Debt for climate swaps: Are they feasible in the Pacific?
And what do debtors need to know?

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Presentation

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Message 1: Debt for Climate Swaps are NOT the Same as Debt Forgiveness

Debt for climate swaps are a mutually beneficial agreement between the debtor and the creditor.
Message 2: Debt for Climate Swaps are an Innovative Financing Mechanism

• How do debt for climate swaps and debt restructuring compare?
• Debt restructuring’s goals → enhance fiscal space, release pressures on the exchange rate
• Debt for climate swaps can contribute to both goals
• However, ...
  • The fiscal space created is earmarked for projects in climate change mitigation and adaptation
  • The scale of the debt swaps is likely to be small
Basic Mechanism

BILATERAL OR DIRECT SWAP

1. Cancellation of debt
   Creditor Government ➔ Debtor Government

2. Local currency payment
   Debtor Government ➔ National fund, environmental project

[Counted as ODA /climate finance]
A Common Scheme

THIRD-PARTY SWAP

1. Debt title (face value)
   - Purchase at a discount or at the secondary market price

2. Cancellation of debt
   - Commitment to fund an environmental project

3. Local currency payment
   - National fund, environmental project

Creditor
Government or Private Creditors

NGO

Debtor Government
Some Features of a Debt for Climate Swap Deal

- Debt with which creditors is desired to be swapped?
- Who will provide financing for the swap? What will be the mix of loans and grants? What will be the conditions for the loans?
- What will be the discount rate on the face value of the debt?
- How much will the government contribute, in local currency, for climate projects?
- What entity will manage the funds and the projects? What will be its governance structure?
- Which projects will be financed through the swap?
Increasing Flexibility: The Commonwealth Proposal

Creditors (multilateral debt holders)
- Climate pledges

Writing down of debtors' liabilities
- Writing down on balance sheets

Debtors
- Debt equivalent in local currency
  - Extendable to bilateral & commercial debt

Trust Fund
- Interest rate

Climate Finance Providers

Project Finance
- Adaptation or Mitigation Project

Scenario 1: Debt is cancelled immediately via a lumpsum payment
Scenario 2: Debt is gradually written off over 10+ years
Debt for climate swaps provide a channel for developed countries to fulfill their climate finance commitments under the Paris agreement. They can do this in various ways...

- As creditors, they can engage in a debt for climate swap deal directly with developing country debtors.
- As donors, they can partially pay off a debt of a developing country with a multilateral development bank or a bilateral donor.
- In either case, the debtor will fulfill a commitment to invest the savings in climate projects.
Composition of Public and Publicly Guaranteed External Debt in Selected Pacific SIDS
Composition of Bilateral Public and Publicly Guaranteed External Debt in Selected Pacific SIDS
## Annex II Parties to the UNFCCC

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The Critical Role of the Trust Fund

- Transparent and effective financial management of the funds provided through the swap
- Accurate and timely monitoring, reporting, and verification of the projects implemented
- Financial contributors to the swap (creditors and/or donors) need to be reassured that the funds are managed and utilized with the highest level of professionalism and according to international best practices
Scale and Capacity Constraints

• Two criticisms of debt swaps:
  • Small scale and high overhead costs → not economical
  • Low levels of specialized financial and technical capacity at the national level

• Both criticisms are likely to be accurate in small economies like the Pacific SIDS
Addressing Scale and Capacities Challenges

- Economies of scale can be gained through a regional institution that can manage the funds and ensure effective project implementation.
- The Pacific Resilience Facility (PRF) will provide specialized fund management and project monitoring, review and verification services for climate adaptation projects in the Pacific SIDS.
- The PRF could provide such services for the implementation of debt for climate swaps by Pacific SIDS.
- Including projects funded by debt for climate swaps in the PRF portfolio will allow it to increase its experience and expertise in financial / technical management of climate projects.
Summing up: A Possible Architecture for Debt Swaps in the Pacific SIDS

- Creditors (multilateral debt holders)
  - Climate pledges

- Climate Finance Providers

- Writing down of debtors' liabilities
  - Writing down on balance sheets

- Debtors
  - Debt equivalent in local currency
    - Pacific Resilience Facility
      - Interest rate
      - Project Finance
        - Adaptation or Mitigation Project

- Scenario 1: Debt is cancelled immediately via a lumpsum payment
- Scenario 2: Debt is gradually written off over 10+ years
Final Considerations

• To consider a debt for climate swap deal it is critical to start with a suitable pipeline of climate projects
• The projects should be aligned with the country’s NDCs and other national planning documents
• Mitigation projects are more likely to be funded by private creditors → consider focusing debt for climate swaps on adaptation projects
• Debt for climate swaps should not wait to the full implementation of the PRF → consider alternative institutional arrangements with a development partner, international NGO or private entity with appropriate expertise
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