Provide Debt Relief for a Green and Inclusive Recovery by Prof Ulrich Volz, Director of the Centre for Sustainable Finance at SOAS (**27 October 2021**) uv1@soas.ac.uk

Many developing countries, including Small Island Developing States, are suffering a triple crisis: debt, Covid-19, and climate change. UNDP estimates that close to US$1.1 trillion is due in debt service payments from developing and emerging countries in 2021 alone, and that 72 countries are at risk of external debt distress this year. Servicing this high debt undermines their ability to invest in climate adaptation despite an urgent need to scale-up investment in climate resilience. There is a danger that vulnerable developing countries will enter a vicious circle: greater climate vulnerability raises the cost of debt, which further diminishes the fiscal space for investment in climate resilience, which further increases climate vulnerability and debt. **This November, the UK is in a unique position to steer discussions and negotiations at the COP26,** and thereby advance the global climate agenda and international climate justice. **The UK must use its role as host to broker a deal for debt relief and facilitate a green and inclusive recovery** for vulnerable developing and emerging countries.

The servicing of public debt removes the possibility of crucial investments for developing countries. As such, climate-proofing their economies and achieving a green, resilient, and equitable recovery remain unattainable. For instance, Caribbean countries are among the most climate-vulnerable in the world; yet their debt service currently absorbs between 30% and 70% of government revenues. This leaves little room for much-needed investments in climate resilience. However, if their governments fail to climate-proof their economies and public-finances, they face an ever-worsening spiral of climate vulnerability and unsustainable debt burdens. This creates a vicious circle – the costs of debt are likely to increase further as financial markets increasingly price climate risks, and global warming accelerates. The risk premia of these countries – which are already high – will thus escalate.

As host of COP26, the UK government can play a decisive role in leading the international community, and the G20 in particular, to agree on an ambitious agenda. Collectively, they must tackle the debt crisis and provide overindebted countries in the Global South with the fiscal space for sustainable crisis responses; this will lay the foundation for a climate-resilient and more prosperous future. In line with recommendations for a green and inclusive recovery developed by an international team of economists (including those from SOAS), we urge the UK government to propose that:

- The Debt Sustainability Analysis carried out by the IMF and the World Bank takes account of climate risks as well as essential spending needed to invest in climate resilience.
- A Guarantee Facility for Green and Inclusive Recovery is set up and managed by the World Bank to help states in restructure negotiations with private creditors. (The Guarantee Facility would provide credit enhancements for new bonds that would be swapped for old debt with significant haircuts.)
- Governments receiving debt relief commit to developing their own Green and Inclusive Recovery Strategy with policies and budgets that align with the Paris Agreement and the Agenda 2030.

Selected References

Volz, U., Akhtar, S., Gallagher, K.P., Griffith-Jones, S., Haas, J., and Kraemer, M. (2021). *Debt Relief for a Green and Inclusive Recovery: Securing Private-Sector Participation and Creating Policy Space for Sustainable Development*. Berlin, London, and Boston, MA: Heinrich-Böll-Stiftung; SOAS, University of London; and Boston University.

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