

How debt-for-climate swaps can help solve low-income countries' fiscal and environmental challenges at the same time

November 1 2022, by Soyoung Oh



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Barbados Prime Minister Mia Amor Mottley spoke passionately to the United Nations General Assembly in September [about the mounting debt](#)

many developing countries are shouldering and its increasing impact on their ability to thrive.

The average [debt](#) for low- and [middle-income countries](#), excluding China, reached [42% of their gross national income](#) in 2020, up from 26% in 2011. For countries in Latin America and the Caribbean, the annual payments just to service that debt [averaged 30% of their total exports](#).

At the same time, these countries are facing a "[triple crisis](#) of climate change, of pandemic and indeed now the conflict that is leading to the inflationary pressures that lead regrettably to people [taking circumstances into their own hands](#)," Mottley said.

Rising borrowing costs coupled with high inflation and slow economic growth have left developing countries like hers in [a difficult position](#) when it comes to climate change. High debt payments mean countries have fewer resources for mitigating and adapting to climate change. Yet climate change is increasing their vulnerability, and that can [raise their sovereign risk](#), increasing the cost of borrowing. [Declining productive capacity and tax base](#) can lead to higher debt risks. It's a vicious cycle.

As one solution, countries and [international organizations](#) are talking about "debt-for-climate swaps" to help tackle both problems at the same time. U.N. Deputy Secretary-General Amina Mohammed [mentioned debt-for-climate swaps](#) ahead of the 2022 [U.N. Climate Change Conference](#), Nov. 6-18, as one option for refinancing countries' "crippling" debt.

How debt swaps work

[Debt-for-climate swaps](#) allow countries to reduce their debt obligations in exchange for a commitment to finance domestic climate projects with

the freed-up financial resources.

They have been [used since the late 1980s](#) to preserve the environment and address the liquidity crisis in developing countries, including Bolivia, Costa Rica and Belize. These are commonly known as "debt-for-nature swaps."

Belize, for example, was able to lower its debt in exchange for committing to designate 30% of its marine areas as protected areas and to spend \$US4 million a year for the next two decades on [marine conservation under a complex debt-for-nature swap](#).

The swap, organized in 2021 by [The Nature Conservancy](#), involves the U.S.-based environmental group lending funds at a low-interest rate to Belize to buy back \$553 million in commercial debt at a deep discount of 45%. The Nature Conservancy raised funds from the investment bank Credit Suisse via the issuance of "blue bonds" backed by the U.S. government, which gave the bonds a strong investment-grade credit rating.

Similarly, Costa Rica has carried out two debt-for-nature swaps with the United States. Under the swaps, Costa Rica agreed to allocate [\\$53 million](#) for conservation projects. It has already planted more than 60,000 trees and [reversed its deforestation](#).

While debt-for-nature swaps have been used mostly for conservation, the same concept could be [expanded to climate change mitigation and adaptation](#) activities, such as building solar farms or sea walls. Some finance experts have [suggested](#) that debt-for-climate swaps could be structured in a way that could also encourage private-sector bond holders to exchange the national debt they hold for carbon offsets.

Three keys to successful debt-for-climate swaps

I work with the [Climate Policy Lab](#) at the Fletcher School at Tufts University. Our experience with debt swaps offers lessons for the design and implementation of debt-for-climate swaps.

First, the complex governance structures of debt swaps have limited their use. In the past, transactions were generally small, [generating only about \\$1 billion](#) in funding for the environment from 1987 to 2003. A [term sheet template](#) for future debt-for-climate swaps could reduce the complexity and lower the time and costs involved.

Second, debt-for-climate swaps would need to relieve enough of the debt burden to allow debtor countries to invest in climate adaptation and mitigation projects. For instance, the U.S. created debt-for-nature swaps with Indonesia in 2009 that were criticized for [not doing enough](#) to help the Indonesian government achieve its conservation goals.

Another concern is known as "additionality"—ensuring that the swaps lead to additional climate efforts, as opposed to [covering efforts already planned](#) or [already paid for](#) with international climate finance.

With [widening gaps](#) between the amount of adaptation assistance reaching countries and the amount they need, debt-for-climate swaps can be a meaningful source of funding. Climate Policy Initiative, a nonprofit research group, recently [estimated that about 90%](#) of the adaptation needs countries listed in their Nationally Determined Contributions—the [climate change](#) plans they submit to the U.N.—can be only met with help from development banks or other countries.

Regions experimenting with debt swaps

A few regions are testing debt-for-climate swaps.

The Economic and Social Commission for Western Africa has developed a [Climate/Sustainable Development Goal Debt Swap](#), in which it functions as a liaison between creditors and [seven pilot countries](#). The initiative focuses on advancing sustainable development and climate goals, such as developing more resilient agriculture.

Similarly, as part of the Caribbean Resilience Fund, the Economic Commission for Latin America and the Caribbean [plans to launch](#) a Debt for Climate Adaptation Swap. It aims to reduce the \$527 million of debt in three pilot countries by issuing green bonds, similar to Belize's debt swap. Development banks would [play a crucial role](#) by guaranteeing new bonds and reducing the credit risk.

With carefully designed debt-for-climate swaps and support from international institutions, developing [countries](#) could expand their finance for desperately needed climate mitigation and adaptation actions and remove some of their heavy debt burden.

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Citation: How debt-for-climate swaps can help solve low-income countries' fiscal and environmental challenges at the same time (2022, November 1) retrieved 26 April 2024 from <https://phys.org/news/2022-11-debt-for-climate-swaps-low-income-countries-fiscal.html>

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