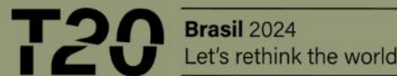
T20 Policy Brief



Task Force 03

REFORMING THE INTERNATIONAL FINANCIAL ARCHITECTURE

How The G20 Can Help Caribbean SIDS Escape from their Debt-Climate Change Trap

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Abstract

Caribbean SIDS are caught in a vicious, middle-income country debt-climate change trap, as the resources they need to invest in climate resilience are increasingly being diverted to repay their debts while their borrowing costs are rising partly due to climate-related vulnerabilities, leading to more debt. This unjust situation, which reflects the inequalities embedded in the global financial architecture, has made these climate vulnerable Caribbean countries the most heavily indebted SIDS worldwide.

In accordance with the T20's Track 3 'Reforming the International Financial Architecture' and particularly relevant to the subtopic 3.3 on addressing the debt burden of developing countries, this Policy Brief puts forward three specific and actionable recommendations to the G20 Group so that it can help Caribbean SIDS to permanently escape from their debt-climate change trap. These recommendations are: (i) for the G20 Group to call on the World Bank to increase Caribbean SIDS' eligibility for and greater access to concessional climate and development finance; (ii) for the former colonial powers within the G20 Group to deliver comprehensive debt relief (cancellation, forgiveness or restructuring) to Caribbean SIDS as a main form of climate reparations; and (iii) for the more industrialised countries within the G20 Group to re-channel US$500 million worth of their unused IMF Special Drawing Rights (SDRs) to the Caribbean Development Bank (CDB).

Keywords: Debt burden, climate vulnerability, Caribbean SIDS, concessional financing, global financial architecture

Diagnosis of the Issue

Caribbean SIDS are caught in a vicious, middle-income country debt-climate change trap, as the resources they need to invest in critical areas such as education, health and climate resilience as well as to address loss and damage are increasingly being diverted to repay their debts, while their borrowing costs are increasing due to climate-related vulnerabilities, leading to more debt. This issue is of relevance to the G20 Group's agenda on reforming the global financial architecture, particularly addressing the debt burden of developing countries and facilitating their access to concessional resources, since it goes to the heart of the inequalities embedded in the 80-year-old international financial system, which emerged in the aftermath of World War II and is now seen as no longer fit for purpose (UNCTAD 2024).

Caribbean nations are among the most heavily indebted SIDs worldwide. At the end of 2023, six Caribbean SIDS ranked in the top 10 of the world's most highly indebted SIDS, with their public debt stock beyond 80% of GDP. These countries are Barbados, Suriname, Dominica, St. Vincent, the Bahamas, and Trinidad and Tobago. Another four Caribbean SIDS - Antigua and Barbuda, St. Lucia, Jamaica and Grenada - have debt-to-GDP ratios ranging from 60% to 80%. Since Greenidge et al. (2012) consider public debt above the 60% of GDP sustainability threshold to be detrimental to growth and development, this suggests that these ten Caribbean SIDS are heading towards debt distress.

Many factors have contributed to heavy debt accumulation in Caribbean SIDS. One key factor is the historical conditions surrounding colonialism. As former colonial masters, Britain and Europe managed their Caribbean colonies for one singular purpose: to achieve maximum wealth extraction from their Caribbean sugar plantations in order to

exclusively fund and sustain their own metropole development. The Caribbean became the "hub of Empire". It was the primary British centre for capital investments, revenue inflows, and market for manufactured goods and financial services such as banking and insurance. Mainland Europe was home to Caribbean-supported manufacturing (Beckles 2013). The industrial benefits to Britain and Europe were extensive, forming the basis for the Industrial Revolution, which has contributed immensely to the global warming impacts now being experienced in the Global South and in the former colonized Caribbean SIDS.

For instance, the European Union region ranks 2nd in the world in terms of its historical cumulative contribution to global warming from 1850 to 2021, the United Kingdom ranks 8th while France ranks 12th. Further, when the Caribbean colonies gained political independence from their British and European colonial masters from around the 1960s, there were no reparations or cancellation of debts. In fact, these new Caribbean nations inherited a legacy of underdevelopment, manifested in a wide range of socio-economic problems – small size, monocrop (sugar) production as the dominant economic activity, and high youth and women unemployment (Beckford 1972). At independence, these newly formed Caribbean nation states severely lacked financial resources and had little choice but to borrow mainly from their former colonial masters to fund their post-independence development.

