V20 | VULNERABLE TWENTY GROUP

V20 Debt Review

An account of debt in the Vulnerable Group of Twenty

BU Global Development Policy Center

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Global Development Policy Center

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I. EXECUTIVE SUMMARY

Emerging market and developing countries (EMDs) are struggling to cope with the persistent presence of the COVID-19 pandemic, the global ramifications of Russia's war in Ukraine, a growing climate crisis and rapid interest rate increases in advanced economies.

The Vulnerable Twenty (V20) Group of Finance Ministers includes 55 climate vulnerable economies. This group is at the epicenter of these crises which threaten their ability to mobilize the necessary resources to build resilient and low-carbon economies moving forward. Even prior to the pandemic, debt levels were climbing across developing countries. In the V20, total debt climbed from $464 billion in 2015 to $570 billion in 2018 and $686 billion in 2020. This comes at the same time that investments in sustainable infrastructure investments need to be scaled up by $3.2 trillion per year to meet the UN 2030 Sustainable Development Goals and to limit global warming to 2°C (Bhattacharya et al. 2019).

In addition to other necessary global measures such as increasing the availability of global liquidity and insurance, the V20 released a statement calling for a global debt restructuring scheme (V20 2021) that would link debt relief to climate and development goals prior to the 2021 United Nations Climate Conference in Glasgow (COP26).

To provide background on the scale, composition and distribution of V20 debt, this policy brief provides a detailed look at the V20's debt profile. It identifies the creditors, their relative salience and trends in debt servicing costs. Understanding these components of the V20's debt profile is crucial to devising a global debt workout and coordinated policy response that places climate change and vulnerable nations at the center.

KEY TAKEAWAYS

- In terms of external debt *stock*, the V20 as a group has a total of $686.3 billion in external public debt. This amounts to 27 percent of the group's gross domestic product (GDP). The V20's total debt stock is one-fifth of all developing country debt (public and publicly guaranteed).
- Private creditors comprise the largest share of external debt stocks in V20 countries at 36 percent, followed by the World Bank at 20 percent and multilateral development banks not including the World Bank at 20 percent. In terms of bilateral credit, Paris Club nations hold close to 13 percent of V20 debt stocks and China holds 7 percent of the total.
- In terms of external debt service *payments*, between 2022-2028, V20 countries will be responsible for almost $435.8 billion in payments to various creditors, with 2024 a particularly acute year at $68.9 billion. Again, private creditors top the payments list (34.6 percent), followed by multilateral institutions (16 percent) and the World Bank (12

percent). China is fifth with a share of 10 percent.

- Countries with the highest outstanding commitments are Colombia ($51 billion), Vietnam ($32.6 billion), Sri Lanka ($31 billion), Bangladesh ($30 billion) and the Philippines ($29.7 billion).
- Lebanon, Bhutan, Maldives and Mongolia have the highest debt-to-GDP ratios. Their debt compositions, however, are different. While private creditors hold most of Lebanon and Mongolia's debt, China is the largest creditor of the Maldives. For Bhutan, bilateral debt forms the largest share, and the precise amount owed to China is uncertain.
- For 13 V20 countries classified as in debt distress or at high risk, the debt stock composition shows that the private sector owns 29 percent of the total debt stock, the World Bank holds 24 percent, China holds 16 percent and bilateral creditors without China also own 16 percent.
- Private bondholders are expected to receive the largest share of payments between 2022-2027, but from 2028 onward, multilateral development banks (MDBs) overtake private bondholders. Of the $18 billion that the V20 will owe to the MDBs, the World Bank is expected to receive $8 billion, with other MDBs receiving $10 billion.

As is the case with the broader group of EMDs, V20 debt portfolios consist of a much more diverse set of creditors than in previous eras, which makes restructuring debt more challenging. Nevertheless, given the diverse debt portfolio of V20 countries, comprehensive debt restructuring across all creditor classes is urgently necessary, rather than case-by-case bilateral negotiations with specific creditor classes.

