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THE INVESTMENT IMPERATIVE AND THE DEBT ROADBLOCK: PROPOSALS FOR THE G7

POLICY BRIEFING
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TABLE OF CONTENTS

INVESTMENT & DEBT: THE CURRENT STATUS

High-interest rates and high debt levels directly limit investment capacity in African countries, including climate-focused investments. This creates a risk of a vicious cycle of underdevelopment and delayed climate preparedness, with potential social and economic implications intensifying over time and spillover effects beyond national borders.

There is clear private sector financial retrenchment from Low- and Middle-Income Countries (LMICs), including IDA-eligible countries of which 39 are in Africa. In 2022, private creditors withdrew U$189 billion more in principal repayments than they provided in loans, **the first time that private creditors have taken out a greater amount than they invested in developing nations since 2015.** Chinese development finance from its two policy banks has decreased, and hit a 13 year low in 2021; meanwhile, finance from multilateral creditors has provided a steady lifeline for countries, increasing 1.5% to US$115.6 billion in 2022.

Debt service costs have grown over the last four decades, reaching $443.5 billion for developing economies in 2022. The combination of debt servicing requirements plus a decreasing supply of loans poses a significant threat to economic stability, with an estimated $70 billion in total debt service due in 2024 for 21 illiquid low and low-middle-income countries. This issue could intensify if interest rates remain high through 2024.

Growing debt repayments are a roadblock preventing African governments from making vital expenditures aimed at addressing pressing social and environmental needs. Investment to address climate change and nature-related development objectives in Emerging Markets and Developing Countries (excluding China) requires $1 trillion in 2025 and U$2.4 trillion by 2030, marking a fourfold increase from current levels, according to the Stern-Songwe report by the Independent High-Level Expert Group on Climate Finance. And to achieve the SDG Agenda by 2030, US$5-7 trillion is needed annually for global investments.

This challenge comes as the world is still grappling with the aftermath of the pandemic crisis, and is yet to fully recover. By the end of 2024, economic activity in LMICs is expected to be 5% lower than initially predicted before the pandemic. Additionally, the growth from 2020 to 2024 is anticipated to be less robust than the average growth observed in any other five-year period since the mid-1990s. Furthermore, this period has seen a surge in geopolitical conflicts, from the war in Ukraine, to the Israel-Hamas conflict, to the seven military coups experienced by Sub-Saharan Africa. These economic and geopolitical developments further compound the challenges faced by nations, creating a complex landscape that demands urgent attention and coordinated efforts from the G7 on multiple fronts.

Geopolitically, the G20 serves as the primary forum for decisions on debt, as China is a key player in the debt conversation. The G7 can, and should, however, play a key complementary role to that of the G20 by fostering dialogue with key stakeholders and institutions. Besides China, the G7 is the largest source of development finance globally and G7 members wield a significant level of influence over international financial institutions such as the International Monetary Fund (IMF) and the Paris Club. **Given the significance of the debt roadblock in impeding sustainable investment in African economies, resolving this impasse should be amongst the highest priorities of the Italian G7 to deliver a prosperous planet for all.**

THE MULTIPLIER EFFECT BETWEEN CLIMATE ON DEBT

Debt poses a significant obstacle in tackling climate change; however, climate itself serves as a threat multiplier, amplifying existing risks and potentially transcending borders. To put things into context, 29 out of 69 poorer countries eligible for concessional finance under the Poverty Reduction and Growth Trust (PRGT) of the International Monetary Fund (IMF) are the intersection of high debt and climate vulnerabilities.

A staggering 80% of global population facing the threat of climate-induced crop failures are located in Sub-Saharan Africa (SSA), South Asia, and Southeast Asia. Rising temperatures could have devastating effects on key crops such as wheat which are less heat tolerant and are critical for many economies. The decline in crop yields, particularly in regions already struggling with food insecurity, is poised to exacerbate poverty levels. A worrying projection indicates that by 2030 an estimated 43 million people in Africa alone could be pushed below the poverty line due to the impact of diminishing agricultural productivity. To invest in resilience and food security, fiscal space will be needed.

