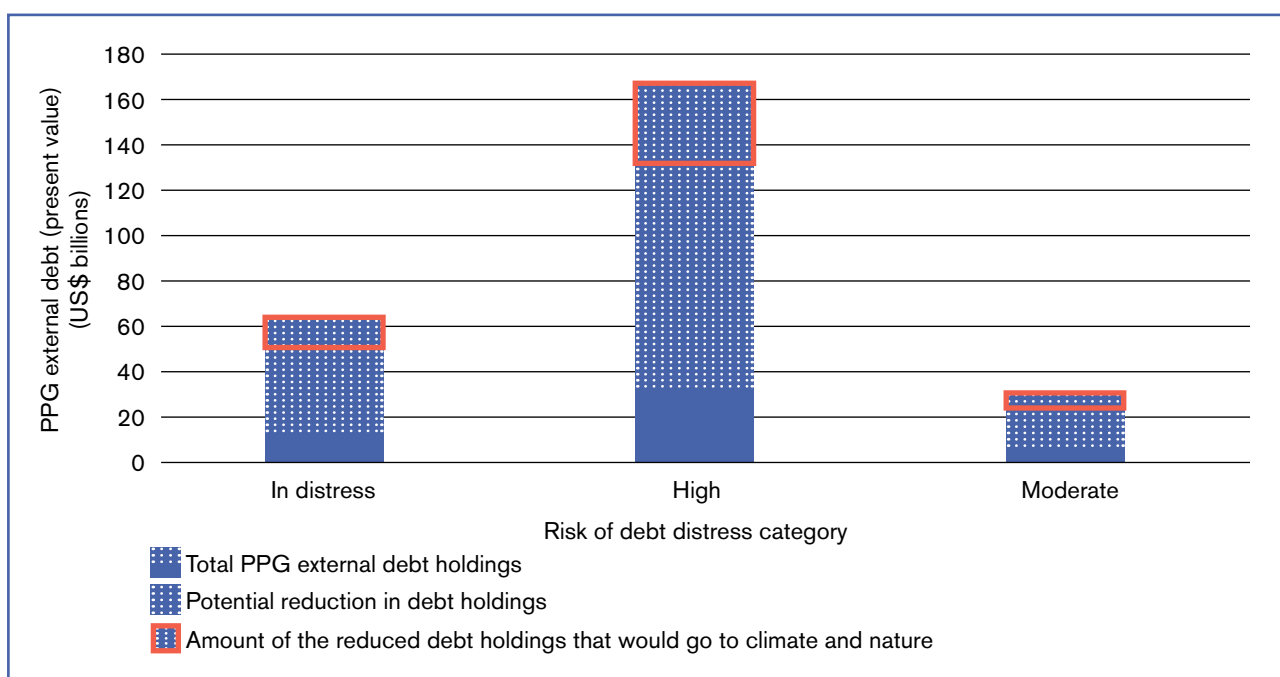


Table 1. Group 1 countries: debt-distress risk and present value of debt

COUNTRY	DEBT DISTRESS RISK ⁵³	PPG EXTERNAL DEBT (BASED ON PRESENT VALUE) (BILLIONS, US\$)
Sudan	In distress	37.9
Kenya	High	29.0
Angola	High	27.5
Ghana	High	27.3
Ethiopia	High	21.3
Senegal	Moderate	12.2
Cameroon	High	10.4
Mozambique	In distress	9.4
Zimbabwe	In distress	8.8
Mongolia	High	8.2
Laos	High	7.5
Georgia	NA	6.3
Papua New Guinea	High	5.5
Gambia	High	5.1
Rwanda	Moderate	4.0
Nicaragua	Moderate	4.0
Somalia	In distress	3.9
South Sudan	High	3.5
Mauritania	High	3.3
Chad	In distress	3.0
Kyrgyzstan	Moderate	2.9
Tajikistan	High	2.7
Malawi	High	2.5
Haiti	High	2.4
Djibouti	High	1.8
Maldives	High	1.5
Sierra Leone	High	1.5
Zambia	High	1.3
Cabo Verde	High	1.1
Afghanistan	High	0.9
Liberia	Moderate	0.8
Lesotho	Moderate	0.7
Congo (Republic of)	In distress	0.6
Central African Republic	High	0.5
Grenada	In distress	0.4
Saint Vincent and the Grenadines	High	0.3
Samoa	High	0.3
Burundi	High	0.3
Comoros	High	0.3
Dominica	High	0.2
Guinea-Bissau	High	0.2
Tonga	High	0.1
São Tomé and Príncipe	In distress	0.1
Republic of Kiribati	High	0.06
Marshall Islands	High	0.05
Micronesia	High	0.05
Tuvalu	High	0.001

⁵³IMF (2021a) List of LIC DSAs for PRGT-eligible countries as of May 31, 2022. <https://www.imf.org/external/Pubs/ft/dsa/DSAlist.pdf>

The analysis finds:

- The total amount of present value PPG external debt held by the 47 countries is US\$261.6 billion. That is **US\$402 billion** in nominal terms.
- The amount of debt that could be reduced, based on past debt reduction experiences (considering the case of a reduction in the 80% net present value of debt) is US\$209 billion. That is **US\$322 billion** in nominal terms. This nominal value is the amount that could be channelled to climate and nature if the full debt reduction was channelled towards those objectives.
- Of the amount of debt held by these countries, this analysis estimates that if 26.3% of these savings could be channelled to climate and nature, that would amount to **US\$84.7 billion** in flows.

These estimates of the amount of finance that could be mobilised for climate and nature are based on mobilisation over the period of the debt burdens that could be relieved. In other words, if a country's debt holding that is being reduced has a payback period of ten years remaining, then the amount redirected to climate and nature following that reduction would be an estimate of the amount that could be mobilised over the same timeframe of ten years – a redirection of the debt service payments during the same timeframe. Debt relief frees up the periodic debt repayment commitments, resulting in space in the budget.

For example, a country may owe X amount to a creditor. Depending on the structure of the loan, they might get the full amount of credit at the start of transaction, and then need to repay the debt over a period of time, such as ten years. Debt relief would then provide relief in relation to the outstanding repayment schedule, which therefore frees up space in the budget over time. This freed-up space could then be used to invest in national priorities, including nature and climate, and that may be made more tangible through an agreement with the creditor in redirecting the debt repayments to those priorities.

Also of note are the broader benefits of this approach. As the debt is reduced, the financing is redirected from the public budget to climate and nature objectives. This builds climate and nature financing into the public institutional architecture. The financing for climate and nature could consequently be expected to continue long after the original debt repayment timeline, meaning the amount mobilised would be increasing beyond US\$84.7 billion as time goes on.

5.1.1 The bigger picture

Comparing the debt mobilisation to the US\$100 billion Paris Agreement goal,⁵⁴ particularly focusing on the grant element of the mobilisation, as this is the amount that will not burden countries with further debt and is therefore most relevant to the debt swap context, the potential for mobilisation through debt swaps is high. The mobilisation under the US\$100 billion goal in 2019 was US\$16.7 billion. This is compared to the potential mobilisation of US\$84.7 billion for climate and nature from the debt reduction. As this amount would be delivered over several years, in the form of redirected debt service payments, this figure could represent upwards of a few billion per year – which would be a significant and much needed increase in the mobilisation of grant financing for climate action.

It is also notable that the US\$100 billion a year mobilisation goal has not yet been met.⁵⁵ Developed country parties have an obligation to develop a delivery plan and ensure that this goal is met as soon as possible. Debt for climate and nature swaps could be a key mechanism that these countries support in working to achieve this goal.

