Climate Debt

Securing adequate climate finance without contributing to debt crises

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Introduction

In the years since the 2008 financial crisis, debt sustainability has worsened rapidly globally. Monetary policies, such as low interest rates and large quantitative easing in Europe and the United States, have aimed at boosting growth. A result of this is that lending has come at a historically low price. This has contributed to unprecedented debt growth globally, seen in both industrialized countries and emerging markets, but also in private companies as well as for individuals. On a state level, the past five years have shown an especially rapid debt accumulation in a number of developing economies. It is however not only the pursuit for economic growth that has driven this debt accumulation. In accordance with international agreements, developed countries shall provide climate finance to developing countries. The reason is that developed countries are the main drivers of climate change, while it is the developing countries that are experiencing the worst effects. However, more and more climate finance is provided as loans, and this may further deteriorate the debt situation for many countries and may ultimately undermine the climate agenda.

On the verge a new debt crisis

Emerging economies have been attractive for private investment due to their higher growth and interests compared to western countries. They have thus seen a rapid growth in debt through, among other sources of financing, issuance of government bonds. The pace of debt accumulation has for a number of countries quickly filled the fiscal space created by the Heavily Indebted Poor Countries Initiative, the debt relief scheme of the 2000s. Few years after the HIPC program 25 countries in the global south are already back at unsustainable debt levels, several of them post-HIPC countries. This process reveals a severe gap in the global financing infrastructure: A lack of adequate checks and balances to secure sustainable and responsible lending and borrowing.

According to the International Monetary Fund (IMF) 31 out of 67 low-income countries are now either in debt distress, or in high risk of being so. The IMF's definition of debt distress is primarily linked to the risk of default on loan repayment. However, one could argue that debt distress occurs earlier than the risk of default – namely when state authorities have to cut public spending on welfare goods in order to free up funds for repayment of debts. The Jubilee Debt Campaign UK uses this broader definition of debt distress when they classify 31 countries of being in debt distress globally, and a further 82 at risk of being so.

When it comes to the case of financing the green shift, this latter definition is useful. Loans to fund climate projects may contribute to unsustainable debt levels and affect a country's possibility to finance social spending. Furthermore, when a state is entering debt distress, the country in question may become unable or reluctant to accepting loans linked to new projects, such as climate measures. If having to choose between providing basic services in health, education and pensions for its citizens on the one hand, and prioritizing green infrastructure on the other, the green shift might receive the short end of the stick.

In short, financing of the green shift and climate change might be linked to debt crisis in four different ways:

1. Providing climate finance through loans without a debt sustainability analysis beforehand might contribute negatively to overall debt sustainability. Some countries are simply unable to take up additional loans without compromising their financial stability or public spending obligations.
2. Once a nation has entered debt distress, financing the green shift will be one of the casualties. Therefore, to secure the necessary sustainable financing, greater emphasis has to be laid on responsible lending and borrowing, debt restructuring and provision of grants to finance climate projects.
3. New UN commissioned research shows that the financial costs of climate risks will rise in the future and that there will be an increase in the cost of debt servicing for climate

vulnerable countries; loans will become more expensive. The capacity of developing countries to finance themselves through external borrowing, both for climate adaptation and other development projects, is thus at stake.

4. Countries that are experiencing the consequences of climate change and disasters often have to finance rebuilding and recovery through loans. This further increases the debt burden of these vulnerable countries, leaving them unable to take up additional loans for climate mitigation and adaptation and/or basic public services.

Financing climate change through loans

The UN has set an international goal of providing USD 100 billion in climate finance from developed countries to developing countries, due to the former's high emissions and historical responsibility. Estimates from Oxfam show that according to developed countries' own reporting, they are halfway to meeting that goal, providing USD 48 billion on average in 2015 and 2016. However, Oxfam's estimates also show that grants constitute only about 25 percent of this, and that if a calculation of the grant equivalent of the non-grant instruments is used, we end up with about USD 25 billion annually. This is only half of what is reported, and just a quarter of the UN-agreed goal. Based on the situation as described above it is thus problematic that so much of the climate finance provided consists of loans. Arguably, only grants or the grant equivalent of loans should count towards the USD 100 billion goal, and it must be additional to regular ODA.

Furthermore, the lack of consistency and a mutually agreed method for reporting the climate finance towards the USD 100 billion goal makes it difficult to know exactly how much is given as loans and the conditions of these loans. It is thus of the utmost importance that the negotiating parties at the COP24 come to an agreement and common understanding of how climate finance should be reported, and that transparency and available data of this is prioritized.

Concessional loans may play a part in mobilizing sufficient amounts of funds for climate projects. However, it is important to take into account that a loan, whether concessional or non-concessional, is still a loan that needs to be repaid and is thus a large expense on a country's budget. If this is going to be used as a tool, debt sustainability analyses must be made and principles for responsible lending and borrowing must be implemented. This also applies to climate projects financed through public-private partnerships (PPPs). PPPs often entail contingent liabilities for governments in the sense that a government engaging in a PPP often assumes liabilities should the project fail. Project failure will then transfer repayment obligations to the government in question. Climate financing through PPPs can therefore contribute to hidden government debt. Due diligence through debt sustainability analyses should therefore also be executed in PPP projects. Contingent loan obligations through public-private partnerships should also be recorded on public balance sheets.

In our common interest

The current global discourse regarding financing for the climate and sustainable development goals is centered around mobilization of private finance and maximizing finance for development. The focus of the Norwegian government on development is largely on domestic resource mobilization, i.e. tax collection. The idea that by improving the systems and institutions for tax collection and increasing the tax base states will have greater capacity to meet new challenges, is good. However, these institutional and structural changes take many years to implement, and with the urgency of climate change there is arguably no time to wait for this to come into place. Additionally, climate change itself has impact on the tax base and opportunities for growth and income by disrupting the natural environment upon which many rely for revenue. Thus, it is not realistic that domestic resource mobilization will be sufficient or be in place in time to finance climate projects. The urgency of the matter requires that funds are provided to those who cannot mobilize this on their own.

The climate goals will not be reached if not all countries cut emissions and contribute, thus it is in our common interest that all countries are able to implement mitigation and adaptation measures. If they are not able, due to high debt levels or a limited fiscal space, poverty or other reason, it is the responsibility of the countries with capacity to ensure that climate efforts are made, by providing funding. The countries with the least amount of responsibility for the current climate situation cannot risk debt distress or pay the price for emissions to which they have neither contributed nor benefited from.

The Norwegian Government should:

- Promote transparent and coherent reporting of climate finance
- Promote openness and availability of data on grants, loans and types of loans, including their conditions
- Promote that the grant equivalent of loans is reported when climate finance is provided as a loan.
- Work for a global consensus on principles for responsible lending and borrowing
- Ensure that the most vulnerable and poor countries receive climate finance as grants
- Ensure that debt sustainability is considered when providing climate finance, but high levels cannot jeopardize the access to finance for adaptation and mitigation: grants must thus be provided
- Propose that debt restructuring is part of the process when providing climate finance, as this may free large amounts of means that can go to climate efforts
- Promote due diligence through debt sustainability analyses and on balance sheet recording of debt obligations pertaining to PPP projects financed through loans
- Continue to be a leading country that only reports the grants towards the USD 100 billion goal, and should advocate that others do the same
- Provide more climate finance and make it additional to regular ODA