Another important factor underlying the unsustainable debt of Caribbean SIDS is the destructive impacts of hurricanes due to the unique geographical location of many of these small islands in the North Atlantic hurricane basin (CDB 2020), even though they have very little responsibility for global warming. Between 1998 and 2017, the top 10 climate extreme events in the Caribbean were from more frequent and powerful tropical storms and hurricanes; six of them were in the three years between 2015 and 2017 (Acevedo

2016; Fresnillo and Crotti 2022). When a hurricane strikes, it can wipe out more than the entire annual GDP of a small island. Dominica is in the top spot after Hurricane Maria devastated the island in 2017 causing loss and damages estimated at over 225% of the country's GDP. In the aftermath of these destructive hurricanes, Caribbean governments with already limited fiscal space have little choice but to reallocate budgetary resources, engage in external borrowing or wait on donor aid to fund the large and unexpected public spending required for emergency response, economic recovery and longer-term reconstruction efforts. This is partly because Ministries of Finance in Caribbean SIDS are yet to fully integrate Climate and Disaster Risk Finance and Insurance (CDRFI) solutionssuch as parametric insurance and catastrophe bonds into their wider macro-fiscal frameworks to better manage climate-related shocks.

Considering the above, Caribbean SIDS urgently require significant concessional financing from the international community to transition to low-carbon economies, adapt to the physical effects of climate change and cope with loss and damage. However, the traditional income per capita measurement, which the World Bank and international donor community use to determine eligibility for aid and concessional financing, classifies Caribbean SIDS as middle-to high-income countries. As a result, most of the development finance which Caribbean SIDS receive has been in the form of loans, which further aggravate their already unsustainable debt burden. Mohan (2022) estimates that Caribbean SIDS need at least US$35 billion to invest in climate mitigation and adaptation between 2015-2030, or almost 25% of the region's 2020 GDP. At COP21 held in Paris in 2015, developed nations reaffirmed their commitment to provide a collective US$100 billion per year by 2025 to developing countries to combat climate change. Apart from falling far short of the promised financial support, this goal prioritised mitigation, left adaptation underfunded and ignored loss and damage.

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Recommendations

In light of the foregoing, we put forward three specific and actionable recommendations to the G20 Group so that it can help Caribbean SIDS to permanently escape from their debt-climate change trap. These recommendations are as follows:

1. **For the G20 Group to call on the World Bank to increase Caribbean SIDS' eligibility for and greater access to concessional climate and development finance.** This will require the World Bank to supplement its Gross National Income (GNI) indicator which it uses to determine eligibility for concessional finance with a multidimensional vulnerability index, which better captures the economic, social and environmental causes of vulnerability in Caribbean and other SIDS. Currently, there is no international, widely accepted index to measure vulnerability or lack of resilience across multiple measures of sustainable development. A United Nations High-Level Panel of Experts has recently developed a Multidimensional Vulnerability Index (MVI) which seeks to fill this gap (UNGA 2023). The MVI establishes the long overdue recognition that a country's vulnerabilities to exogenous shocks and stressors should be considered in determining its eligibility for development assistance, particularly if it also lacks inherent resilience. To accompany the index, the High-Level Panel has also developed Vulnerability and Resilience Country Profiles (VRCPs) which provide granularity on a country's specific challenges related to vulnerability and resilience. The World Bank can use the MVI score and the VRCPs to provide a better understanding of each Caribbean SIDS' development needs, including its requirements for concessional financing. However, any scaling up of concessional climate finance to Caribbean and other SIDS must be additional to the aid commitments made by the G20.

