V20 Debt Review

An account of debt in the Vulnerable Group of Twenty

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2024
By Rishikesh Ram Bhandary and Nathalie Marins
The perspectives in this report represent the combined interests of a group of now 68 countries representing 1.74 billion people - so it is truly the 'voice of the climate vulnerable', and must surely be listened to by the international community.

We used to talk about "trade-offs" in development and climate, as if the two were necessarily opposed. This was a problem because no developing country should be expected to trade their development aspirations in the name of climate stability when the Global North has so clearly failed to do its fair share in mitigation ambition.

However, we now reject the trade-offs discourse. The 68 CVF members do not want high-carbon development: we now have Climate Prosperity Plans (CPPs), which show that with the right projects, programs and financing, climate action and development are no longer trade-offs.
Accordingly, we ask the financial community to invest in and support our CPPs. Clean development will need the world to pay serious attention to the investment needs of the climate vulnerable countries, starting with an urgent focus on reducing their debt burdens.

The CVF countries are not just victims in the climate picture. Our CPPs outline at the project level the investment opportunities that are needed in different sectors, from energy to transport to agriculture. We estimate that there are $2 trillion in investment opportunities for CVF countries for the remainder of this decade to achieve and deliver this climate prosperity agenda. We need to move from billions to trillions in this conversation, and we need to ensure that CVF countries are not locked out of investment flows because of debt and the high cost of capital.

I hope this report, which details the immediate debt crisis and the steps that are needed to avert it, can begin to move us in this positive direction. The G7 and G20 today have the opportunity to deliver the four pillars of the Accra-to-Marrakech Agenda and Bridgetown Initiative with timelines to restore trust, knowing far tougher decisions need to be made everywhere over this decade. As the Paris target of 1.5 degrees becomes ever harder to achieve, and global heating accelerates beyond control, there is no time to lose.

EXECUTIVE SUMMARY

Climate vulnerable economies are confronting multiple, intersecting crises. Economic growth has been slow to bounce back after the COVID-19 pandemic. The macroeconomic environment has become more challenging with high inflation, high costs of borrowing, and ongoing conflicts and geopolitical uncertainties. What is more, with climate impacts intensifying, the economic consequences of runaway climate change have never been clearer. However, the global community’s efforts on climate change continue to fall short and are yet to demonstrate the urgent need for immediate action. There is now a growing convergence that a limiting factor of climate ambition is the sustainability of sovereign debt.

The Vulnerable 20 (V20) Group of Ministers of Finance includes 68 climate vulnerable economies. This debt review captures the external sovereign debt profile of V20 members. It explores the composition and distribution of the V20’s external debt to identify where the international financial architecture needs to be improved.

KEY FINDINGS:

- The V20’s total external public and publicly guaranteed debt stock amounts to $946.7 billion.
- External debt servicing is expected to escalate to $122.1 billion in 2024. V20 members are expected to pay $904.7 billion in debt service over 2022-2030.
- Eight countries spend more than 20 percent of their tax revenue servicing external debt.
- Based on the data available, only Costa Rica, Côte d’Ivoire, the Philippines and Vietnam are estimated to be able to borrow from international capital markets on a sustainable basis, defined as economic growth rates exceeding borrowing costs. Another 18 countries have unsustainable borrowing costs in international capital markets and would face unsustainable debt levels if they borrowed on those terms.
- High levels of external sovereign debt across the V20 group are constraining the ability of these governments to make the investments that are required to achieve climate and development goals.

KEY POLICY RECOMMENDATION:

The V20’s debt profile illustrates the need for a multi-pronged approach to tackling sovereign debt distress.

- First, debt solutions need comprehensive participation. The prominence of private bondholders and multilateral development banks as creditors indicates the importance of ensuring that debt restructuring efforts obtain their participation through appropriate incentives. Without the full engagement of all creditors, debt solutions will neither be effective nor lasting.
- Second, debt solutions must be ambitious. Debt relief should free up fiscal space so that countries can make the investments that they need to achieve their development and climate change goals. This will enable countries to focus on growth-enhancing investments. Relatedly, given the market access constraints and high cost of borrowing, finance must be affordable. Low-cost, long-term finance will be key.
- Finally, speed is of the essence. Debt solutions need to be rapidly deployed. The debt crisis is a development and climate crisis. Ambitious action is needed immediately so that countries can be on the path to climate prosperity.