In addition to having significant mobilisation potential, these innovative climate and nature linked debt-management instruments provide other benefits for the debtor country's national systems, by helping to strengthen:

- National institutions' knowledge and financial capabilities
- National public financial management (PFM) systems
- Coordination and prioritisation of climate and nature
- Climate and nature investment frameworks and partnerships.

5.1.2 Extrapolating to include the countries without available data

From the larger pool of Non-Annex I countries, a potential 11 further countries could be categorised in the Group 1 category. Based on a crude average/extrapolation, the analysis finds:

- The total amount of present value PPG external debt held by the 58 countries is US\$323 billion. That is **US\$497 billion** in nominal terms.
- The amount of debt that could be reduced, based on past debt reduction experiences (considering the case of a reduction in the 80% net present value of

⁵⁴ UNFCCC (undated) Climate finance in the negotiations. <https://bit.ly/3b7TntT>

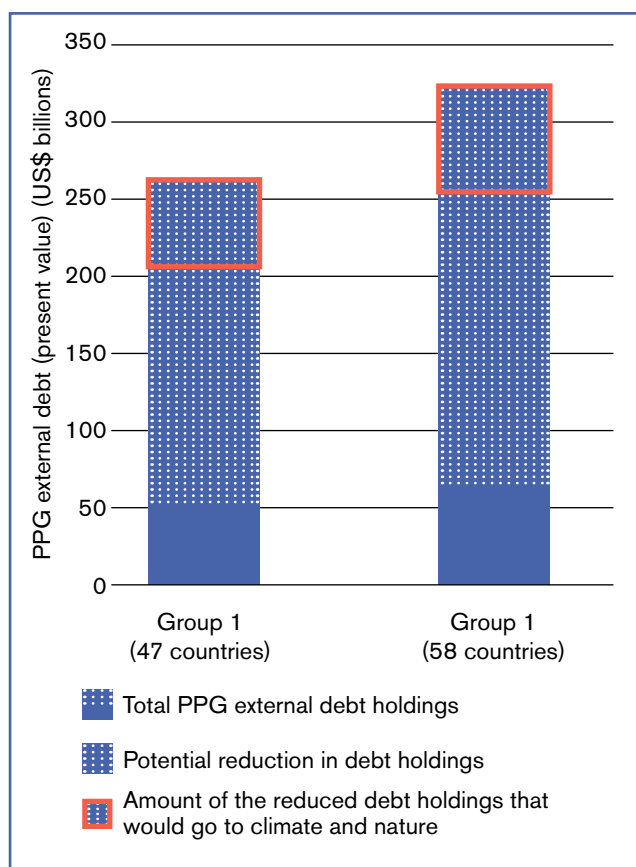
⁵⁵ OECD (2021) Statement from OECD Secretary-General Mathias Cormann on climate finance in 2019. <https://bit.ly/3xSRmur>

debt) is US\$258 billion. That is **US\$397 billion** in nominal terms. This nominal value is the amount that could be channelled to climate and nature if the full debt reduction was channelled towards those objectives.

- Of the amount of debt held by these countries, this analysis estimates that if 26.3% of these savings could be channelled to climate and nature, that would amount to **US\$104.5 billion** in flows (in nominal terms).

Figure 3 shows the total present value PPG external debt held by the 47 countries in Group 1 for which there is data (blue and dotted areas combined). It also illustrates the totals if this is expanded to the group of 58 countries (including the 11 countries that could be in this group but for which there is no data). Figure 3 also shows the amount that could be reduced (dotted area) and the amount that could be redirected to climate and nature spending (area outlined in red).

Figure 3. Potential PPG external debt holdings of the 58 countries that could be included in Group 1



5.2 Findings for Group 2 countries

Table 2 shows the current levels of sovereign borrowing space for countries in Group 2 by the end of 2020.

Table 2. Levels of sovereign borrowing space for Group 2 countries by the end of 2020

COUNTRY	SOVEREIGN BORROWING SPACE, END-2020 (PRESENT VALUE) (US\$ BILLIONS)
The Bahamas	3.1
Bangladesh	140.2
Benin	3.2
Bhutan	0
Botswana	5.7
Burkina Faso	4.0
Cambodia	8.6
Congo (Democratic Republic of)	0.2
Côte d'Ivoire	7.4
Egypt	21.1
Guatemala	14.0
Guinea	1.6
Guyana	1.5
Honduras	6.5
Madagascar	2.5
Mali	3.5
Moldova (Republic of)	4.8
Myanmar	22.2
Nepal	13.9
Niger	2.5
Nigeria	148.2
Saint Lucia	3.2
Solomon Islands	0.5
Tanzania (United Republic of)	13.8
Timor-Leste	0.6
Togo	1.6
Uganda	5.0
Uzbekistan	20.2

The analysis finds:

- The difference between the current debt level and the sustainable debt threshold for the 28 countries in Group 2 with data is **US\$706.9 billion**.
- Of this amount, this analysis estimates that about half – or **US\$353 billion** – could be used for new debt issuances.
- This analysis is based on the scenario where the new issuances take the form of sustainability-linked bond instruments, which provide general purpose finance linked to KPIs. Since these instruments provide general purpose finance, to support flexibility and country ownership, only a portion of the debt issuance would be directed towards climate and nature. The analysis estimates that 26.3% of the mobilised financing goes to climate and nature investment, this amounts to **US\$93 billion**. This is the amount that would be made available at the issuance of the debt instrument.

This increase in borrowing would represent an increase in debt-to-GDP ratios for each country. The analysis calculated mobilisation amounts based on countries borrowing a volume that decreases their remaining fiscal space by half. This borrowed financing would then be invested in growth-producing activities (such as climate and nature, education and gender equality). The expectation is that this would lead to growth in GDP at a rate higher than the cost of the debt servicing, leading to reductions in the debt-to-GDP ratio over time. Therefore, countries would then have more fiscal space to borrow larger amounts over time (see Figure 4).

5.2.1 Extrapolating to include the countries without available data

From the larger pool of Non-Annex I countries, a potential further 71 countries could be in the Group 2 category. Based on a crude average/extrapolation, the analysis finds:

- The difference between the current debt level and the sustainable debt threshold for the 99 countries in Group 2 is **US\$2499 billion** (see Figure 5).
- Of this amount, this analysis estimates that about half – or **US\$1249 billion** – could be used for new debt issuances.
- This analysis is based on the scenario where the new issuances take the form of sustainability-linked bond instruments, which provide general purpose finance linked to KPIs. Since these instruments provide general purpose finance, to support flexibility and country ownership, only a portion of the debt issuance would be directed towards climate and nature. The analysis estimates that 26.3% of the mobilised financing goes to climate and nature investment, this amounts to **US\$328.7 billion**. This is the amount that would be made available at the issuance of the debt instrument.

