THE WORST EVER GLOBAL DEBT CRISIS: PUTTING CLIMATE ADAPTATION SPENDING OUT OF REACH

Produced by:

Development Finance International

In partnership with:

Debt Justice · Norwegian Church Aid (actalliance) · erlassjahr.de (Entwicklung braucht Entschuldung) · Latindadd (Red Latinoamericana por Justicia Económica y Social) · Jubilee USA Network · AFRODAD

SUMMARY

This policy briefing, prepared for the COP 28 Climate Summit in Dubai, shows that the debt crisis is putting climate adaptation spending way out of reach. Based on Development Finance International's new Debt Service Watch (DSW) database, it shows that citizens of the Global South face the worst debt crisis since records started. Debt service is absorbing on average 38% of budget revenue and 30% of spending across the Global South. This rises to 54% of revenue and 40% of spending in Africa. In climate vulnerable small island developing states (SIDS), debt service is absorbing 30% of revenue and 21% of spending. Across all countries of the Global South, 35 countries are paying more than half of revenue, and 54 over one third in debt service. These figures are more than twice the levels faced by low-income countries before debt relief was provided via the Heavily Indebted Poor Countries (HIPC) Initiative and Multilateral Debt Relief Initiative (MDRI); and slightly higher than those paid by Latin American countries before the Brady Plan in the 1980s.

The UN Environment Programme (UNEP) estimates that spending needs for climate adaptation in the Global South are up to US$340 billion a year: of this, Official Development Assistance (ODA) for adaptation is only US$36 billion. This briefing compiles the latest data on planned spending on climate adaptation by lower-income countries and small island developing states (SIDS) reported in their Nationally Determined Contributions (NDCs) to the UNFCCC. It finds that for 42 countries, planned spending on climate adaptation totals only US$12.7 billion. Most countries are spending less than 2% (many less than 1%) of their budgets on adaptation. Two conclusions can be drawn: (1) there is a massive shortfall in current adaptation spending, and (2) far more countries need to report transparently to the UNFCCC how much they are spending.

Debt is pushing aside key spending to confront the climate crisis at a time when taking action to tackle climate change is becoming increasingly urgent. In 2023, spending on debt service will be ***12.5 times higher*** than spending on climate adaption. Failure to invest now in tackling climate change will also push up future costs.

Developing countries need another major round of debt cancellation to allow them to spend more on climate adaptation. Yet current debt relief efforts are falling well short of what is needed to free-up room for scaled-up investments in climate adaptation: the most recent debt relief deals are leaving debt service at average 48% of revenue. The international community must take urgent steps to reduce debt service much more sharply, through enhanced debt relief and reduced borrowing costs. Only with these measures can it provide its fair share of funding for climate-related actions and put SDG 13 (climate action) within reach.

THE WORST EVER DEBT CRISIS IN THE GLOBAL SOUTH

Since the COVID-19 pandemic, international policymakers have agreed there is a new debt crisis in many countries of the Global South. However, many in the international financial community continue to argue that this is not yet a "systemic" crisis and is less serious than past global debt crises. They have advanced two reasons for this assessment, that: i) relatively few countries (especially among the largest debtors) have defaulted on their external debts in recent years; and ii) debt/GDP ratios are lower than they were before and during the Latin American debt crisis of the 1980s, or the low-income country debt crisis of the 1990s.

On the other hand, the UN Secretary-General has stated that the debt crisis is extremely severe and widespread. This is because the UN is assessing the crisis based on the effects debt is having on prospects of reaching the Sustainable Development Goals (SDGs). UN agencies have found that debt service is massively crowding out spending on public services to reduce poverty and inequality (education, health, social protection); and to confront climate and other environmental crises (like nature and biodiversity loss).

Evidence to support this development-based assessment has until now been limited. Data on both debt service and SDG spending have not been timely enough; debt service data have covered only external debt, and social protection and climate spending data have been old or non-existent. This briefing draws from a new database, Debt Service Watch, compiled by Development Finance International (DFI) with financing and support from Norwegian Church Aid, LATINDADD and UNAIDS. It covers 139 countries and compares domestic and external debt service with total government revenue and spending, and spending on education, health, social protection and climate adaptation. It has been compiled from national budget and debt management documents, IMF programme documents, and various international spending databases.

