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Climate/SDGs
debt swap mechanism

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VISION

ESCWA, an innovative catalyst for a stable, just and flourishing Arab region

MISSION

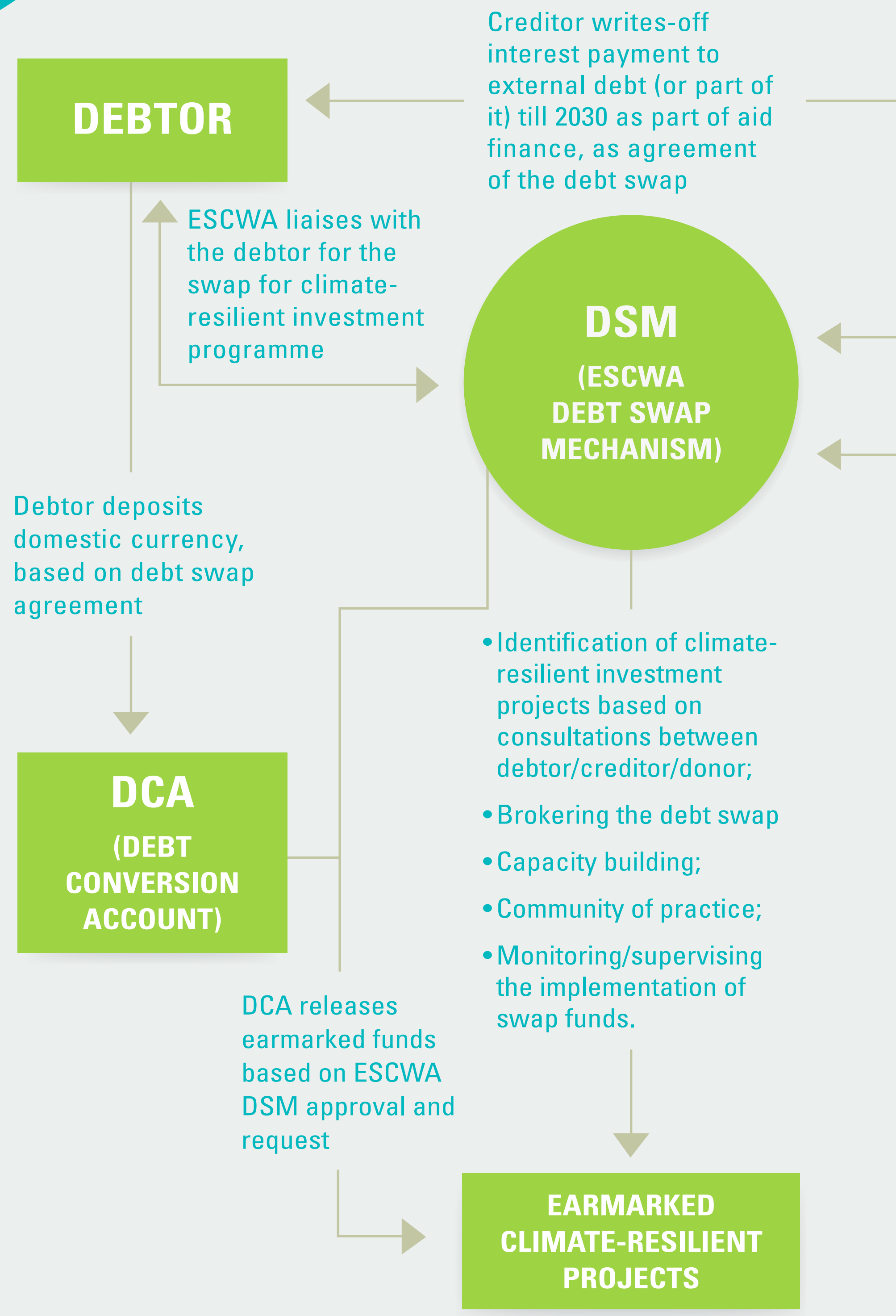
Committed to the 2030 Agenda, ESCWA's passionate team produces innovative knowledge, fosters regional consensus and delivers transformational policy advice. Together, we work for a sustainable future for all.