Many chronic climate-related hazards, such as rising sea levels, glacial melts, desertification, degradation of fertile soils and droughts often go unnoticed in the calculation of financial assessments. For instance, droughts resulted in 650,000 deaths between 1970-2019 and caused global economic losses of approximately USD 124 billion between 1998 to 2017. **Without investments developing countries could face losses of a total of US$290–580 billion in 2030 and reach US$1–1.8 trillion in 2050.**

Countries facing climate disasters endure economic losses and heightened borrowing costs. Low and Middle-Income Countries (LMICs) lose on average 0.8–1% of their GDP annually to disasters. The climate premium is expected to double in the next decade, adding a financial strain to resource-limited nations. The consequences of this include weakened economic activity, infrastructure damage, higher social costs and population displacement.

In many developing countries, infrastructure finance is typically secured with some degree of government participation, and as such, where the energy transition impacts the lifetime of the infrastructure, this would have a knock-on effect on the government balance sheet. **Investing in new oil and gas projects in Africa entails economic, financial, and climate risks, including exposure to stranded assets.** The justification for such investments often relies on the belief that fossil fuels will spur economic and social development, particularly in countries where national debt sustainability is linked to fossil fuel revenues. However, the volatile international oil and gas markets jeopardise a stable income for nations heavily reliant on fossil fuel exports, hindering consistent and sustainable growth. [Mozambique](#) is a prime example of this, where new fossil fuel investments are exacerbating the debt trap.

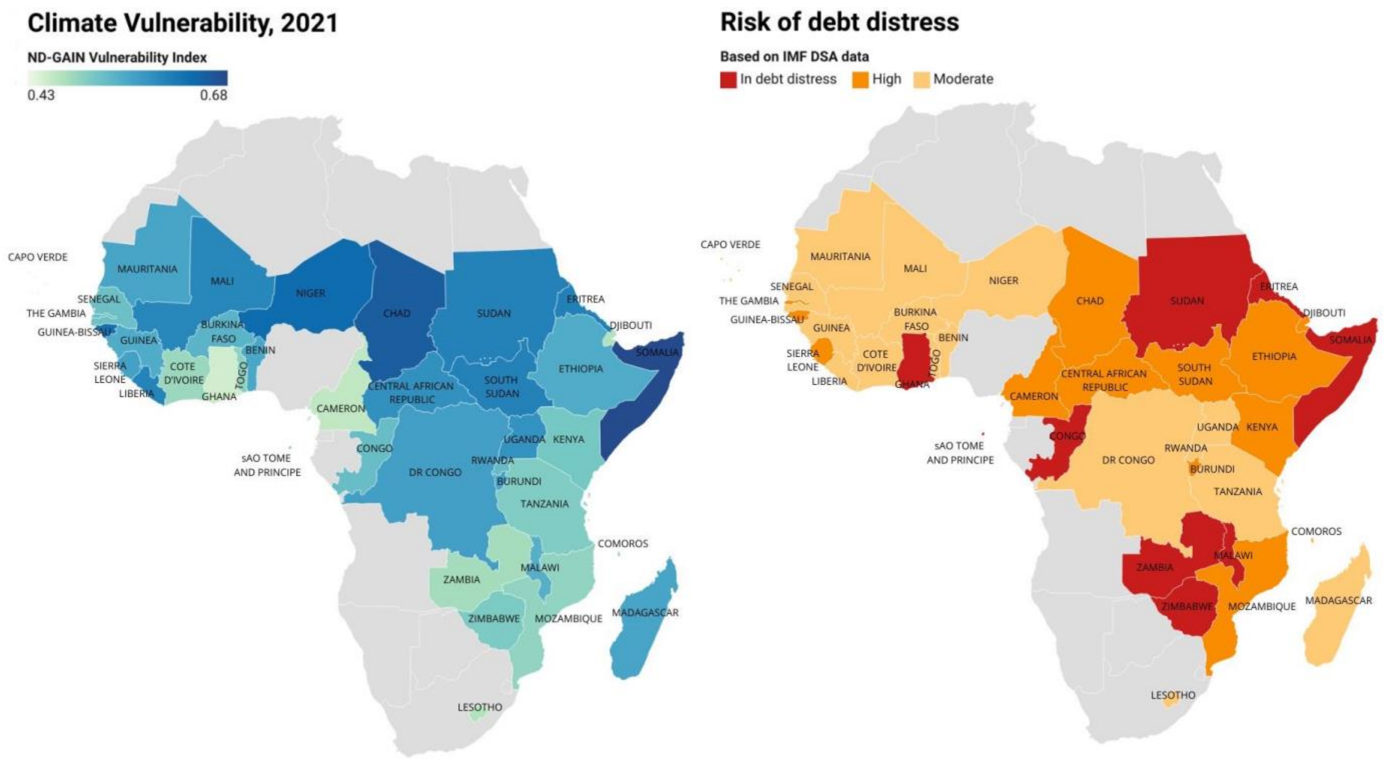

***Figure 2 –** Climate vulnerability and risk of debt distress in low-income PRGT eligible countries. Source: IMF data and the Notre Dame Global Adaptation Index 2021.*