Figure 4. Potential new issuances and mobilisation for climate and nature

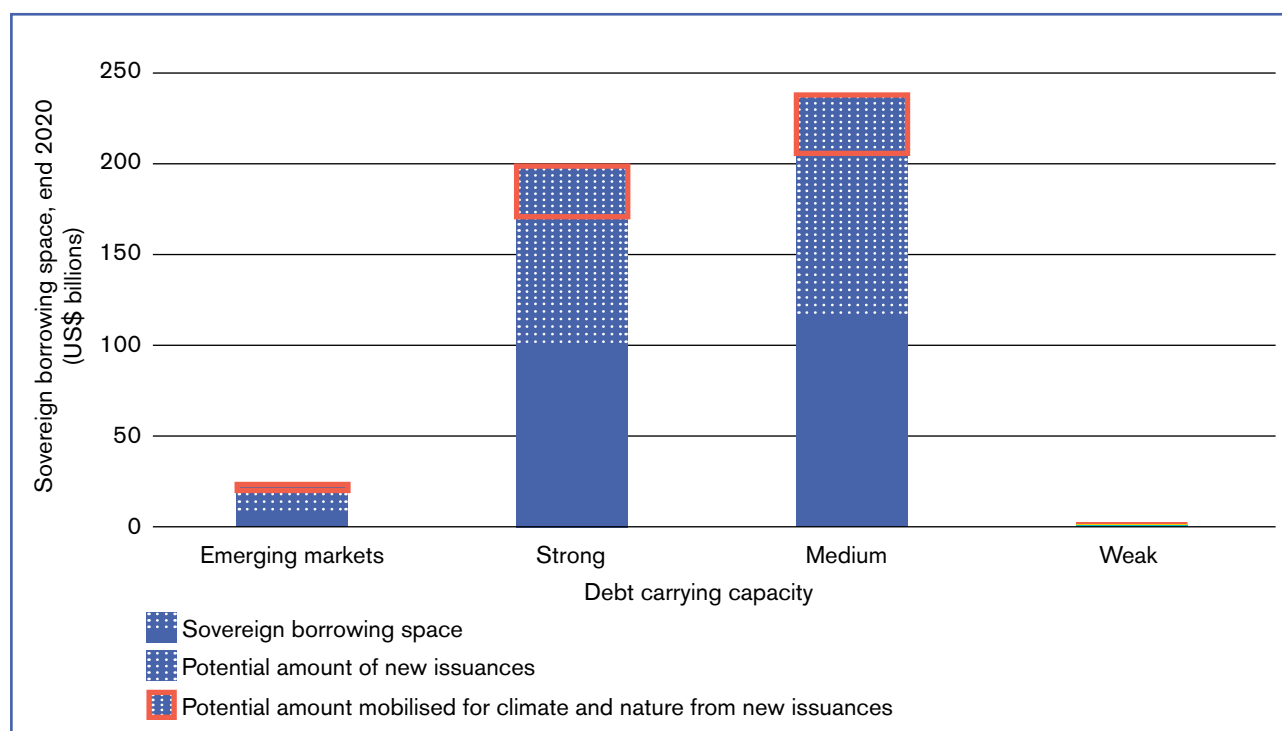
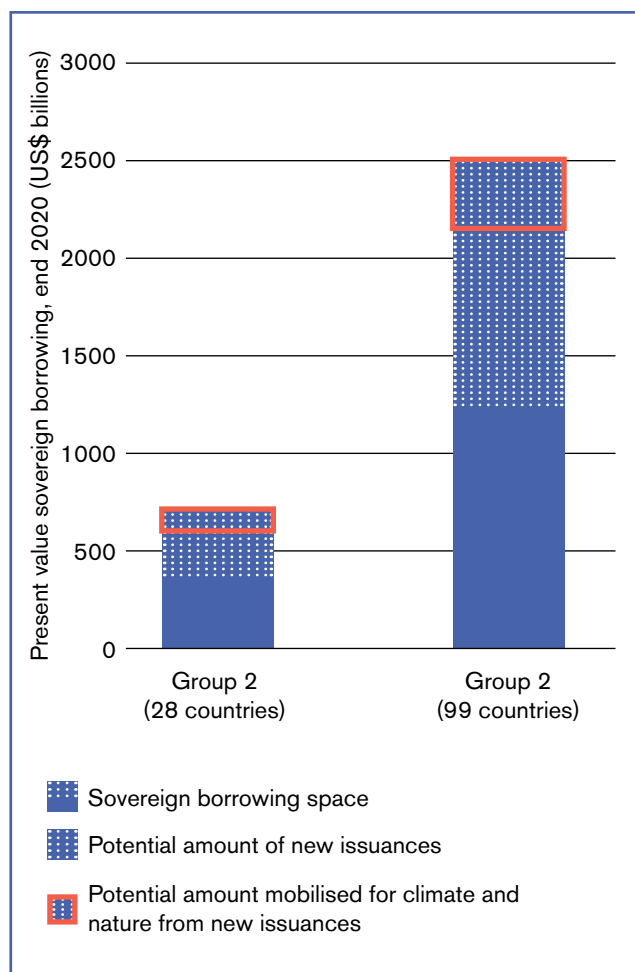


Figure 5. Potential new issuances and mobilisation if 99 countries were included in Group 2



An extrapolation from 28 countries to include a further 71 countries provides a highly unreliable estimate. But the analysis makes the case that the total that could be mobilised from the 71 additional countries would probably be much higher than that mobilised by the 28 countries for which there was data, because the majority of the 28 countries are PRGT-eligible countries, and the data has been taken from Article IV DSAs. This means that these are countries at the lower end of development, vulnerable to shocks or eligible for concessional financing for another reason. Therefore, it is likely that non-PRGT-eligible countries will have a higher capacity to borrow. This analysis does not account for these effects, so the total extrapolation is likely to be an underestimate.

5.3 Total financing mobilised for climate and nature action

The total amount of financing that could be mobilised for climate and nature across the sub-set of countries with data in a HIPC-style initiative that incorporates climate and nature priorities for debt forgiveness could be US\$84.7 billion. New issuances of KPI climate and nature performance SLB bonds could generate upwards of US\$93 billion for climate and nature for the countries included in the analysis with data. This would make a total of US\$177.7 billion of new climate and nature financing from the two groups.

Rough extrapolations across all Non-Annex I Parties finds that this amount could represent US\$105 billion among the first group of countries, and US\$329 billion among the second group, mobilising approximately US\$434 billion of financing for climate and nature. These transactions would also likely lead to high amounts of sustained financing beyond the debt/loan periods.

5.4 How would this mobilisation be distributed across different country groupings?

5.4.1 Low-income countries

Of the 27 low-income countries,⁵⁶ the analysis categorises 19 countries in Group 1 and eight countries in Group 2.

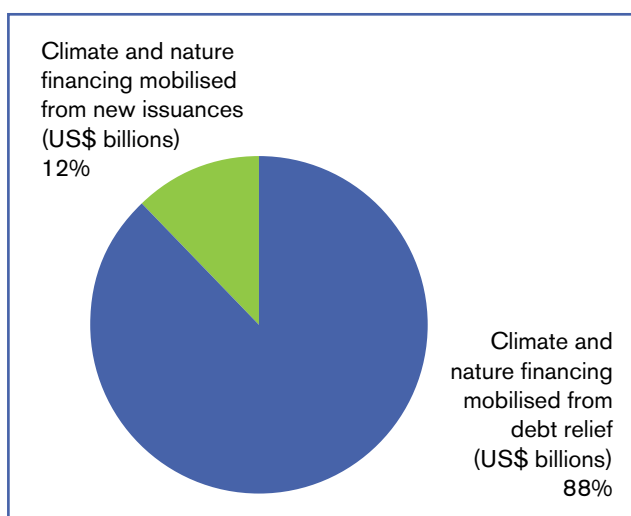
Of the 19 Group 1 countries, the analysis estimates that the amount of debt held is US\$173 billion. A HIPC-type initiative could help reduce this debt by US\$138 billion. Of this amount, approximately US\$36 billion could be mobilised for climate and nature.

The analysis estimates that the eight low-income Group 2 countries could mobilise US\$18.3 billion in new issuances, of which US\$4.8 billion could be directed to climate and nature.

Therefore, the analysis finds that approximately US\$40.8 billion could be mobilised from climate and nature-linked debt instruments (see Figure 6).