Climate vulnerable economies have put forward ambitious Climate Prosperity Plans, nationally determined contributions, and national plans and policies. Without a supportive macroeconomic environment, undergirded by an effective sovereign debt architecture, not only will the goals articulated in national plans remain a distant reality, but the intensifying nature of climate change will roll back decades of progress made in development. Urgent action to alleviate debt distress will help secure benefits now and lay the foundation for shared prosperity - one that brings development-positive climate action.
INTRODUCTION

The urgency of addressing the climate crisis requires a rapid mobilization of resources towards climate-positive development. The Songwe report estimates that $2.4 trillion annually will be required by 2030 to meet climate change goals (Songwe, Stern and Bhattacharya 2022). The report of an Independent Expert Group (IEG) that was commissioned by the Indian Group of 20 (G20) Presidency estimates that $1.4 trillion will need to be mobilized domestically with $1 trillion from foreign sources. However, emerging market and developing economies are facing a challenging macroeconomic environment precisely when they need to be scaling up investments. Global economic growth is expected to remain weak, at 2.4 percent (World Bank 2024). What is more, 80 percent of the United Nations 2030 Sustainable Development Goals (SDGs) are off track. Long periods of under-investment will lead to a ‘development crisis,’ and development goals will continue to remain out of reach (United Nations 2023).

There is growing convergence on the need to reform the international financial architecture to achieve development and climate change goals. This policy message shone through major international summits that took place throughout 2023, including the UN SDGs Summit, the Africa Climate Summit, the Summit for a New Financing Pact and more. The Paris Agreement recently took stock of climate action through its Global Stocktake and recognized the close association between fiscal space and climate change investments (UNFCCC 2023).

The Vulnerable 20 (V20) Group is a bloc of 68 climate vulnerable economies. Climate vulnerable countries are already perceived to be risky compared to countries with similar macroeconomic fundamentals. This creates the condition for a vicious cycle between debt distress and climate vulnerability whereby underinvestment accentuates climate vulnerability and results in higher debt loads as countries recover and rebuild from climate impacts which in turn crowds out space for new investments. This vicious cycle dynamic is illustrated in Figure 1.

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V20 EXTERNAL DEBT PROFILE

This section highlights major trends in external public and publicly guaranteed debt. In the World Bank International Debt Statistics (IDS) database, data are available for 59 of 68 V20 members. In 2022, the total external debt stock of V20 members was $946.7 billion. The largest creditor class is multilateral development banks (MDBs) at 39 percent, with the World Bank forming 19 percent of the total V20 debt stock. Paris Club creditors and China follow at 11 percent and 9 percent, respectively. Figure 2 depicts the composition of V20 external debt stock by creditor class.

Figure 3 shows how the V20’s external debt stock has changed over time, from 2008 to 2018 and 2022. The evolving composition of the V20’s debt stock is congruent with the changing creditor landscape more generally (Ramos et al. 2023). Private bondholders have risen in prominence. MDBs continue to be highly salient for the V20 membership. Furthermore, there is a noticeable shift in the importance of new creditors, such as China, whose share rose to 9 percent in 2022 compared to just 2 percent in 2008. The share of the Paris Club creditors has declined from 23 percent in 2008 to 11 percent in 2022.
Over the period of 2022-2030, V20 members will be responsible for debt service payments totaling $904.7 billion. Figure 4 provides the breakdown in debt service payments by creditor class for the period of 2022-2030. Like debt stock, MDBs are the most significant credit class with payment obligations totaling 33 percent of the total. Bondholders come second with 25 percent, followed by Paris Club and China at 15 percent and 13 percent, respectively. In this period, private bondholders are owed debt service payments totaling $224 billion dollars (2022-2030). Multilateral creditors (World Bank and other MDBs) are owed $302 billion.

Figure 5 illustrates debt service payments by creditors over the 2022-2030 period. While the diagram depicts debt service payments peaking in 2024 at $122.1 billion, it is important to remember that the figure captures debt that has already been contracted. Countries are continuing to issue debt and a real-time figure would capture recently issued debt as well.

Based on the IMF’s classification system, 18 of 68 V20 members are in debt distress or at a high risk of debt distress. We define market access countries as those that have sovereign risk spreads plus a risk-free rate higher than 1,000 basis points. We also identify countries that are facing unsustainable borrowing costs in international capital markets, defined as the cost of capital exceeding the economic growth rate.