Debt has become a key concern for many countries around the world, as demonstrated by statements over the last year or so from country groupings including the V20, the G24, the United Nations Economic Commission for Africa, and regional groupings such as the Community of Latin American and Caribbean States (CELAC), and the Association of Southeast Asian Nations (ASEAN). These statements emphasise the challenges posed by tightening global financing conditions and escalating debt distress and raise the alarm regarding the potential effect of the debt roadblock on efforts to harness and protect development gains. These systemic challenges also significantly curtail a country's capacity to invest in climate resilience and in the transition to a low-carbon economy.

Several countries have joined forces to establish initiatives aimed at expanding fiscal space to facilitate crucial investments in development and climate priorities. Notable initiatives include the Sustainable Debt Coalition, and the V20 Accra to Marrakech Agenda. Over the past year alone, at least seven initiatives have emerged, many of which are intricately linked to addressing climate concerns, including the expert review on debt, climate, and nature launched at COP28 by Kenya, Colombia, and France, which will focus on developing strategies to create fiscal space and to navigate the intersection of debt, climate, and development challenges.

ANTICIPATING A SHIFT: WHY 2024 MIGHT MARK A CHANGE

Scheduled for 28-29 January, the Italy-Africa Summit will showcase the unveiling of the 'Piano Mattei,' a strategic plan aimed at fostering energy cooperation with Africa and addressing root causes of migration. Italy has articulated its commitment to establishing a model of equal partnership with African nations. The strategic process is expected to extend through the Italian G7 Presidency where Africa and migration, including resilience and food security are anticipated to be focal points.

The onset of 2024 has been marked by an increased prominence of the voices of developing countries, notably from Africa, in global discussions, including the fact that the African Union was granted permanent membership of the G20. This reinforces the calls made by developing economies throughout 2023, such as the Bridgetown Initiative led by Mia Mottley which has advocated for the overhaul of the international financial system. A series of 2023 summits, including the Paris Summit for a New Financial Pact and the Africa Climate Summit featuring the Nairobi Declaration, not only highlighted existing challenges but also laid out potential solutions. These solutions extend to meeting the diverse needs of countries, encompassing structural transformations anchored in the international financial architecture, with a particular emphasis on increasing the fiscal space to increase investment where most it's needed at the country level, including on embarking on the transition and increasing resilience.

One opportunity to rebuild trust with African economies hinges on a pivotal process integral to the expansion of the MDBs, which includes the imminent replenishment of the International Development Association (IDA). In the fiscal year ending in June 2023, African countries received 75% of IDA commitments for grants and low-interest loans. The G7 is amongst the top donors for IDA, and the effectiveness of IDA can be boiled down to the fact that 30% of its financing is provided as grants and it also provides lending at very favourable rates (approximately 1-3%) and long tenor 30-40 years. Negotiations for the next IDA replenishment started last month and will run throughout 2024, with the first disbursements scheduled for July 2025.

This year a new climate finance goal will be set at COP24, which will replace the $100 billion target in 2025. This presents an opportunity to rebuild trust and confidence in the transformations needed to mobilise and deliver the finance needed to achieve the Paris Goals.

The actions taken by the international community on debt have been recognised as critical for transforming the international financial architecture and for ensuring finance flows towards climate growth opportunities, which until now **have been grossly insufficient to make a real impact and to enable progress.**

The G20 initiated the Debt Service Suspension Initiative (DSSI) which was introduced in May 2020, designed to provide a temporary hiatus on official debt payments for the world's most economically challenged nations. It expired in December 2021. Subsequently, recognising the need for more comprehensive solutions, the G20 established the Common Debt Framework to replace the DSSI, which aims to assist countries in effectively restructuring their debt, addressing issues of insolvency, and navigating prolonged challenges related to liquidity. Both initiatives are strongly supported by the G7.