A companion briefing entitled "The Worst Debt Crisis Ever: Shocking New Debt Service Numbers" was released at the 2023 Annual Meetings of the IMF and World Bank in Marrakech, Morocco, and looked at debt service versus spending on education, health and social protection. This briefing is being released at the COP28 Climate Change Conference in Dubai in November-December 2023. It looks at debt service versus spending on climate adaptation, and assesses the extent to which high debt service is crowding-out much-needed (and urgent) investments in climate adaptation.

DEBT SERVICE AND CLIMATE ADAPTATION SPENDING: THE FINDINGS

1/ FINANCING NEEDS AND CURRENT SPENDING ON CLIMATE ADAPTATION

According to the Intergovernmental Panel on Climate Change (IPCC), approximately 3.3–3.6 billion people live in contexts that make them highly vulnerable to climate change.[1] They are located mostly in the Global South, which is already disproportionately suffering from the worsening impacts of climate change whilst being the least responsible for it. In 2022, the United Nations Environment Programme warned that climate adaptation was becoming more expensive as climate change rapidly sets-in. It estimates that between US$160 billion and US$340 billion needs to be mobilised annually for the countries of the Global South by 2030.[2] Yet just a fraction of this is currently being mobilised by domestic public budgets and donor flows.

[1] See: IPCC Sixth Assessment Report

[2] UNEP Adaptation Gap Report, 2022: Too Little Too Slow

When it comes to ***donor flows***, the OECD reports that in 2021, just US$24.6 billion (27% of total climate finance mobilised that year) was provided for climate adaptation to all developing countries, down US$4 billion or 14% from 2020. A further US$11.2 billion had dual climate mitigation and adaptation aims.[3] In total, US$89.6 billion was provided by OECD-DAC donors for climate-related actions in 2021, falling short of the US$100 billion pledged by the international donor community by 2020. Of particular concern are the low shares allocated to low-income countries (9%) and climate vulnerable countries like small island developing states (4%). The OECD reports that the US$100 billion target is likely to be met in 2022, two years behind schedule, but these resources are mostly *not* being provided in addition to previous development aid, and are instead being sourced from existing aid budgets.[4] Of equal concern, over 2/3 of climate adaptation ODA is being delivered as loans which increase debt in the Global South, specifically 84% of climate finance to transportation and storage; 78% to disaster preparedness; 71% in water and sanitation; and 59% in agriculture.[5] Blended finance approaches, which are also increasing in popularity, can also increase indebtedness. While there has been an agreement on a historic loss and damage fund to help compensate poor and climate vulnerable countries from climate breakdown, the extent to which this will be sufficiently capitalised by wealthy countries to the tune of the trillions of dollars needed by the Global South remains unclear.

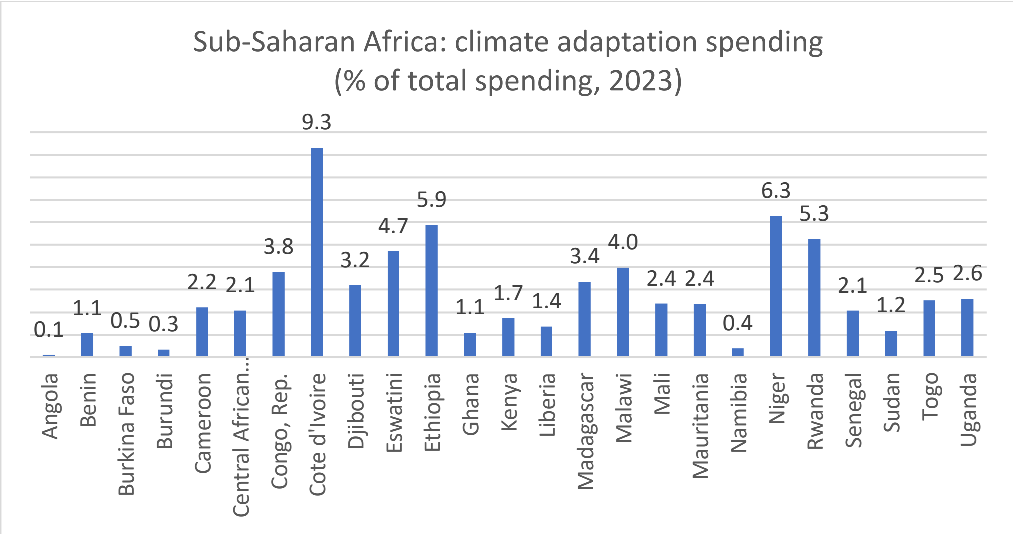
Data on ***developing countries' budget allocations*** to climate adaptation are more difficult to track since country reporting systems and reporting periods differ. However, Development Finance International and Debt Justice have partnered to analyse countries' most recent NDC reports submitted to the UNFCCC, which set out what a country plans to invest in climate change adaptation.[6] The plans are a mixture of what a country would *like to* invest if it received international funding to do so, and what it *will invest* from its own domestic resources. They represent the most up-to-date figures on current and planned adaptation spending. The research prioritised lower middle-income and low-income countries, and small island developing states because these countries have extremely high climate adaptation financing needs as a proportion of national output, but have the fewest resources to invest in climate adaptation.