II. INTRODUCTION

Emerging market and developing countries (EMDs) are struggling to cope with the persistent presence of the COVID-19 pandemic, the global ramifications of Russia's war in Ukraine, a growing climate crisis and rapid interest rate increases in advanced economies.

Even prior to the pandemic, debt levels were climbing across developing countries. In the Vulnerable Twenty (V20) Group of Finance Ministers – a bloc of 55 climate vulnerable nations – total debt climbed from $464 billion in 2015 to $570 billion in 2018 and $686 billion in 2020. This is in the context of the need for a stepwise mobilization of resources across V20 countries to build resilient and low-carbon economies. According to Bhattacharya et al. (2019), investments in sustainable infrastructure investments need to be scaled up by $3.2 trillion per year to meet the UN 2030 Sustainable Development Goals and to limit global warming to 2°C.

V20 economies are being squeezed from multiple sides. They are witnessing supply chain bottlenecks from COVID-19, capital flight as interest rates rise in advanced economies, rocketing fuel and food prices and rising costs of inputs, such as fertilizers, that jeopardize future food production levels from Russia's war in Ukraine and associated sanctions. Given their dependence on imported oil, the V20 are particularly sensitive to fluctuations in fossil fuel prices; only Guyana, Timor-Leste, Sudan, Ghana and Colombia have oil rents of more than 2 percent of their gross domestic product (GDP) (World Bank 2022).

Climate change itself is also raising the cost of capital for V20 countries. Higher levels of climate vulnerability are associated with higher costs of sovereign borrowing (Volz et al. 2020; Beirne et al. 2021). Based on an examination of historical bond yields and spreads, countries that are more resilient to climate impacts face lower borrowing costs than countries that are more vulnerable (Cevik and Tovar Jalles 2020). Moreover, credit rating agencies are increasingly viewing climate change as a sovereign risk, which may further impact borrowing costs (Volz et al. 2020).

Before the 2021 United Nations Climate Conference in Glasgow (COP26), the V20 released a statement on debt restructuring (V20 2021) proposing an initiative linking debt relief to a green and inclusive recovery. This policy brief provides a detailed look at the V20's debt profile. It identifies the creditors, their relative salience and trends in debt servicing costs. Understanding these components of the V20's debt profile is crucial to devising a global debt workout and coordinating global policy that places climate change and vulnerable nations at the center.

III. DEBT DISTRESS AND CLIMATE CHANGE

International Monetary Fund (IMF) Managing Director Kristalina Georgieva has noted that 60 percent of low-income countries are already either in or at high risk of debt distress (IMF 2022). Such a fiscal situation not only constrains the ability of governments to meet immediate development needs but also limits their ability to invest in longer-term challenges, such as climate change. As countries spend a large share of their revenue on debt payments, governments have found it challenging to put together meaningful crisis response packages from the myriad crises they face. Existing data shows that low- and middle-income countries have spent far below what advanced economies have spent in pandemic response and recovery (UN 2022). Moreover, many developing countries provided recovery packages by reducing public expenditure in other areas (UN 2022).

The need to make climate investments continues to grow. A recent V20 report on loss and damage estimated that between 2000-2019, the V20 suffered losses amounting to $525 billion due to temperature and precipitation impacts, or 76 percent of the V20's debt stock and 20 percent of GDP (V20 2022). The report also found that climate losses negate increases in GDP for 10 percent of the V20 members (V20 2022).

When scarce public finances are mostly spent on paying debt service rather than making the necessary investments to build a more resilient economy, the most vulnerable countries will be locking themselves in a cycle of unsustainable debt further fueled by climate impacts. Countries that have manageable levels of debt may also find their fiscal space constrained if their adaptation needs are so great (Chamon et al. 2022). In an IMF working paper, the authors found that, out of 29 low-incomes countries with adaptation needs, only seven have the necessary fiscal space to make those investments (Chamon et al. 2022). In other words, without a combination of debt relief and grants, these countries will not have the fiscal space to address climate change.