Following Domar (1944), debt is considered sustainable when the ratio between liabilities and the repayment capacity does not grow indefinitely. In other words, if the growth rate of debt exceeds the growth rate of the country’s ability to generate income to repay the debt, the debt burden becomes heavier. To estimate this cost of capital, we use data from the JP Morgan Emerging Market Bond Index (EMBI) and the Secured Overnight Financing Rate (SOFR) as the risk-free rate. For external debt, mostly denominated in foreign currency, a more appropriate indicator of repayment capacity would be exports (Medeiros and Serrano 2006; Bhering et al. 2019). However, since our projections are based on IMF World Economic Outlook data, which does not provide an estimate of nominal growth rate of exports, we use the domestic growth rate as a broadly informative indicator. Therefore, in this analysis, we offer a preliminary estimate of potentially unsustainable borrowing costs for external...
For a more comprehensive and precise evaluation of external debt sustainability, a deeper analysis is required. While the cost of borrowing in international markets can serve as a proxy for the highest cost of debt (which tends to increase its share in the weighted average sum over time), the absence of a reliable indicator of repayment capacity in foreign currency means that this analysis should be considered tentative (taken with a grain of salt) and supplemented with other measures of foreign currency access and with the inclusion of external liabilities more broadly.

Figure 6 captures the creditor breakdown of V20 members that are not eligible for the IMF Poverty Reduction and Growth Trust (PRGT). It captures the diversity of creditors which illustrates the complex credit landscape. These countries do not have access to concessional finance in the same manner that PRGT/International Development Association (IDA) eligible countries do.

The relationship between climate vulnerability and debt distress is also illustrated by Figure 7. In Figure 7, climate vulnerability as measured by the Notre Dame Global Adaptation Initiative (ND-GAIN) index score is plotted against debt service payments as a fraction of exports (over 2022-2028). The upward sloping trendline indicates a positive association between higher levels of climate vulnerability and higher levels of debt service payments as a fraction of exports, meaning that climate vulnerable countries are more likely to face higher debt service burden relative to their export earning.

![Figure 6: Main Creditors of PRGT Non-eligible Countries](source: Compiled by authors using World Bank IDS)

![Figure 7: Climate Vulnerability and Debt Service](source: IMF WEO database, World Bank IDS and ND-Gain (2022))
Figure 8 shows the evolution of the debt service-to-export ratio of the 10 countries with the highest ratio in 2022 (identified in Figure 8), and the navy line represents the average ratio of all 59 countries. For example, the debt service-to-export ratio for Mozambique, Pakistan and Colombia is 63 percent, 42 percent and 34 percent, respectively. The figure shows how there is considerable variation across the V20 members. 2022 marked the highest debt service-to-export ratio for these 10 countries; the average was 15 percent for the 59 countries. While the trend has slightly declined over the last two years, the debt service-to-export ratio remains large for many V20 members.

Debt service payments as a fraction of annual tax revenue provides another lens of the relative size of debt burden. On average, debt service payments represent 13 percent of tax revenues garnered by all V20 members. For eight countries, debt service represents more than 20 percent of their tax revenue.

Figure 9: Tax Revenue vs. Debt Service Payments
Source: Compiled by authors using World Bank IDS and IMF Data.

Note: The blue line is the average for the sample of 59 countries. The diagram depicts 10 countries with the highest ratio of debt service-to-exports.
The IMF identifies risk ratings for PRGT-eligible member countries. Eighteen V20 members are in external debt distress or have a high risk of external debt distress. Table 1 shows capital market access and borrowing costs for V20 members. Market access is defined as countries with sovereign spreads plus risk-free rates higher than the threshold of 1,000 basis points. The market access column in Table 1 identifies whether countries have market access or not based on this definition.

Table 1 also provides some insights about the sustainability of borrowing for V20 members. We define borrowing costs to be sustainable if the cost of capital is lower than the economic growth rate.

In other words, we define borrowing costs to be sustainable if the cost of capital is lower than the economic growth rate. In other words, if the cost of borrowing minus the nominal gross domestic product (GDP) growth rate projection is negative, borrowing is unsustainable, and the country is likely to witness an unsustainable debt load.

Further, data shows the capital market constraints faced by members. Apart from the countries facing debt stress, 18 countries as of January 2024 faced borrowing costs higher than their expected economic growth rates. Borrowing under such conditions is expected to lead to unsustainable debt burdens.

**DISCUSSION AND POLICY RECOMMENDATIONS**

The debt profile of the V20 illuminates the macroeconomic constraints shaping climate action in these countries. As 18 PRGT-eligible countries are at risk of debt distress, there is an urgent need for comprehensive debt relief to ensure that these countries have the fiscal space necessary to pursue their development and climate change goals. Based on the trends identified, mobilizing resources to meet the development and climate change goals requires a multi-pronged approach.