⁵⁶ World Bank (a) (undated) World Bank country and lending groups <http://bitly.ws/sC8n>

Figure 6. Potential climate and nature financing mobilised by debt instruments in low-income countries



5.4.2 Least developed countries

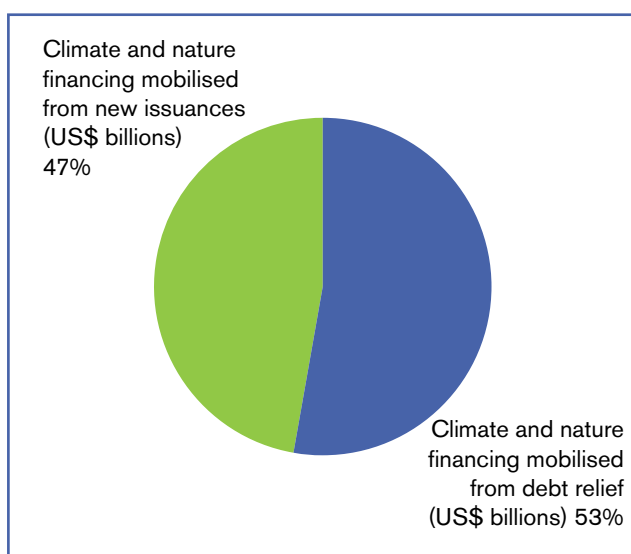
Of the 46 least developed countries, this analysis categorises 29 in Group 1 and 17 in Group 2.

Of the 29 Group 1 LDC countries, the analysis estimates that the amount of debt held is US\$244 billion. A HIPC-type initiative could help reduce this debt by US\$195 billion. Of this amount, approximately US\$51 billion could be mobilised for climate and nature.

The analysis estimates that the Group 2 LDC countries could mobilise US\$172.2 billion in new issuances, of which US\$45.3 billion could be directed to climate and nature.

Therefore, the analysis finds that approximately US\$96.3 billion could be mobilised from climate and nature-linked debt instruments (see Figure 7).

Figure 7. Potential climate and nature financing mobilised from debt instruments in LDCs



5.4.3 PRGT-eligible countries

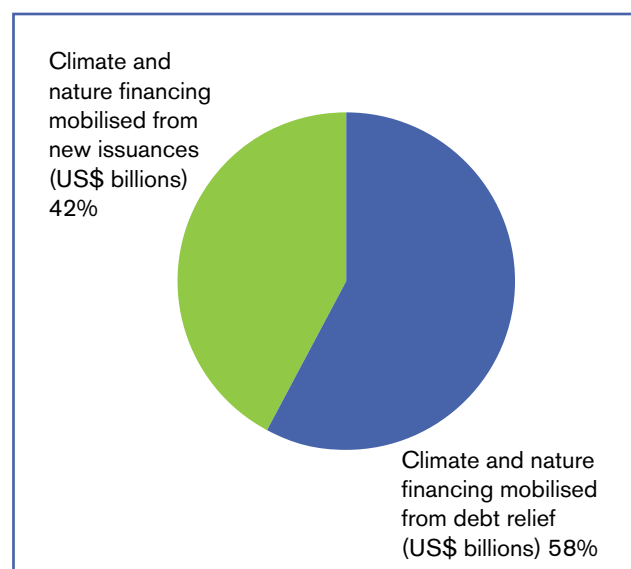
Of the 70 PRGT-eligible countries, this analysis would categorise 47 countries in Group 1 and 23 in Group 2.

Of the 47 Group 1 PRGT-eligible countries, the analysis estimates that the amount of debt held is US\$360.1 billion. A HIPC-type initiative could help reduce this debt by US\$288.8 billion. Of this amount, approximately US\$76 billion could be mobilised for climate and nature.

The analysis estimates that the Group 2 PRGT-eligible countries could mobilise US\$205.7 billion in new issuances, of which US\$54.1 billion could be directed to climate and nature.

Therefore, the analysis finds that approximately US\$130.1 billion could be mobilised from climate and nature-linked debt instruments (see Figure 8).

Figure 8. Potential climate and nature financing mobilised from debt instruments in PRGT-eligible countries



5.4.4 SIDS

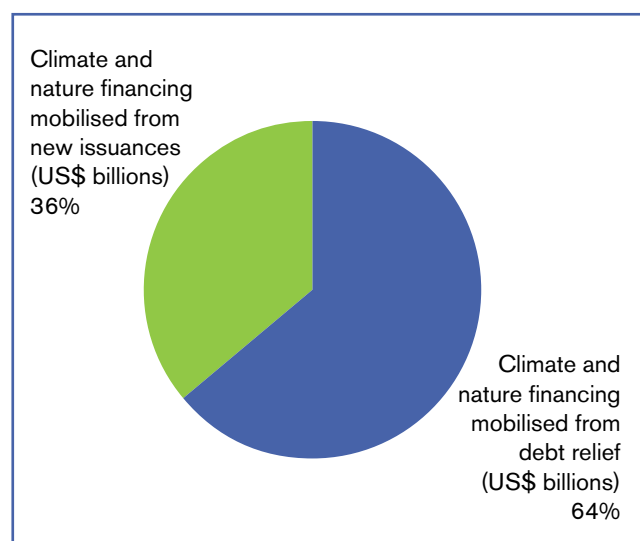
Of the 38 SIDS, this analysis categorises 29 countries in Group 1 and nine countries in Group 2.

Of the 29 Group 1 SIDS, the analysis estimates that the amount of debt held is US\$34.5 billion. A HIPC-type initiative could help reduce this debt by US\$27.6 billion. Of this amount, approximately US\$7.2 billion could be mobilised for climate and nature.

The analysis estimates that the Group 2 SIDS could mobilise US\$15.4 billion in new issuances, of which US\$4.1 billion could be directed to climate and nature.

Therefore, the analysis finds that approximately US\$11.3 billion could be mobilised from climate and nature-linked debt instruments (see Figure 9).

Figure 9. Potential climate and nature financing mobilised from debt instruments in SIDS



5.4.5 V20 members

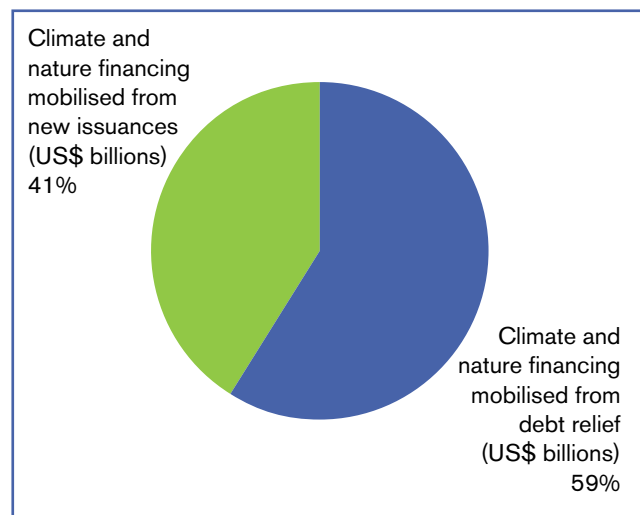
Of the 48 V20 member countries, this analysis categorises 31 countries in Group 1 and 17 countries in Group 2.

Of the 31 Group 1 V20 countries, the analysis estimates that the amount of debt held is US\$387 billion. A HIPC-type initiative could help reduce this debt by US\$309.7 billion. Of this amount, approximately US\$81.4 billion could be mobilised for climate and nature.

The analysis estimates that the Group 2 V20 countries could mobilise US\$211.3 billion in new issuances, of which US\$55.6 billion could be directed to climate and nature.

Therefore, the analysis finds that approximately US\$137 billion could be mobilised from climate and nature-linked debt instruments (see Figure 10).