The IMF classified 13 V20 members as being in debt distress or are at a high-risk of debt distress. These countries owed $118.6 billion (17 percent of V20 total debt) in debt in 2020, or $9.1 billion on average per country. Of these, the countries with the highest outstanding debt to GDP include the Maldives, Samoa, Sudan and Grenada at 76 percent, 49 percent, 48 percent and 48 percent, respectively. Twenty-two out of the 55 V20 countries qualify as Heavily Indebted Poor Countries (HIPC). For HIPCs, debt service payments between 2022-2028 are nearly five times their climate change adaptation costs (author calculations using adaptation costs from Nicholls et al. 2019 and Bellon, Matthieu, and Massetti. 2022).

As shown below, between 2022-2028, V20 members will be responsible for almost $435.8 billion in debt service payments to various creditors. In 2024, V20 members will see their debt payments rise to the highest level this decade at $68.9 billion. Countries with the highest outstanding commitments are Colombia, Vietnam, Sri Lanka, Bangladesh and the Philippines at $51 billion, $32.6 billion, $31 billion, $30 billion and $29.7 billion, respectively (author calculations).

However, despite their vulnerability to climate impacts, their carbon footprints are negligible. On average, V20 members emit 1.53 tons of carbon dioxide emissions annually, though there is considerable diversity amongst the V20 membership (World Bank 2022). The V20 consists of 40 low-income countries and lower middle-income countries, 13 upper middle-income countries, two high-income countries (Barbados and Palau). The V20 also includes 17 small states. The average GDP per capita of V20 members was $3,391 in 2020 (World Bank 2022).

IV. THE V20 EXTERNAL DEBT PROFILE

Given their vulnerability, V20 nations have had trouble navigating the global capital flow cycle amidst the turbulence that has wracked the world economy in recent years. Given the enormous resource mobilization needs and the lack of climate finance for V20 countries, governments turned to capital markets and development finance institutions for help. Quantitative easing and associated low interest rates in advanced economies made the costs of capital relatively cheap and fueled growth and exchange rate appreciation. Countries then saw themselves as having seemingly more collateral and borrowed more. COVID-19, Russia's war in Ukraine and recent interest rate hikes to tame inflation in advanced economies have led to a sudden stop and capital flight from EMDs—depreciating exchange rates and increasing foreign currency denominated debt.

This section of the policy brief provides an overview of the debt profile for V20 countries.

A DIVERSITY OF CREDITORS

A closer look at the V20 debt profile reveals illuminating trends. The V20 as a group has a total of $686.3 billion in external public debt. This amounts to 27 percent of the group's gross domestic product (GDP) and amounts to one-fifth of all developing country debt (public and publicly guaranteed). Of this total, private creditors hold a third of the debt at 36 percent. The World Bank and other multilateral institutions follow at 20 percent each. China holds 7 percent of the total, while the total share of Paris Club bilateral loan is 13 percent. Figure 1 illustrates the creditor disaggregation for the outstanding debt stock.

Lebanon, Bhutan, Maldives and Mongolia have the highest debt-to-GDP ratios. Their debt compositions, however, are different. While private creditors hold most of Lebanon and Mongolia's debt, China is the largest creditor of the Maldives. For Bhutan, bilateral debt forms the largest share, and the precise amount owed to China is uncertain.

In terms of debt service payments, the most significant creditors between 2022-2028 are private creditors (34.6 percent), Paris Club bilateral creditors (16.6 percent), multilateral development banks (MDBs) without the World Bank (16 percent) and the World Bank (12 percent). China is fifth with a share of 10 percent.