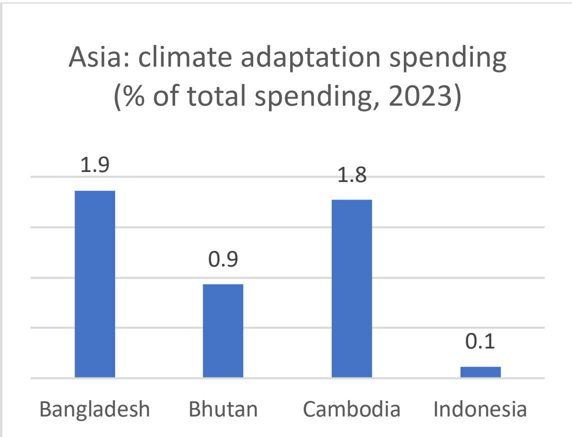
In total, we found data on climate adaptation spending for 42 developing countries (see annex for full list). In 2021, these 42 countries reported a total of US$12.7 billion in climate adaptation spending: of this, US$4.6 billion is in Sub-Saharan Africa, US$1.36 billion in Asia, US$1 billion in Latin America and the Caribbean and US$5 billion in the Middle East and North Africa – but only US$178 million in SIDS. For many countries, there are no data at all, highlighting a need for much more systematic - and standardised - reporting to understand how much is being planned and spent on adaptation to climate change. These figures are also probably an overestimate – in some countries, *actual disbursements* may be lower (sometimes much lower) than plans.

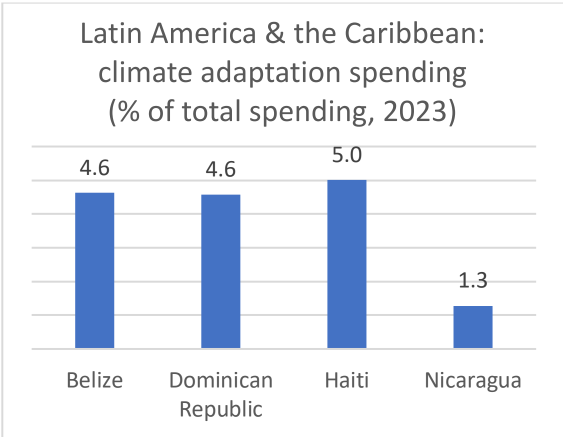
In most countries, the amounts being spent on climate adaptation represent a very small share of their overall budget spending for that year. In Sub-Saharan Africa, nine out of 25 countries are spending less than 2% of their budget on climate adaptation, and four less than 1%. In SIDS, Comoros, Dominica, the Solomon Islands and Tuvalu are all allocating less than 2% of their budget. In Asia, all four countries analysed are