Figure 10. Potential climate and nature financing mobilised from debt instruments in V20 member countries



5.4.6 FCAS

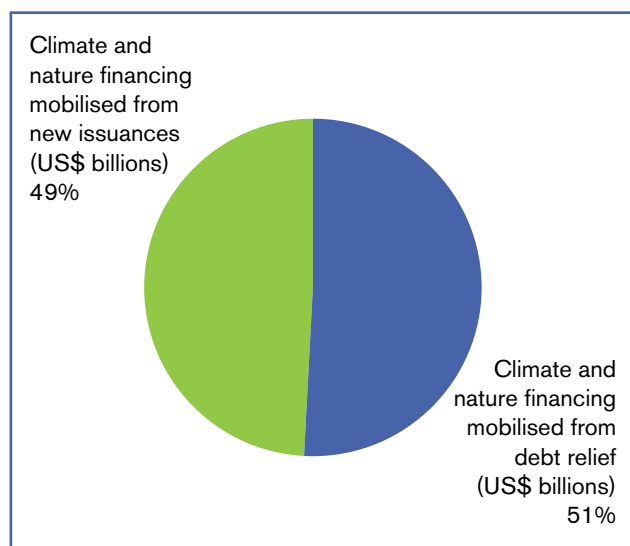
Of the 37 FCAS, this analysis categorises 29 countries in Group 1 and eight countries in Group 2.

Of the 29 Group 1 FCAS countries, the analysis estimates that the amount of debt held is US\$185.3 billion. A HIPC-type initiative could help reduce this debt by US\$148.2 billion. Of this amount, approximately US\$39 billion could be mobilised for climate and nature.

The analysis estimates that the Group 2 FCAS countries could mobilise US\$139.8 billion in new issuances, of which US\$36.8 billion could be directed to climate and nature.

Therefore, the analysis finds that approximately US\$75.8 billion could be mobilised from climate and nature-linked debt instruments (see Figure 11).

Figure 11. Potential climate and nature financing mobilised from debt instruments in FCAS countries



5.4.7 Regional groupings

The following presents a breakdown of the potential scale of mobilisation by region, based on World Bank regional groupings:

- East Asia and Pacific (29 countries)
- Europe and Central Asia (18 countries)
- Latin America and the Caribbean (33 countries)
- Middle East and North Africa (21 countries)
- South Asia (8 countries)
- Sub-Saharan Africa (48 countries)

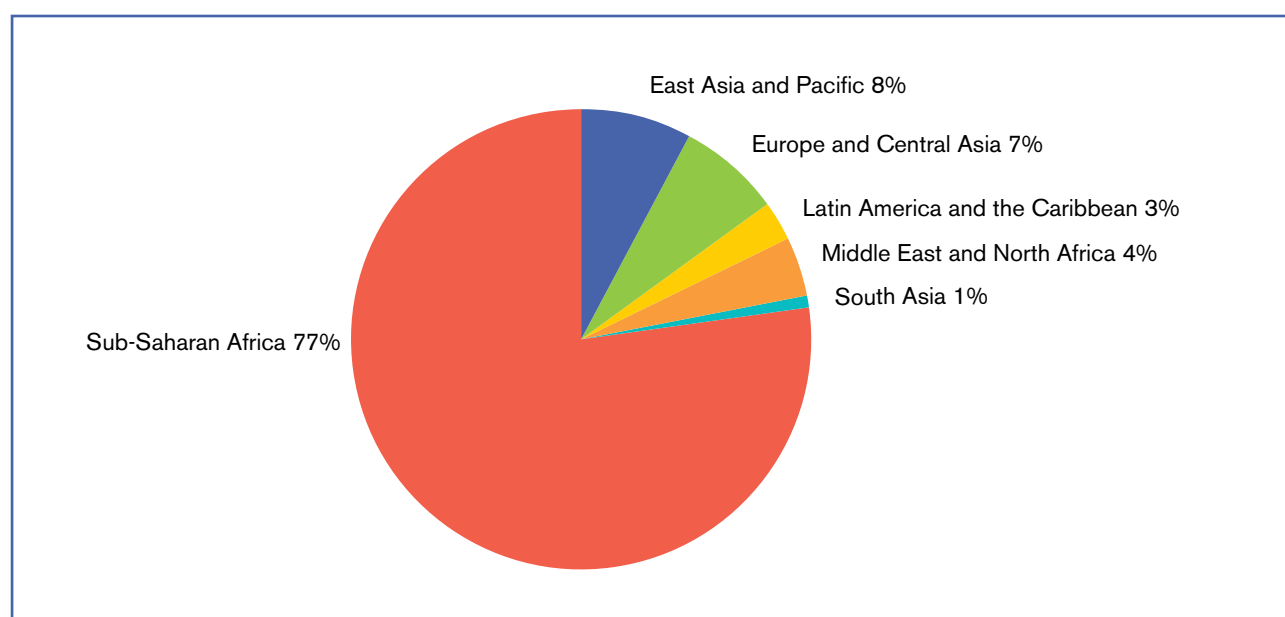
Table 3 shows the potential scale of mobilisation that a debt relief initiative could support Group 1 countries with, broken down by region. Figure 12 illustrates the amount of climate and nature financing that could be mobilised by region as a result.

At the regional level, the largest PPG external debt holdings in absolute terms are in sub-Saharan African. This value represents the total PPG external debt held by the countries analysed, and not looking at the average debt holdings per country or on a per capita or

Table 3. Potential scale of mobilisation from a debt relief initiative in Group 1 countries, by region

REGION	NUMBER OF COUNTRIES IN GROUP 1	AMOUNT OF DEBT HELD (US\$ BILLIONS)	AMOUNT OF DEBT THAT COULD BE REDUCED UNDER A HIPC-TYPE INITIATIVE (US\$ BILLIONS)	AMOUNT THAT COULD BE MOBILISED FOR CLIMATE AND NATURE AS PART OF THE REDUCTIONS (US\$ BILLIONS) ⁵⁷
East Asia and Pacific	10	37.2	29.8	7.8
Europe and Central Asia	5	30.5	24.4	6.4
Latin America and the Caribbean	6	13.4	10.7	2.8
Middle East and North Africa	7	19.0	15.2	4.0
South Asia	2	3.7	2.9	0.8
Sub-Saharan Africa	28	345.5	276.4	72.7

Figure 12. Climate and nature financing mobilised as a result of debt relief, by region



⁵⁷ Note: because the countries were split by regional groups to undertake these estimates, the sum of this table would not match the total mobilisation figures for Group 1 presented in section 5.1.2.