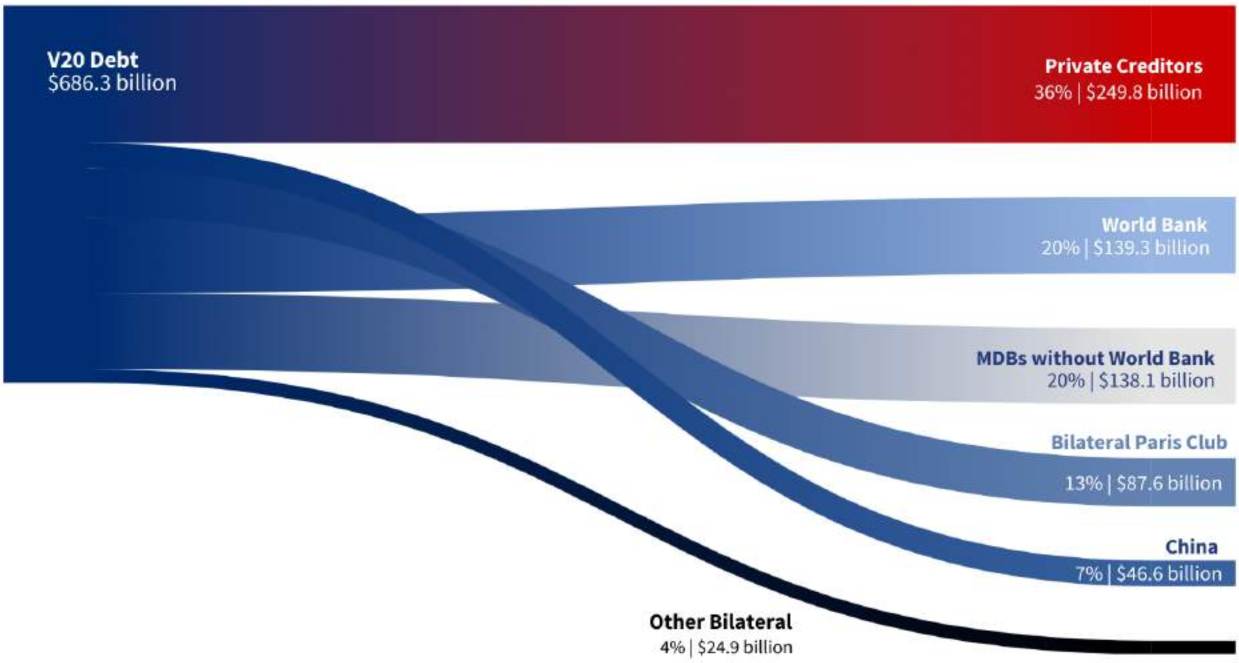

Figure 1: V20 Debt Stock by Creditor

Source: Compiled by authors using World Bank IDS.