2. **For the former colonial powers within the G20 Group to deliver comprehensive debt relief (cancellation, forgiveness or restructuring) to Caribbean SIDS as a main form of climate reparations.** These former colonial powers, especially the United Kingdom, have a moral responsibility to help Caribbean SIDS escape the debt and climate change trap and to compensate them for the destruction and harm that the developed countries caused them through global warming. This is because historical cumulative emissions from the developed countries spanning colonialism to the Industrial Revolution to the present day have contributed the most to the climate crisis. In addition, persistent poverty, now averaging 30% of the regional population, and rising inequality have been the most visible and enduring signs of extraordinary exploitation of Caribbean SIDS by their former colonial masters. The Caribbean Policy Development Centre (CPDC), the authoritative voice of civil society in the Caribbean, has developed 'Caribbean Emancipation 2030' an ambitious sovereign debt and climate justice initiative which seeks to cancel US$30 billion in debt of Caribbean SIDS, freeing up resources to boost climate resilience actions aligned with the Paris Agreement and to support sustainable development. Caribbean Emancipation 2030, which draws upon the principles of the Brady Plan and the enhanced Heavily Indebted Poor Countries (HIPC) Initiative, can be further refined and expanded to include other heavily indebted, climate vulnerable nations.

3. **For the more industrialized countries within the G20 Group to re-channel US$500 million worth of their unused IMF Special Drawing Rights (SDRs) to the Caribbean Development Bank (CDB).** The Caribbean Development Bank (CDB) is the region's Multilateral Development Bank and is therefore in a unique position to marshal concessional financing to help Caribbean SIDS achieve the SDGs and fight climate

change. The IMF has designated the CDB as a prescribed holder of SDRs. This new status gives the CDB an additional avenue to pursue more affordable funding for sustainable development solutions for the Caribbean. By rechanneling some US$500 worth of their unused SDRs, the more industrialized countries within the G20 would be able to provide the CDB with more than enough funding to ramp up lending to finance SDGs and climate resilience projects of Caribbean SIDs. Further, these countries within the G20 group should ensure that any rechanneling of SDRs to the CDB preserves the existing debt-free, no-conditionality characteristics of this reserve asset.

Scenario of Outcomes

Without substantial debt relief, projections are grim for the future debt sustainability of Caribbean SIDS. By 2030, when the United Nations' 2030 Agenda for Sustainable Development has run its course, debt will remain unsustainable in the most heavily indebted Caribbean SIDS. In these countries, reducing public debt to a more sustainable 60% of GDP requires them to maintain sizeable primary fiscal surpluses (around 3% of GDP) over a sustained period of at least a decade. Achieving this in nearly all Caribbean SIDS, except Jamaica, is highly questionable based on their track record of weak fiscal performance. At the same time, the scarring legacy of the COVID-19 pandemic has posed a further drag on debt dynamics within the region. Elevated interest rates in the United States and other advanced economies will further drive up the cost of debt and make international refinancing even harder for those Caribbean SIDS that still maintain access to the Eurobond markets. Meanwhile, Russia's war on Ukraine and tensions between the United States and China have fragmented the geopolitical landscape, creating an increasingly multipolar world which is further diminishing faith and trust in global institutions and multilateralism to work for the benefit of both people and planet. These effects are likely to further undermine debt sustainability prospects in the Caribbean.

Climate change is likely to worsen the precarious debt burden of Caribbean SIDS. Climate projections suggest that as the century progresses, the Caribbean under the worst scenarios will be a significantly different place - much warmer and drier, with higher sea levels and prone to more intense storms - than at present, with the magnitude of projected changes greater than the magnitude of change seen over the last century (CDB 2020). Caribbean SIDS could therefore remain in the middle-income country debt-climate trap

in which greater climate vulnerability continues to raise the cost of debt and continues to diminish the fiscal space to invest in climate resilience.

Collectively, these potential scenarios make a compelling special case for urgently resolving the looming twin debt and climate change crises in Caribbean SIDS. Breaking free from this vicious debt-climate change trap calls for a multi-faceted response from the G20 and the rest of the international community, as outlined in the suggested recommendations. At a minimum, it will require reform of the governance structure of the IMF and World Bank, so that developing countries have a greater voice and representation. This has to be supported by a transformed global debt architecture in which institutions such as the IMF, World Bank, regional multilateral development banks, international partners and philanthropies all step up their support with debt relief and more grants and concessional financing while respecting the principles of climate justice and solidarity.

In effect, in the absence of the G20 Group supporting the above recommendations, there is a real danger that the Caribbean region would lose the first three decades of the twenty-first century, and forego opportunities to reduce poverty and meet the other Sustainable Development Goals (SDGs).

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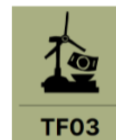

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