First, effective debt solutions must be deployed urgently. Efforts to tackle sovereign debt distress will need to include the full range of creditors as the creditor landscape has shifted. It is critical, for example, for MDBs to be a part of solutions, as they hold 40 percent of the total debt stock for V20 countries. This should include a wider participation of creditors in the G20 Common Framework, as well as broader reforms, such as ensuring middle-income countries have access and aligning the Common Framework with the Paris Agreement and the SDGs. Currently, 46 of 68 V20 countries have access to the G20 Common Framework.

To incentivize private creditor participation, the V20 has called for a guarantee facility to back new bonds (V20 2021). In exchange for taking a haircut comparable to other creditor classes, private creditors would be able to hold bonds that have payment streams guaranteed by the facility. This design encourages private sector participation and enables the debtor government to receive a steeper debt reduction. The freed fiscal space could be used to implement Climate Prosperity Plans and other nationally owned policies designed to achieve climate-positive development.

Debt restructuring discussions should be anchored by Debt Sustainability Analyses (DSAs) that incorporate climate shocks and the full benefits of transforming economies through development-positive climate investments and climate-positive development investments.

Second, V20 members face a high cost of borrowing in capital markets - only four countries have a cost of borrowing that is lower than the expected economic growth rate. Such high costs of borrowing are likely to lead to unsustainable debt paths. This underscores the need for scaled up concessional finance, grants and private sector participation. MDBs as providers of concessional, long-term financing will have an important role, particularly as the creditor landscape has shifted towards bondholders in recent years. Bondholders often require higher rates and offer shorter maturities. Development-positive climate investments require low rates with long-term horizons.

Third, MDBs need a capital increase to ensure that they have the funds to support scaled up investments. Relatedly, debt vulnerabilities underscore the importance of concessional finance. The G20 IEG has called for a tripling of IDA resources during the replenishment round (G20 IEG 2023), and this was echoed by the V20 Finance Ministers in October 2023 (V20 2023a). While the World Bank has offered climate resilient debt clauses to borrowing governments (World Bank 2024),
it is critical that this does not increase the cost of capital and evolves to include options for debt relief. Climate resilient debt clauses are expected to provide governments with some breathing room if countries are faced with shocks so that they can focus on rebuilding and reconstruction. This is a welcome step forward, but the list of qualifying countries should be expanded to include all climate vulnerable economies. The IMF’s Catastrophe Containment and Relief Trust (CCRT) could play a similar role; however, it needs to be urgently replenished. Its cash balance stands at Special Drawing Rights (SDR) 124 million (IMF 2024). Furthermore, the IMF should also expand eligibility to include climate vulnerable economies that are susceptible to rapid onset as well as slow onset shocks. A well-resourced CCRT should be one tool in the IMF’s toolkit to help countries address loss and damage and build a more shock resilient international financial architecture.

Climate vulnerable economies have put forward ambitious Climate Prosperity Plans, nationally determined contributions, and national plans and policies. Without a supportive macroeconomic environment, undergirded by an effective sovereign debt architecture, not only will the goals articulated in national plans remain a distant reality, but the intensifying nature of climate change will roll back decades of progress made in development. Urgent action to alleviate debt distress will help secure benefits now and lay the foundation for shared prosperity - one that brings development-positive climate action.

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APPENDIX

Figure A1 disaggregates creditor type for countries that are eligible to access the IMF’s Poverty Reduction and Growth Trust (PRGT). The figure depicts the external debt stock for these countries in 2022. Figure 6 illustrates the creditor classes for V20 members that are not eligible to access the PRGT.

Figure A1: Main Creditors of PRGT-eligible Countries
Source: Authors’ calculations based on World Bank IDS data.

METHODOLOGY NOTE

This worked relied on the World Bank’s International Debt Statistic data for 59 of 68 V20 countries. Countries with missing data include Barbados, Kiribati, Marshall Island, Namibia, Palau, Palestine, South Sudan, Trinidad and Tobago and Tuvalu. For the analysis, we used public and publicly guaranteed external debt series and IMF credit. For debt service, we also used public and publicly guaranteed data series and IMF repurchases and charges. It is important to highlight that these amounts are estimated. The current values may differ due to new debt issuances, as well as interest and exchange rate fluctuations. All projected data are based on the latest IMF World Economic Outlook Database (October 2023).