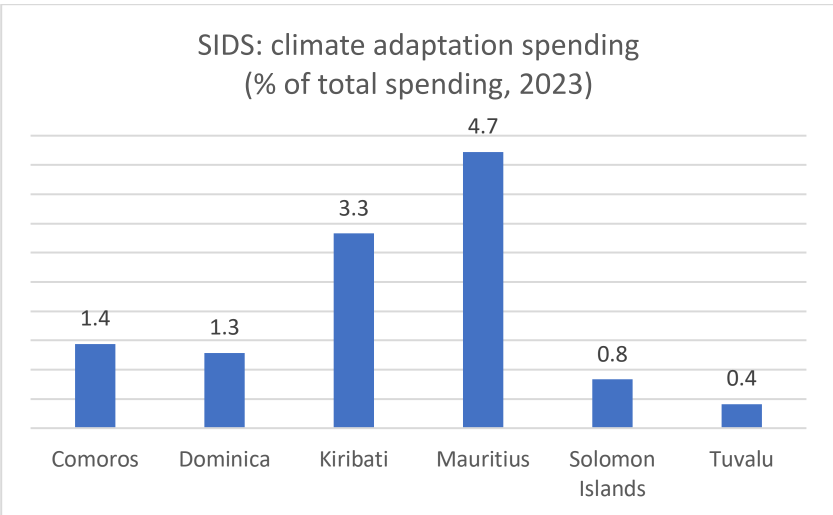
[3] OECD, Climate Finance Provided and Mobilised by Developed Countries in 2013-2021
[4] OECD, Growth accelerated in the climate finance provided and mobilised in 2021 but developed countries remain short and must continue scaling up to reach the USD 100 billion goal, November 2023
[5] OECD, Scaling Up Adaptation Finance in Developing Countries: Challenges and Opportunities for International Providers
[6] Research carried out in partnership with Debt Justice UK. See: https://debtjustice.org.uk/

currently allocating less than 2%. In Latin America and the Caribbean (LAC), three countries are reporting over 4% of GDP being spent on climate adaptation, making it vital to check whether the plans are being met.









2) DEBT SERVICE IS CROWDING OUT SPENDING ON ADAPTATION TO CLIMATE CHANGE

One key challenge to scaling-up much-needed financing for climate adaptation is high levels of public debt. Global debt burdens are the highest since records began. DFI has found that the key ratio which the IMF and World Bank use to measure the debt service or "liquidity" burden of public debt is the debt service/budget revenue ratio, which shows a country's fiscal capacity to pay its debts. Debt service currently averages 38% of budget revenue (excluding grants) across 139 countries of the Global South, and 57.5% for low-income countries. By way of comparison, the HIPC Initiative of the 1990s and early 2000s targeted a debt service/revenue ratio of 15%, arguing that this ratio would enable low-income countries to scale-up essential pro-poor spending (which they did). In terms of the worst affected countries (measured as debt service over 50% of revenue), 18 are in Sub-Saharan Africa, 6 in Latin America and the Caribbean, 5 in the Middle-East and North Africa and 5 in Asia. In total, 25 low-income countries are classified by the IMF at "high risk" of debt distress while a further 10 are classified as already "in debt distress.[7]

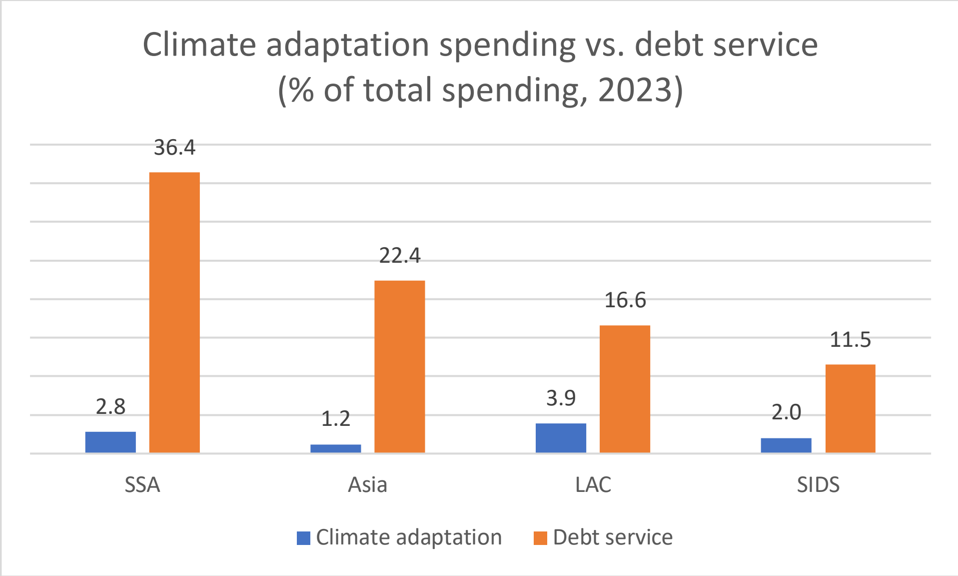
As a proportion of total budget spending, debt service is a huge problem in many countries, including in many low-income countries and small island developing states. In 2022, countries in the Global South spent on average 27.8% of their public budget on debt service. In 2023, it is projected to rise to 29.6% and climb higher to 30% in 2024.