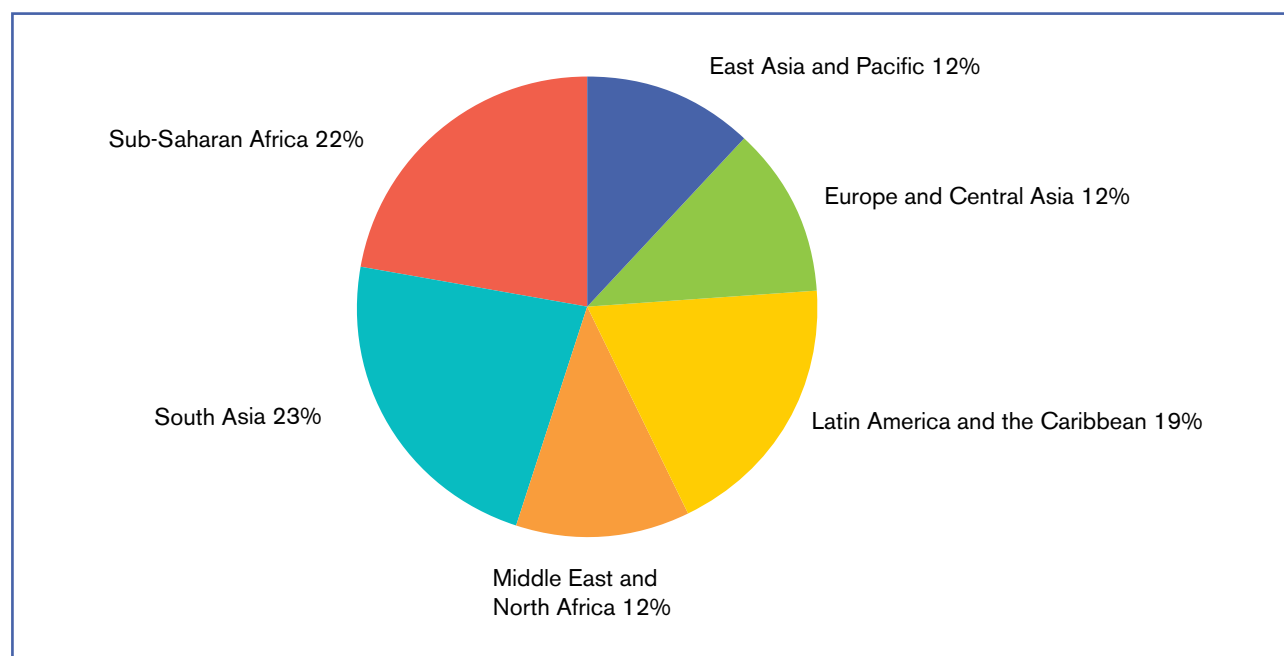
proportion of GDP basis. On this basis, sub-Saharan Africa would be mobilising the largest amount of financing for climate and nature from reductions in the present value of their debt.

Table 4 shows the amount of finance Group 2 countries could mobilise from new issuances by region. Figure 13 illustrates the potential climate and nature financing that could be mobilised from new issuances by region. Financing for climate and nature action from new issuances is fairly evenly spread across regions.

Table 4. The amount of finance Group 2 countries could mobilise from new issuances

REGION	NUMBER OF COUNTRIES IN GROUP 2	AMOUNT THAT COULD BE MOBILISED IN NEW ISSUANCES (US\$ BILLIONS)	AMOUNT FROM THE NEW ISSUANCES THAT COULD BE DIRECTED TO CLIMATE AND NATURE (US\$ BILLIONS) ⁵⁸
East Asia and Pacific	19	116.6	30.7
Europe and Central Asia	13	124.9	32.8
Latin America and the Caribbean	27	191.9	50.5
Middle East and North Africa	14	125.6	33
South Asia	6	237.1	62.4
Sub-Saharan Africa	20	222.3	58.5

Figure 13. Climate and nature financing mobilised from new issuances by region



⁵⁸ Note: because the countries were split by regional groups to undertake these estimations, the sum of this table would not match the total mobilisation figures for Group 2 presented in section 5.2.1.

Policy implications

6

This analysis leads to the following policy implications:

A significant amount of financing could be mobilised for climate and nature while also supporting countries to deal with their debt burdens

Climate and nature-linked debt financing has the potential to tackle the interlinked crises of climate, nature and debt in a coherent and integrated manner. The estimates presented in this analysis show that mobilising finance for climate and nature through debt management solutions can bring significant additional benefits to the system. These include better integration of climate and nature into national plans and investment frameworks, strengthening national public financing management systems and strengthening the capacities and capabilities of finance ministries to support financing for climate and nature while building a track record of investment that can be leveraged to obtain further financing. These benefits will help increase national climate and nature financing in the long term.

There is evidence from the previous debt relief experiences of continued increased spending on key national priority areas – both as a result of freed up fiscal space from the debt relief, and from the institutionalisation and mainstreaming of these key areas into the national systems. For example, before the HIPC Initiative, eligible countries were spending on average slightly more on debt service than on health and education combined. With HIPC, they have markedly increased their spending on health, education and other social services – to an average of about five times the amount of debt-service payments.⁵⁹

Debt relief invested in ensuring a lower-carbon, climate-resilient economy – ie which would bring about structural changes in the economy – will increase future debt carrying capacity and will therefore increase the amount available for climate activities. The debt relief will therefore generate and leverage further finance.

This is a significant channel of funding in relation to the US\$100 billion Paris Agreement goal, and with the increasingly urgent need to address climate impacts and the destruction of nature, it is a channel that should be explored further.

The international system can mobilise to provide better support for climate and nature-linked debt instruments

The current level of support provided by the international community to address the triple crisis of climate change, the destruction of nature and rising debt burdens is inadequate to halt these crises.

International actors must respond to the urgency of mobilising financing for climate and nature and must support innovative forms of mobilisation. They also need to acknowledge their failure to meet their commitments, including the commitment to mobilise US\$100 billion for climate action, which has highlighted the need to explore all opportunities to increase climate financing as a matter of urgency.

Both debt swaps for climate and nature and SLBs are nascent instruments that will require support at the international level to be implemented and scaled up. Currently, there is little concrete support for these types of innovative instruments, although they are being recognised, monitored and commended. These one-off transactions now need to move into mainstream use and this can only be done through sufficient support and an enabling environment created at the international level. This includes getting bilateral, multilateral and private sector creditors behind these initiatives.

National governments can explore whether climate and nature-linked debt instruments are suitable for their contexts

Not all debt is eligible for write off, nor would it be appropriate for some debts. National governments need to scope what is working and what could be improved in their contexts.⁶⁰ They can then use this information to advocate at international level to show demand for these types of instruments.

As noted above, these instruments could mobilise much-needed support towards climate and nature priorities at national and global level. A significant amount of finance could be generated in comparison to other existing flows and in the context of climate and nature finance needs to be mobilised from as many sources as are available. This financing could bring wider benefits than just the volume of financing mobilised: strengthening national public financial management in relation to climate and nature financing; building national capacities for debt instruments; and attracting further climate and nature financing from wider sources through countries showing their commitment to climate and nature action.

⁵⁹ IMF (2016) Debt Relief Under the Heavily Indebted Poor Countries Initiative <http://bitly.ws/sC8t>

⁶⁰ IIED, Potomac Group LLC, UNECA, UNESCWA and UNDP (2021) Linking sovereign debt to climate and nature outcomes: a guide for debt managers and environmental decision makers. IIED, London <https://pubs.iied.org/20651iied>

Looking forward



As more and more countries face debt distress, there is an urgent need to support coherent and integrated approaches to debt management. Just as important and urgent is the need to deal with the macroeconomic challenges resulting from the climate and nature crises.

The United Nations Conference on Trade and Development (UNCTAD)⁶¹ points out that there has been a persistent tendency to underestimate the scale of the debt relief needed in the past, which in turn has contributed to the build-up of the debt. Long periods of debt distress and inadequate support leaves countries struggling – with millions of people suffering the impacts. We are in the midst of repeating this mistake again.⁶²

The HIPC initiative aimed to learn from the multiple debt reschedulings carried out by the Paris and London Clubs from the 1980s, which were on non-concessional ‘standard terms’ and inevitably led to the need for repeated short-term rescheduling. Even with this learning, it took a few iterations of the terms of HIPC to make them less rigid and more inclusive. In the current context, the international community should learn from these experiences and design mechanisms that will help in a timely and inclusive manner to improve the debt situation for indebted and debt-distressed countries.

