The debt and climate crises: A perfect storm

February 2023

1. Summary

The economic shocks of the pandemic and rising food and fuel prices have plunged 54 global south countries into debt crisis. These countries are also experiencing the devastating impacts of the climate crisis, despite being some of the least responsible for causing it. Resources are needed to address the climate crisis now, but instead countries are trapped repaying vast sums to creditors every year.

Unsustainable debt means limited resources for addressing the climate crisis. Countries in the global south are currently spending five times more on debt repayments than they are on addressing the climate crisis.

The G20 response to the debt crisis has been inadequate. The 2020 Common Framework was intended to enable countries in crisis to restructure their debts, but three years on only four countries have applied, and none have received debt cancellation.

In February 2021, Zambia applied for a debt restructuring through the G20 Common Framework after defaulting on payments to private creditors, but has yet to reach an agreement on debt relief. Private creditors, such as BlackRock, have so far refused to cancel enough debt to make it sustainable, even though they lent to the country at interest rates as high as 9%, and could potentially make profits of 110% if repaid in full.

2. Inadequate climate finance means increased debt

Climate finance itself pushes vulnerable countries into debt. Over 70% of climate finance is provided as loans, piled on top of already unsustainable debt burdens and forcing vulnerable countries to bear the costs of the climate crisis. Loans to countries vulnerable to the impacts of the climate crisis are also often at high interest rates because lenders are factoring in their vulnerability to future impacts. Higher interest rates based on climate vulnerability are predicted to cost the most vulnerable countries $168 billion over the next decade.

Meanwhile, woefully inadequate levels of climate finance mean many global south governments have no choice but to borrow to cover the costs of adaptation, mitigation and addressing Loss and Damage.

In 2009, wealthy nations agreed to provide $100 billion in climate finance a year between 2020-2025, but even this inadequate goal has still not been reached, and is not likely to be met until late 2023. According to the most recent Needs Determination Report from the UN's Standing Committee on Finance, countries in the global south will require at least USD 5.8-5.9 trillion cumulatively to reach their individual internationally agreed commitments for adaptation and mitigation by 2030. Small island states spend 18 times more in debt repayments than they receive in climate finance.

Without adequate finance for addressing Loss and Damage – the destruction already being caused by the climate crisis – countries are forced to pay for these costs themselves through debt. This keeps vulnerable countries locked in a cycle of debt and climate extreme events where they must borrow to recover and reconstruct, only to have efforts wiped out again by the next extreme event, forcing them to borrow more.

Over the next 10 years, without finance for addressing Loss and Damage and adequate finance for adaptation, we calculate that Sub-Saharan African countries will have to take on almost $1 trillion in additional debt - a 50% increase on current debt levels as a percentage of GDP.

3. Debt drives fossil fuel exploitation

In order to service their debts, some global south countries turn to natural resource extraction, including fossil fuels, as a quick way to increase exports and foreign currency revenues. This can have devastating environmental and human impacts, and leave countries more vulnerable to the effects of the climate crisis by removing natural barriers such as forests. Many such projects across the global south are financed by export credit agencies such as UK Export Finance and banks (including many based in the UK), and often do not result in expected financial returns, pushing governments further into debt.

The August 2022 flooding in Pakistan caused an estimated $40 billion of damage, and untold harm for both people and the environment. Pakistan urgently needs resources for its emergency response and reconstruction, but is stuck paying vast sums in debt repayments to its external creditors. Even before the floods, Pakistan's external debt totalled $136 billion, with external debt interest and principal payments expected to be $18 billion in 2022 - 40% of government revenue.

While the international community has mobilised resources totalling about $9 billion to support Pakistan's recovery, the amount falls short of what is required, and is primarily being provided in the form of loans, adding to Pakistan's unsustainable debt and forcing the costs of the climate crisis onto the government and citizens.

Unless Pakistan's debt levels are addressed and grant-based support is mobilised, Pakistan will be pushed into more debt to cover the costs of recovery and reconstruction. We estimate that, as a result of the 2010 flooding, the government of Pakistan had to borrow at least $20 billion more than it would otherwise have needed to, leading to additional annual interest payments of at least $1.6 billion. Over the following ten years, we estimate that the total cost to the people of Pakistan of the debt and the interest payments has been at least $36 billion.

4. The opportunity to address the debt and climate crises

The run up to COP28 presents a vital opportunity to raise the importance of debt and its direct linkage to the climate crisis. It is vital that climate finance mechanisms do not force vulnerable countries deeper into debt. It is also a vital moment to apply pressure on decision makers and global leaders outside of the UNFCCC to tackle the debt crisis as a necessary element in addressing the climate crisis.

5. Priorities for the UK government

The UK government should:

- **Update the UK's 2010 Debt Relief Act by introducing legislation to ensure private creditors take part in internationally agreed debt relief**, as a way of incentivising their participation in the G20 Common Framework and other debt restructuring negotiations. 90% of the bond contracts of countries eligible for the Common Framework (76 of the poorest countries in the world) are governed by English law, so there is an important opportunity for the UK to take the lead.
- **Make adequate financial commitments to the newly established Loss and Damage Fund**, with funds committed being grant-based and reaching the most vulnerable people.
- **Ensure international climate finance commitments provided from the UK are additional to existing overseas development assistance and other international commitments, and continue to be provided in the form of grants (as opposed to loans, or guarantees for loans).**
- **Encourage other lenders, including multilateral institutions, to include clauses in their loans to suspend debt payments when climate disasters strike.**

About Debt Justice: We are a UK charity working to end poverty caused by unjust debt through education, research and campaigning. For more information contact: Jerome Phelps, jerome@debtjustice.org.uk or 07906 813716