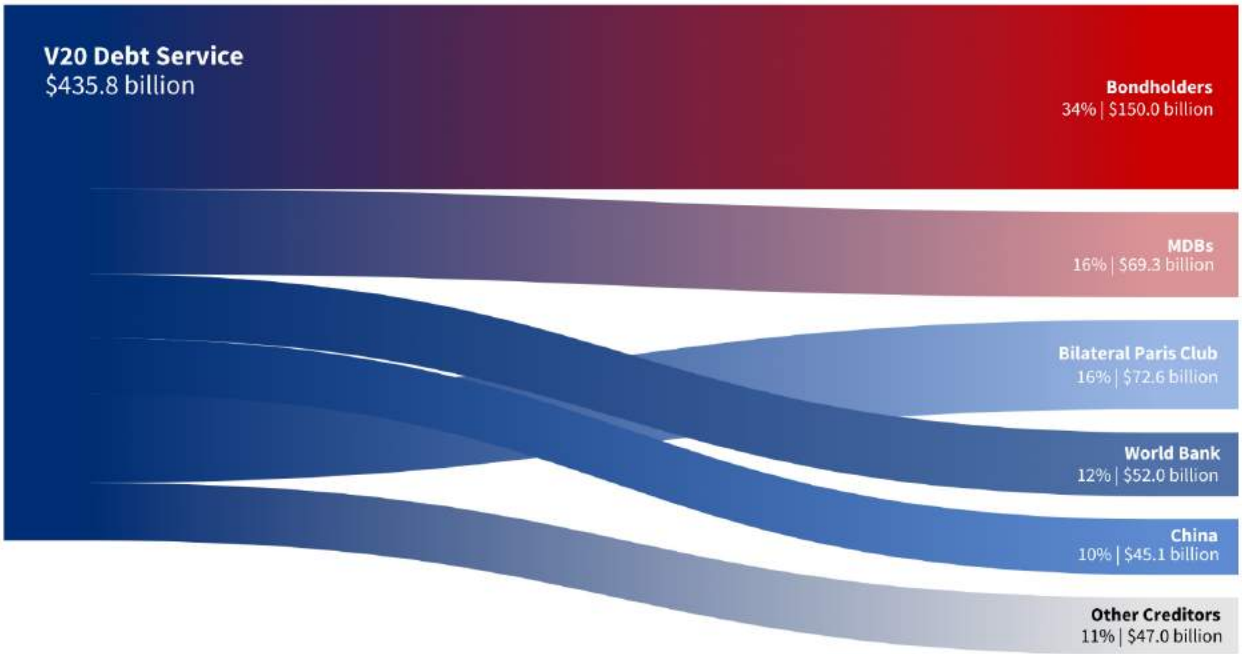

Figure 2: V20 Debt Payments by Creditor

Source: Compiled by authors.

The relative share changes after 2027. Our calculations show that private bondholders are expected to receive the largest share of payments between 2022-2027. From 2028 onward, however, MDBs overtake private bondholders. Figure 4 shows how debt service payments will change over time. Of the $18 billion that the V20 will owe to the MDBs, the World Bank is expected to receive $8 billion, with other MDBs receiving $10 billion. Please see Table 1 for an illustrative example of the largest shareholders for a select number of multilateral development banks.

While private creditors are important to the V20, their relevance varies across the countries. For example, private creditors form a very high share of the debt stock of Lebanon, but private bondholders are not a very relevant group of creditors to most of the low-income V20 members.

For the 13 countries classified as in debt distress or at high risk, the debt stock composition shows that the private sector owns 29 percent of the total debt stock, the World Bank holds 24 percent, China holds 16 percent and bilateral creditors without China also own 16 percent.