The analysis shows that climate and nature-linked debt instruments are important innovations in the toolbox

of solutions. Individual country transactions are costly and affect countries’ credit ratings, so an international initiative to link debt with climate and nature would be very useful in supporting individual country actions. An international initiative can also help bring coherence and consistency to enable countries to engage with their multiple creditors on equal terms. However, neither the G20 nor the IMF are likely to take forward any such debt initiative for the foreseeable future because their focus is currently elsewhere – for example, on institutional tensions and the economic fallout of the war in Ukraine and, for the IMF, on operationalising the Resilience and Sustainability Trust Fund (RST). But in the absence of these institutions, the agenda could be taken up by other parts of the international system, such as the UN.

To support these instruments, we recommend two key steps forward:

- Develop an international initiative to link debt with climate and nature
- Prioritise this agenda throughout the international climate and nature meetings in 2022 and raise it as a key outcome for the 27th United Nations Climate Change conference (COP27) in November 2022. The UN is well positioned to play a key role in this process, despite carrying less weight than the international financial institutions on debt instruments.

⁶¹ UNCTAD (2000) The least developed countries report, 2000. Aid, private capital flows and external debt: the challenge of financing development in the LDCs. <https://bit.ly/3b3Ydbg>

⁶² Shalal, A. (2022) IMF’s Georgieva warns against ‘complacency’ on global debt problems <http://bitly.ws/sKF2>

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Annexes

Annex 1. Lessons from the Highly Indebted Poor Countries (HIPC) Initiative

Lessons from the estimates of the amount of debt relief needed made under HIPC

The estimates on amount of debt relief needed that were calculated during the development of HIPC are some of the most concrete examples of debt relief estimates produced within a similar context. The analysis in this paper therefore drew on the lessons of developing those estimates:

- The HIPC estimation methodology was based on HIPC's very clear intention to create a consolidated framework compared to the ad hoc debt relief provided by the Paris Club, London Club and by other forms of debt restructuring at the time.
- The group of countries considered, and eligibility components, formed a key part of the considerations of the methodology. There were groups calling for more countries to be included. This was weighed against creditor positions. Thirty-nine countries were ultimately considered eligible.
- HIPC's eligibility was controversially linked to rigid ratios and excluded quite a number of countries: the present value (PV) of debt-to-exports ratio was initially set at above 200–250% and was later lowered to a fixed level of above 150%; and the PV of debt-to-budget-revenue ratio was initially set at above 280% and then lowered to above 250%.⁶³ Also, access to debt relief via the fiscal window (debt/budget ratio) required a country to meet two further thresholds: an openness criterion (export-to-GDP ratio of 30% or more) and a revenue criterion (budget revenue-to-GDP ratio of 15%). The debt of a country was considered unsustainable if either of its debt ratios was higher than the above thresholds. Besides these, there were other conditions such as having an IMF programme and having per capital income below a certain level.

Background to the HIPC/MDRI initiative

The Heavily Indebted Poor Countries Initiative (HIPC) was launched in 1996 by the IMF and World Bank, with the aim of ensuring that no poor country faced a debt burden that it could not manage.⁶⁴ In 2005, to help accelerate progress toward the UN's Sustainable Development Goals (SDGs), the HIPC Initiative was supplemented by the Multilateral Debt Relief Initiative (MDRI). The MDRI allowed for 100% relief on eligible debts by three multilateral institutions – the IMF, the World Bank and the African Development Fund (ADF) – for countries completing the HIPC Initiative process. Somalia is currently still going through the HIPC process. In 2007, the Inter-American Development Bank (IDB) also decided to provide additional ('beyond HIPC') debt relief to five HIPCs.

The HIPC initiative was implemented as a two-step process. Countries had to meet certain criteria, commit to poverty reduction through policy changes, and demonstrate a good track record over time. Interim debt relief was provided at the start, and then full debt relief was provided after the country met its commitments. The first step was for the country to fulfil four criteria. Each country had to:

- 1) Be eligible to borrow from the World Bank's International Development Agency (IDA), which provides interest-free loans and grants to the world's poorest countries, and from the IMF's Poverty Reduction and Growth Trust (PRGT), which provides loans to low-income countries at subsidised rates;
- 2) Face an unsustainable debt burden that could not be addressed through traditional debt relief mechanisms;
- 3) Have an established track record of reform and sound policies through IMF and World Bank supported programmes; and
- 4) Have developed a poverty reduction strategy paper (PRSP) through a broad-based participatory process in the country.

⁶³ UNCTAD (2000) The least developed countries report, 2000. Aid, private capital flows and external debt: the challenge of financing development in the LDCs. <https://bit.ly/3b3Ydbg>

⁶⁴ IMF (2021b) Fact sheet: debt relief under the Heavily Indebted Poor Countries (HIPC) Initiative. <https://bit.ly/3b6uHSv>

The second step was execution. For the country to receive the full reduction in debt available under the initiative, they needed to meet certain conditions. Each country had to:

- 1) Establish a further track record of good performance under programmes supported by loans from the IMF and World Bank;
- 2) Implement satisfactorily key reforms agreed at the decision point; and
- 3) Adopt and implement its PRSP for at least one year.

The debt relief freed up resources for social spending:

- It boosted social spending: before the initiative, countries were on average spending slightly more on debt service than on health and education combined. After HIPC, they were able to markedly increase their expenditures on health, education and other social services. On average, such spending post-HIPC was five times the amount of debt-service payments.
- It reduced debt services: for the 37 countries receiving debt relief, debt service paid declined by about 1.5% of GDP between 2001 and 2015.
- It improved public debt management: the debt relief markedly improved the debt position of post-completion point countries, bringing their debt indicators down below those of other HIPCs or non-HIPCs.

UNCTAD notes that HIPC Initiative innovated debt management in three important ways:⁶⁵

- It widened the coverage of the types of debt which were eligible for relief to include multilateral debt. This was a critical shift because it recognised the need for a formal mechanism of multilateral debt relief. Prior to the initiative, the only way in which the World Bank and IMF could respond to the growing debt-serving difficulties for their debtors was through providing new financing – in other words, maintaining a sufficient flow of new lending to debtor countries to ensure they could continue to service past credits.

- It set an explicit target for debt sustainability and provided a commitment to the HIPCs that if traditional debt relief mechanisms could not reduce debts down to a level at which they were sustainable, additional action would be taken by the international community to do so. Within the HIPC initiative, the target for debt sustainability was set as a threshold ratio of the present value (PV) of debt to exports or to government revenue. The present value is a measure of the value of a country's future debt service obligations which is calculated within the HIPC Initiative by discounting the future debt service flows at the commercial interest reference rate (CIRR). This was calculated for each country at a particular moment in time, and then an estimate made of how much a country's future debt service obligations would have to be reduced in order for the debt to be sustainable. Creditors were expected to share the reduction in the future debt service obligations required to bring the PV ratios down to sustainable levels according to their share of the present value of the debt at the decision point. Debt relief was distributed on future maturities of the loans, and could take up to 20 years or more before the relief was finally delivered.
- New sources and mechanisms for financing debt relief were introduced under HIPC. These included IMF gold sales, enabling the World Bank and other multilateral institutions to use some of their own resources, and the setting up of the HIPC Trust Fund, to which bilateral donors could contribute to help the multilateral institutions provide debt relief.