Although some countries have participated in the Common Debt Framework, instead of accelerating debt restructuring the process is taking three times longer than in the past. It has a major shortcoming, in that it fails to impose a minimum standard of similar debt relief requirements on private creditors. For those countries that have applied, including Chad, Zambia, Sri Lanka, and Ethiopia, it has been a long, drawn-out process. Egypt and Tunisia will potentially be the next countries to default.

The solvency issue continues to be a pressing one and expediting the process of debt restructuring, and potentially debt relief for some should be high on the agenda. But there is another issue brewing and it's the illiquidity problem faced by many countries. Alternative "bridge proposals" are emerging that try to address both the short-term concerns of debt illiquidity, combined with a focus on long-term sustainability objectives, where at least 20 countries could benefit from solutions that can unlock net positive flows for those facing liquidity constrains. Implementing these proposals would require a greater lever of coordination and concerted action among bilateral creditors, private lenders, multilateral institutions and borrowing countries than is currently the case.

ITALY'S G7 PRESIDENCY: HOW TO DEVELOP NEW MOMENTUM TO TACKLE INCREASING THREATS

Italy's G7 Presidency in 2024 has the opportunity not only to ensure continuity with Japan's 2023 G7 Presidency but also to contribute fresh perspectives and added value. By addressing emerging challenges and fostering collaboration, including through the Mattei Plan, Italy can play a pivotal role in shaping a more resilient and sustainable future for Africa.

We recommend Italy takes the following actions as G7 President:

1. Build on the foundations laid in previous G7 Presidencies to achieve sustained progress and impact in relation to debt reform and increasing fiscal space.

    - Committing to offer Climate Resilient Debt Clauses (CRDCs) and reiterate the calls for all creditors to offer this instrument as per the G7 Hiroshima Communique; France and Canada have signalled their intention to follow the UK's lead. CRDCs should be included in new and existing loans.
    - Commit to an ambitious IDA 21 replenishment, taking into account the potential decline in debt ratings across many countries. It is imperative to uphold or enhance the grant element, given its role as the largest single source of concessional finance for many African nations. Sustaining the current level of grants is crucial. Proactive preparations should be made for a worst-case economic scenario, including the possibility of augmenting donor contributions from 50% to 94%.
    - Remain committed to the implementation of an ambitious evolution of the MDBs to address the global challenges, starting with the implementation of the Capital Adequacy Framework (CAF) review and ensuring that the MDBs are well-resourced in line with their shareholders' priorities to remain relevant and agile.
    - Explore other innovative sources of finance that alleviate debt pressure, such as global levies, and further delivery and reallocations of Special Drawing Rights, including rechannelling SDRs through the Multilateral Development Banks (MDBs), starting with a reallocation to the African Development Bank.
    - Capitalise on the potential of SDRs as a tool to increase steady growth in global liquidity, and call on the IMF to look into regular issuance of SDRs, and utilise SDRs as a tool for promoting economic stability and cooperation among IMF member countries, ensuring that corrective measures are taken without resorting to actions that could be detrimental to overall prosperity.

2. Explore opportunities to go beyond past achievements and proactively address emerging global issues with novel ideas and initiatives. Demonstrate Italy's commitment to enhancing the effectiveness of the G7, working closely with the G20.

- Work with the G20, Africa Union (AU) and the V20 to find solutions to address the liquidity crunch, based on the proposal put forward by the African Union during the Nairobi Climate Action Summit to introduce debt moratorium, e.g. a 10 year moratorium on interest payments, to reflect the extreme challenges and circumstances that many developing countries find themselves in. Climate could be incorporated as part of the solution.
- Welcome and endorse Colombia, Kenya and France's initiative to launch an expert review on debt, climate and nature at COP28 which aims to provide innovative ideas and recommendations to address the complex challenges posed by the converging crises of debt, climate change and environmental degradation.
- Call on the IMF to include climate in its debt sustainability analysis, including capturing the key opportunities that early climate action could offer to ensure economic and debt sustainability. Initiate a comprehensive dialogue and strategic plan aimed at kickstarting the evolution of the International Monetary Fund (IMF) with a focus on aligning its vision of macroeconomic and financial stability with climate imperatives.
- Call on the IMF to expand the access for vulnerable economies to the Resilience and Sustainability Trust, by changing onerous eligibility requirements to expand access and introduce more flexible conditionalities; and to ensure that climate is a factor taken into consideration across all the lending facilities that the IMF provides.

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