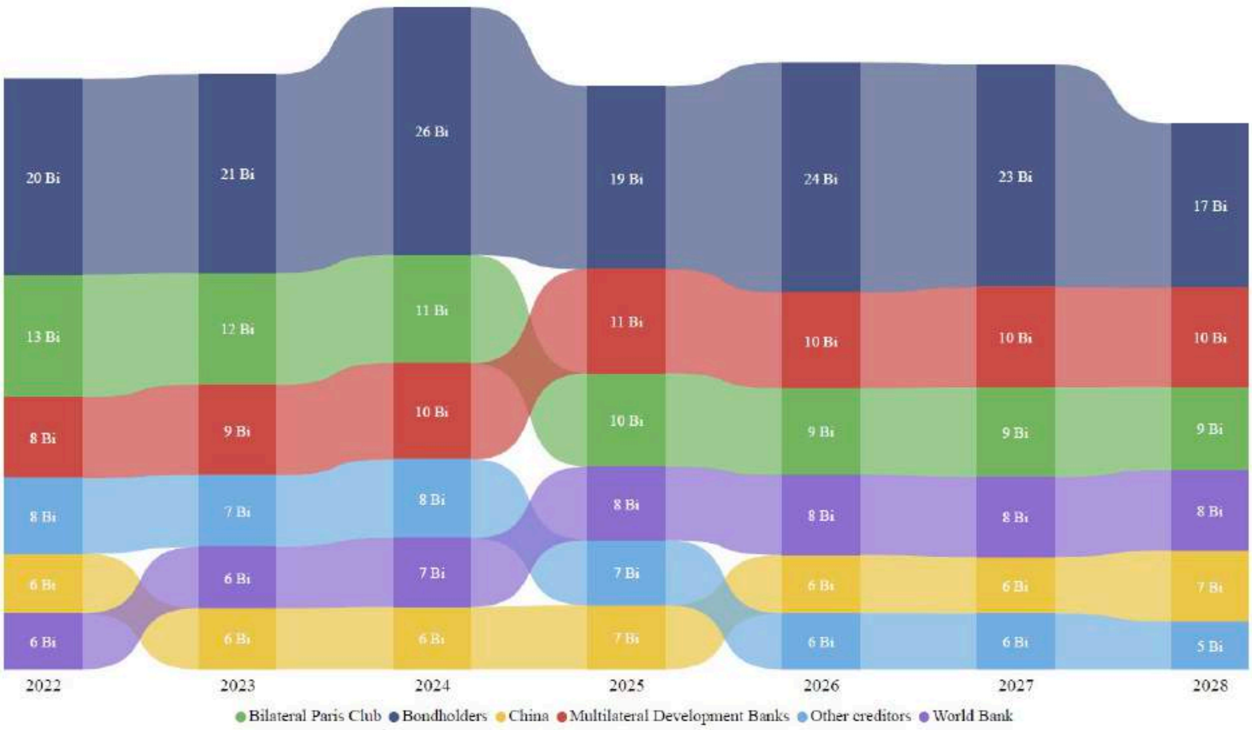

Figure 3: V20 Debt Payments Disaggregated by Creditors, 2022-2028

Source: Compiled by authors using World Bank IDS.

African Development Bank	Nigeria, the United States, Egypt, Japan, South Africa, Algeria, Germany, Canada and France
Asian Development Bank	Japan, United States, China, India, Australia, Indonesia and Canada
Inter-American Development Bank (IDB)	United States, Argentina, Brazil, Mexico, Japan, Canada, Venezuela and Chile
European Bank for Reconstruction and Development	United States, France, Germany, Italy, Japan, United Kingdom, Russia, and Canada
World Bank (IBRD)	United States, Japan, China, Germany, the UK, France, India, Russia, and Canada

Table 1: An Illustrative Example of Multilateral Development Banks and Their Largest Shareholders