Brady bonds

In middle-income countries, where most of the debt was owed to commercial creditors, the debt problem of the 1980s was resolved following the financial innovation of the Brady Plan – which involved the conversion of debt into bonds, with a discount. The Brady Plan included around 18 Brady Plan deals.⁶⁶ The debt relief process in these cases was informed by market valuations of the probability of debt repayment, together with practical calculations of the returns which had already been realised on outstanding debts. Debt relief of an average 37% was achieved across these cases.⁶⁷

⁶⁵ UNCTAD (2000) The least developed countries report, 2000. Aid, private capital flows and external debt: the challenge of financing development in the LDCs. <https://bit.ly/3b3Ydbg>

⁶⁶ Brady bonds were issued in Argentina, Brazil, Bulgaria, Costa Rica, the Dominican Republic, Ecuador, Ivory Coast (Cote d'Ivoire), Jordan, Mexico, Nigeria, Panama, Peru, the Philippines, Poland, Russia, Uruguay, Venezuela and Vietnam. Trade Association for The Emerging Markets (EMTA) (undated) The Brady Plan <https://www.emta.org/em-background/the-brady-plan/> See also: Cruces, J, and C. Trebesch. 2013. "Sovereign Defaults: The Price of Haircuts." *American Economic Journal: Macroeconomics* 5 (3): 85-117.

⁶⁷ Nagle, P. (2022) 5 lessons from past episodes of debt relief. World Bank. <https://blogs.worldbank.org/developmenttalk/5-lessons-past-episodes-debt-relief>

Annex 2. Data sources

This analysis uses the Joint IMF-World Bank Debt Sustainability Framework/Debt Sustainability Analysis (DSF/DSA), captured in country Article IV reports⁶⁸ to gather data on the present value of public and publicly guaranteed external debt:⁶⁹

- The Debt Sustainability Framework (DSF) was introduced in April 2005.
- The framework is designed to guide the borrowing decisions of low-income countries (LICs) in a way that matches their financing needs with current and prospective repayment ability.
- Under the DSF, Debt Sustainability Analyses (DSA) must be conducted regularly. These consist of:
 - An analysis of a country's projected debt burden over the next ten years, and its vulnerability to economic and policy shocks, based on baseline and stress test scenarios, and
 - An assessment of the risk of external and overall public debt distress, based on indicative debt burden thresholds and benchmarks respectively, that place demand on the country's macroeconomic framework and other country-specific information (see Table 5).
- The DSF focuses on the present value of debt obligations for comparability, as terms extended to low-income countries vary considerably and many are considered concessional. A 5% discount rate has been used since 2013 to calculate the present value of external debt.
- Countries with different policy and institutional strengths, macroeconomic performance, and buffers to absorb shocks, have different abilities to handle debt. The DSF classifies countries into one of three debt-carrying capacity categories (strong, medium and weak), using a composite indicator, which draws on the country's historical performance and outlook for real growth, international reserves coverage, remittance inflows, and the state of the global environment, in addition to the World Bank's country policy and institutional assessment (CPIA) index. Different indicative thresholds for debt burdens are used depending on the country's debt-carrying capacity. Thresholds corresponding to strong performers are therefore higher, indicating that countries with good macroeconomic performance and policies can generally handle greater debt accumulation.

Table 6 provides an example of a country with a strong carrying capacity and low risk of debt distress. The table shows all indicators are below the country's

Table 5. Debt burden thresholds and benchmarks under the DSF. Source: IMF (2021)

	PV OF EXTERNAL DEBT IN PERCENT OF		EXTERNAL DEBT SERVICE IN PERCENT OF		PV OF TOTAL PUBLIC DEBT IN PERCENT OF
	GDP	Exports	Exports	Revenue	GDP
Weak	30	140	10	14	35
Medium	40	180	15	18	55
Strong	50	240	21	23	70

Table 6. Example of a country's public external debt sustainability indicators showing a country qualified as having a 'strong' debt-carrying capacity

PUBLIC EXTERNAL DSA	THRESHOLD	2018/ 2019	2019/ 2020	2020/ 2021	2021/ 2022	2022/ 2023	2028/ 2029	2038/ 2039
PV of debt-to-GDP ratio	55	15.9	15.0	14.4	13.6	12.8	8.6	4.7
PV of debt-to-exports ratio	240	112.4	105.9	101.4	95.8	85.4	56.4	30.4
Debt service-to-exports ratio	23	15.0	12.6	10.7	10.4	8.8	6.8	4.8
Debt service-to-revenue ratio	22	15.0	12.3	10.4	10.4	9.1	6.4	3.7

⁶⁸ IMF, Surveillance, www.imf.org/external/about/econsurv.htm

⁶⁹ IMF and World Bank (2021) Fact sheet: joint World Bank-IMF debt sustainability framework for low-income countries. <https://bit.ly/3zH6FYf>

threshold levels in the 2018/2019 period, and with predicted continued levels below the thresholds up to the 2038/39 period. These projections will of course change as external shocks, such as the global pandemic and the Ukraine conflict, impact on the economy.

Based on the comparisons between the indicators and the thresholds, countries are given risk signals over the projection period. There are four ratings for the risk of external public debt distress:

- Low risk, if none of the debt burden indicators breach their respective thresholds under the baseline and stress tests;
- Moderate risk, if none of the debt burden indicators breach their thresholds under the baseline scenario, but at least one indicator breaches its threshold under the stress tests;
- High risk, if any of the external debt burden indicators breaches its threshold under the baseline scenario, but the country does not currently face any repayment difficulties; or
- In debt distress, when the country is already experiencing difficulties in servicing its debt, as evidenced for example by the existence of arrears, ongoing or impending debt restructuring, or indications of a high probability of a future debt distress event (such as debt and debt service indicators showing large near-term breaches, or significant or sustained breach of thresholds).
- In addition to the risk ratings signalled by the framework, judgment may be used to arrive at a final risk rating. In particular, judgment can help assess the gravity of threshold breaches and country-specific factors that are not fully accounted for in the framework.

The analysis in this paper focuses on the measure in the first column of Table 5, the present value of external debt as a percentage of GDP, as external debt remains the largest component of total public debt in most LICs, and the most relevant on the international stage – that is where international support is being provided, overwhelmingly as loans,⁷⁰ and where this support can be rethought.

The analysis also draws on World Bank external debt statistics data⁷¹ and DataBank for data on countries' GDP.⁷²

To get a deeper understanding of country positions at the national level from an external perspective, this analysis considers the following national documents to be important:

- National medium-term investment plans/debt strategies to understand how much more finance the country already plans to raise using debt financing in the coming year and beyond. This can help indicate national borrowing priorities and approaches.
- Fiscal/budget speeches and their annexes, which again point to national priorities for borrowing and spending, and national approaches for doing so.

This analysis uses data on NDC costings from the Institute for Global Environmental Strategies (IGES) NDC database.⁷³

⁷⁰ More than 70% of climate finance is being delivered in the form of loans, which is increasing debt levels of already highly climate vulnerable countries (OECD (2020) Climate finance provided and mobilised by developed countries in 2013–18: key highlights. <https://bit.ly/3kOJ7sD>).

⁷¹ World Bank (b), Debt statistics, www.worldbank.org/en/programs/debt-statistics.

⁷² World Bank (c), DataBank, <https://databank.worldbank.org/home.aspx>

⁷³ Hattori, T and Takahashi, K (2021) IGES NDC Database. Institute for Global Environmental Strategies. www.iges.or.jp/en/pub/iges-indc-ndc-database/en

Sixty per cent of low-income countries are already in or at high risk of debt distress, while the global economic and debt sustainability outlook is quickly deteriorating due to higher interest rates, higher food prices and depreciating currencies. At the same time, macroeconomic risks caused by the crises of climate change and nature loss further undermine current siloed efforts to recover. Innovative climate and nature-linked debt instruments can help to address the current crises. This analysis estimates that these instruments could mobilise upwards of US\$105 billion from debt relief for climate and nature in the short term, and more than US\$329 billion in new debt issuances, with the possibility of even more in the medium and long term. Based on these findings, the paper recommends increased support for and promotion of these instruments, and a new architecture for international debt treatment.

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