The situation is however even more difficult in many African countries and small island developing states. In 2022, Sub-Saharan Africa countries spent on average 35.7% of their public budgets on debt service; in SIDS, it was on average 21% but this hides wide variations across island nations. For example, Papua New Guinea and Sao Tome and the Principe spent 70% of their public budget on debt service in 2022. The Bahamas spent over 50% while in the Seychelles it was over 40%. Antigua and Barbuda, the Dominican Republic, Guinea-Bissau, Jamaica and Suriname all spent above 30%.

In the 42 countries of the Global South analysed for this report, debt service represented on average 32.7% of the public budget in 2023, while climate adaptation spending came in at only 2.5%. This means that in 2023, ***debt service is 12.5 times higher than the amount spent on climate adaptation***; and based on 2024 budgets and debt service ratios, ***this will rise to 13.2 times***.

Broken down by region, the data show that in 25 Sub-Saharan African countries, debt service was particularly high at 36.3% of the budget while climate adaptation spending was only 2.7%. In six SIDS, debt service represented 11.5% of the budget while climate adaptation spending was just 2%. In four countries of Asia, debt service represented 22.3% of the budget but climate adaptation spending was only 1%. In four LAC countries, debt service amounted to 16.5% of the total budget while climate adaptation spending was on average 3.8%. And of course, actual climate spend might be lower while debt service (which is typically given "statutory priority" in countries' budget payments) will not be.

[7] IMF. Correct as at August 2023. See: https://www.imf.org/external/pubs/ft/dsa/dsalist.pdf



3) CURRENT DEBT RELIEF IS WOEFULLY INADEQUATE TO ADAPT TO CLIMATE CHANGE

Faced with these historically high burdens, is the current debt resolution architecture providing adequate debt relief to free-up room for increased spending on climate adaptation in line with countries' increasingly urgent needs?

Judging by the recent agreements reached or under negotiation with Chad, Ghana, Sri Lanka, Suriname and Zambia, the answer is clearly no. After their recent debt restructuring deals, according to IMF forecasts, these countries will still be paying an average of 48% of their budget revenue on debt service over the next 3 years, with only Sri Lanka bringing its service below 30% of revenue (but well above the HIPC Initiative target of 15%). They will also have to cut government spending by a cumulative 4% of GDP over the next 5 years.

TABLE 1. DEBT SERVICE TO BUDGET REVENUE AFTER DEBT RESTRUCTURING

	2023	2024	2025	Average
Chad	65	53	48	55
Ghana	42	59	72	58
Sri Lanka	26	19	18	21
Suriname	36	44	37	39
Zambia	75	62	59	65

Debt is already playing a key role in preventing countries from scaling-up much needed – and urgent – investments in adaptation to climate change. By prioritising their fiscal resources for debt service, this situation may even be exacerbating the climate crisis, as countries may be forced to maximise their exports to generate the foreign exchange required to meet high debt service costs. This often means, in turn, continuing fossil fuel extraction that is profitable in the short-term and even expanding fossil fuel projects, potentially delaying their own energy transitions in the process.

In addition, for many countries in the Global South, especially the poorest, spending on education, health and social protection are also extremely low and far from the levels needed to achieve universal coverage of these services (see DFI's companion policy briefing here). In this context, it can be politically very difficult to scale-up spending on adaptation to climate change, particularly from domestic public sources, even where there are clear positive benefits to the poor of doing so. For example, investments in climate resilient agriculture can have a disproportionate benefit on the poor, since poor farmers are particularly exposed to the terrible impacts of extreme climate events like drought. Investments in upgrades to buildings and homes in hurricane and cyclone-prone regions can help protect small and medium-sized businesses and vulnerable households who are more likely to live in or trade from sub-standard structures, or be located in high flood-risk zones. It can also dramatically reduce fatalities and injuries and therefore reduce forecast health spending needs.