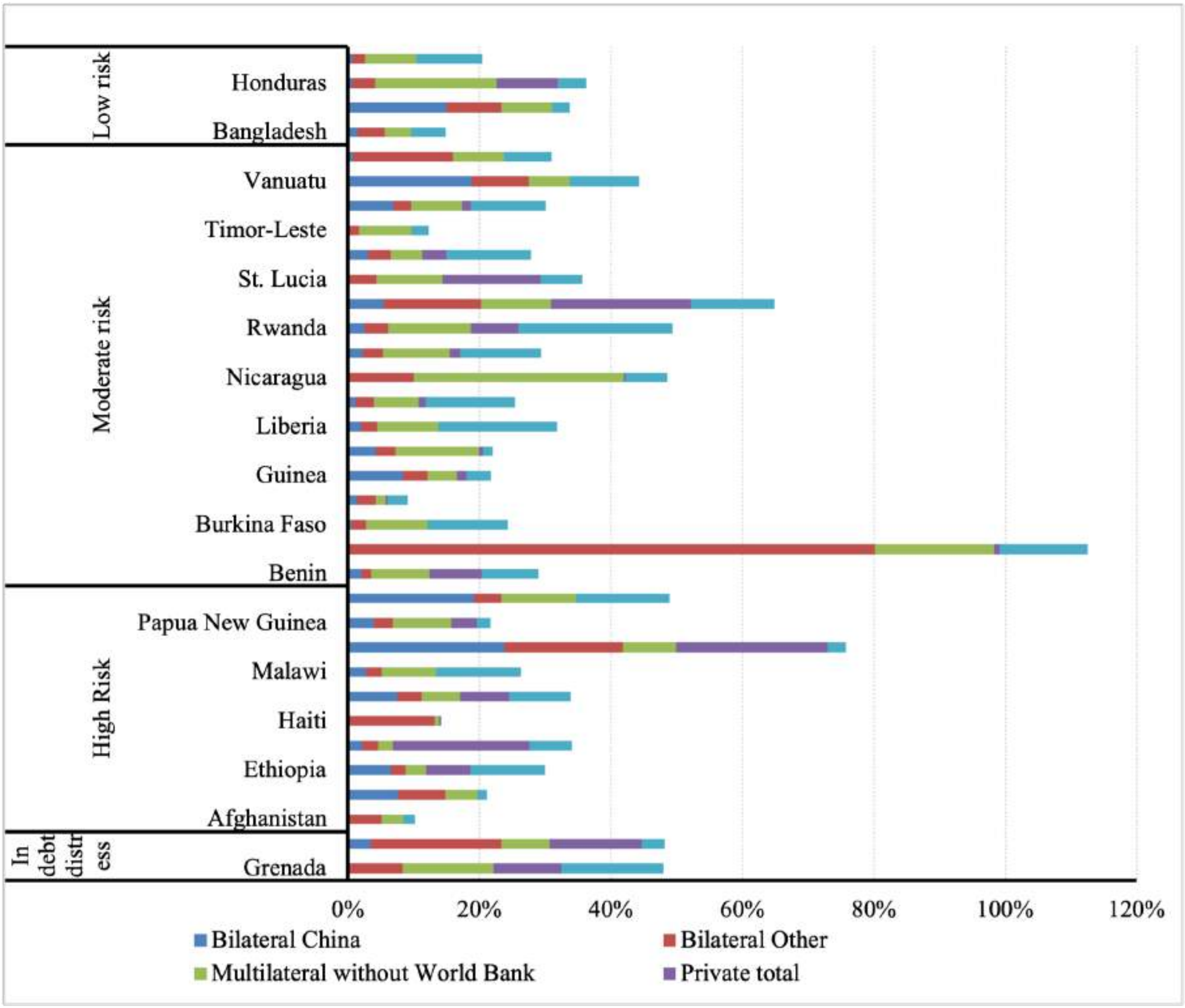

Figure 4: V20 Share of Debt-to-GDP Disaggregated by Creditor

Source: Compiled by authors using World Bank IDS.

v. DISCUSSION AND RECOMMENDATIONS

This policy brief outlines the magnitude and composition of the external debt stock and future payments for V20 countries. While debt relief alone will not be enough to mobilize the necessary resources for a green and inclusive recovery that puts V20 countries on a more sustainable growth path, it is an essential component of a multi-pronged strategy. The results in this brief also underscore the need for urgency, as debt service payments will peak in 2024. Without debt relief and other complementary measures such as grants, V20 countries will postpone their ability to reap the benefits of climate investments, such as improved resilience and enhanced power generation through renewables.

This policy brief underscores how broad engagement across creditor classes is essential to debt relief—multilateral institutions, private banks and bondholders, and official bilateral creditors from the Paris Club and China. The Group of 20 (G20) Common Framework has many elements of what a successful mechanism might look like but suffers from several flaws. First, lower middle-income and middle-income countries that are climate vulnerable are excluded from the Common Framework. Second, MDBs outside of the World Bank are not required to participate, despite the fact that in many countries they hold the largest share of external debt. Third, the Common Framework has yet to deliver in general, and commercial actors in the West and China have been reluctant to come to the table with commensurate proposals. Finally, the IMF's Debt Sustainability Analyses (DSAs) that underwrite the framework do not link debt relief with climate and development needs, but rather work to lower debt levels below thresholds that do not incorporate climate risk nor resource mobilization needs.

Given the acceleration of climate change, MDBs should also consider the inclusion of hurricane and typhoon clauses in the loan agreements, as was done in the case of Grenada and proposed by Pacific Ministers (Brown 2016). The inclusion of such clauses should be on the assessment of the debt portfolio compositions and if they are amenable to including hurricane/typhoon and cyclone clauses, and whether such clauses would cover a large enough proportion of a country's debt to deliver adequate fiscal space in the event of a natural disaster.

The IMF has recently lent support to the V20's proposed approach to debt restructuring. The V20 proposed a scheme that could be obtained through a reform of the Common Framework and would broaden engagement to all climate vulnerable nations and all of their creditor classes (V20 2021). Given the diverse debt portfolio of V20 countries, comprehensive debt restructuring across all creditor classes is urgently necessary, rather than case-by-case bilateral negotiations with specific creditor classesAnalogous to the HIPC initiative, multilateral institutions would sell gold and/or issue Special Drawing Rights (SDRs) through the IMF to buy back their debt and maintain preferred creditor status. The World Bank and/or other MDBs would guarantee new bonds representing the amount of 'haircut' that commercial sector actors agree to pay (Volz et al. 2020; Volz et al. 2021). Finally, the V20 agreed to use some of their new fiscal space to support their V20 Climate Prosperity Plans.

The IMF has a key role to play in this effort. The IMF needs to upgrade its DSAs to better account for climate risks and climate investment needs. Given that climate impacts are increasing the cost of capital increase for vulnerable countries, the close association between climate change and debt sustainability needs to be captured and should inform the discussion on the countries needing debt relief (Maldonado and Gallagher 2022; Monsod et al. 2022). Recent work by the Task Force on Climate, Development and the IMF points to how the IMF can adapt their own DSA models toward this end (Maldonado and Gallagher 2022; Monsod et al. 2022). What is more, the IMF pledged to deliver a debt-for-climate change scheme at COP26, but it has yet to deliver on this pledge (Reuters 2021). In a recent paper leading up to the design of the IMF's new scheme, the IMF lent credence to a full-scale restructuring effort that incorporated climate change and guarantees for commercial sector participation over one-off bilateral negotiations with individual creditor classes (Chamon et al, 2022).

The urgency is now. The longer the world waits, the larger the loss and damage will be for V20 countries and their people. Given the feedback loops in the global ecosystems and global economy, the entire international community will face the consequences of inaction.

METHODOLOGICAL NOTE

This work relied on the World Bank's International Debt Statistics data for 48 of the 55 V20 countries. Countries with missing data include Barbados, Kiribati, Marshall Islands, Palau, Palestine, South Sudan and Tuvalu. For the analysis, we used public and publicly guaranteed external debt series. It is important to highlight that these amounts are estimated. The current values may differ due to new debt issuances, and interest and exchange rate fluctuations.

VI. ACKNOWLEDGEMENTS

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Boston University, Debt Relief for a Green and Inclusive Recovery
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ABOUT THE V20

Formed in 2015, the V20 Group of Finance Ministers is a dedicated cooperation initiative of economies systematically vulnerable to climate change. V20 Group members are also states of the Climate Vulnerable Forum (CVF). The Group's incoming chair is the Republic of Ghana. The V20 membership stands at 55 economies including Afghanistan, Bangladesh, Barbados, Benin, Bhutan, Burkina Faso, Cambodia, Colombia, Comoros, Costa Rica, Democratic Republic of the Congo, Dominican Republic, Ethiopia, Eswatini, Fiji, The Gambia, Ghana, Grenada, Guatemala, Guinea, Guyana, Haiti, Honduras, Kenya, Kiribati, Nicaragua, Lebanon, Liberia, Madagascar, Malawi, Maldives, Marshall Islands, Mongolia, Morocco, Nepal, Niger, Palau, Palestine, Papua New Guinea, Philippines, Rwanda, Saint Lucia, Samoa, Senegal, South Sudan, Sri Lanka, Sudan, Tanzania, Timor-Leste, Tunisia, Tuvalu, Uganda, Vanuatu, Viet Nam and Yemen.

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