Looking forward, climate change is likely to further stretch public finances as a failure to invest sufficiently in climate mitigation and adaptation further increases the costs of sustainable development, increases vulnerability and leads to losses in economic output and higher health costs. This could force countries in the Global South to take-on even more debt. Ironically, increasing vulnerability to climate change can also increase borrowing costs for the countries that can least afford it, as their credit ratings are downgraded.

It is clear that in a context of high debt, many developing countries have very little scope to scale-up spending on climate adaptation at the pace and scale that is needed, putting SDG13 (and several others) at serious risk. The same scale of effort as that which was provided under the HIPC and MDRI debt relief initiatives is needed. This should see debt service brought down to no more than 15% of budget revenues, and involve a real haircut on the debt by all creditors where needed. For countries that depend on bond markets for their financing needs, it is also essential that measures are taken now to reduce their borrowing costs sharply.

Only with enhanced debt relief and reduced borrowing costs, and access to scaled-up concessional financing free of conditionalities such as through a new allocation of Special Drawing Rights (SDRs), will it be possible to fund the UN Secretary General's suggested SDG Stimulus package of US$500 billion a year and put SDG13 back-on-track. To be truly effective, these measures must all be in addition to ODA and unfulfilled climate finance commitments. The window for action is rapidly shrinking and there is no time to waste.

#CancelTheDebt #DebtCrisis #COP28

About Development Finance International

Development Finance International is a non-profit research and capacity-building organisation. It has worked for 32 years with more than 60 Global South governments, helping them to mobilise the best development finance and debt relief to reduce poverty and inequality, and confront the climate crisis. It has also provided advice and analysis to intergovernmental organisations, development partners, civil society organisations (including Jubilee 2000), trade unions and parliamentarians. For more details, see www.developmentfinance.org

This briefing was written by Gail Hurley and Matthew Martin, based on data provided by Myriam Sallah and David Waddock, with inputs and support from Debt Justice.

ANNEX: CLIMATE ADAPATATION AND DEBT SERVICE SPENDING FOR 42 COUNTRIES (2024)

Country	Climate Adaptation Spending (% total expend.)	Debt Service (% total expend.)	Country	Climate Adaptation Spending (% total expend.)	Debt Service (% total expend.)
Angola	0.10	70.25	**Indonesia**	0.12	29.35
Bangladesh	1.86	25.71	**Kenya**	1.73	52.93
Belize	4.63	16.04	**Kiribati**	3.33	1.28
Benin	1.07	27.81	**Kyrgyz Rep.**	1.55	16.73
Bhutan	0.93	34.47	**Liberia**	1.38	27.99
Burkina Faso	0.50	43.92	**Madagascar**	3.36	36.92
Burundi	0.34	37.96	**Malawi**	3.99	57.41
Cambodia	1.77	5.48	**Mali**	2.39	46.52
Cameroon	2.21	35.70	**Mauritania**	2.37	14.77
Central African Rep.	2.08	33.74	**Mauritius**	4.72	24.61
Comoros	1.44	17.64	**Namibia**	0.39	12.13
Congo, Rep.	3.78	71.87	**Nicaragua**	1.28	15.87
Cote d'Ivoire	9.30	37.58	**Niger**	6.28	36.23
Djibouti	3.20	15.94	**Rwanda**	5.25	33.80
Dominica	1.28	18.74	**Senegal**	2.06	20.90
Dominican Rep.	4.57	24.24	**Solomon Islands**	0.83	4.01
Egypt	4.61	154.31	**Sudan**	1.17	10.00
Eswatini	4.71	13.13	**Togo**	2.53	38.28
Ethiopia	5.88	22.98	**Tuvalu**	0.41	0.57
Ghana	1.09	100.05	**Uganda**	2.60	39.72
Haiti	5.00	18.99	**Zambia**	0.01	88.50