Climate/SDGs debt swap mechanism

Climate/SDGs Debt Swap

DEBTOR'S BENEFIT

- Relieves from interest payment on external debt;
- Increases investment into climate-resilient projects;
- Accelerates SDGs and Paris Agreement implementation;
- Supports national adaptation and mitigation commitments/ targets;
- Increases donor's support toward climate/green investments;
- Increases sustainable public investment without additional pressure on public budget;
- Promotes economic transformation/diversification/ private sector opportunities;
- Increases job creation;
- Improves livelihoods and reduces inequality;
- Advances local community development and women empowerment.



CREDITOR

- ESCWA liaises with the creditors for the swap for climate-resilient investment projects;
- Ensures monitoring & implementation;
- Negotiates conditionalities and remedies.

ESCWA liaises with GCF, GEF, Adaptation Fund, MDBs and bilateral donors to scale-up swap funds for climate-resilient investments

GCF/GEF/ ADAPTATION FUND/ MDBs/BILATERAL DONORS

CREDITOR'S BENEFIT

- Increases ODA disbursements/ climate finance pledges;
- Strengthens ability to leverage donor finance to DSM;
- Supports accelerating the implementation of SDGs and Paris Agreement;
- Advances meeting global adaptation/mitigation targets;
- Reduces risk of default for other debts due to the 'feel good factor';
- Reduces risk of moral hazard and fungibility of investments;
- Enhances socio-economic stability.

DONOR'S BENEFIT

- Increases opportunity to provide grant support toward achieving climate and SDGs-related actions;
- Avoids transaction costs related to the complex process of engaging with national stakeholders;
- Avoids direct monitoring of implementation of grants;
- Reduces risk of moral hazard and fungibility of grants;
- Scales up resources for climate-resilient projects and SDGs actions;
- Increases partnership opportunity for climate/SDGs actions with public and private actors.

THE CLIMATE/ SDGS DEBT SWAP MECHANISM

Debt swaps convert national debt serving payments on foreign debt into domestic investment for implementing climate-resilient projects through collaborative arrangements between debtors, creditors and donors. The mechanism is operationalized through the following:

- The Economic and Social Commission for Western Asia (ESCWA) holds dialogues with member States facing significant debt serving payments to identify a portfolio of climate-resilient investment projects that are aligned with national plans, and are of potential interest to sovereign creditors. The projects identified must have clear deliverables and measurable results that can achieve or accelerate progress toward the Sustainable Development Goals (SDGs) by 2030 and the Paris Agreement;

- ESCWA initiates consultation with a debtor country in the Arab region and a bilateral creditor for a debt swap for climate-resilient investment projects;

- A bilateral creditor agrees to a debt swap. It agrees to write down interest payments on external debt starting 2021 to 2030 in return for a commitment by the debtor country to deposit the equivalent amount in domestic currency[1] in a dedicated debt conversion account (DCA) to finance climate-resilient projects. The creditor entrusts ESCWA to monitor the debt swap arrangement and ensure that the converted funds are used to implement climate-resilient projects that are in line with the swap agreement;

- The debtor agrees with the creditor on the debt swap arrangement, including the conditionalities and remedies, and continues consultation with ESCWA on monitoring and implementation arrangements;

- ESCWA liaises with donors to contribute matching finance (that is external or part of the swap) to scale up swap investment in the earmarked climate-resilient projects. To ensure transparent monitoring and management of the project, the donor agrees to provide an operational grant to the debt swap mechanism (DSM), managed by ESCWA;

- The DCA in the debtor country releases funds to the earmarked climate-resilient projects based on ESCWA DSM approval. In parallel, ESCWA DSM releases donor earmarked grants in support of project implementation.

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[1] The exchange rate date can be determined through the agreement.

MAIN ACTORS ENGAGED IN THE PROPOSED DEBT SWAP

DEBTOR: Middle-income countries that face external liquidity challenges, suffer high debt burdens, and spend a significant share of their revenues on interest payments/debt servicing in external currency. Such debtor countries in the region include Egypt, Jordan, Morocco and Tunisia.

CREDITOR: Bilateral creditors whose official development assistance (ODA) disbursements to developing countries are less than their commitments. Scaling up ODA or climate finance pledges in the immediate and near terms can pose a challenge for these countries, especially given the adverse economic consequences of COVID-19 and constraints affecting bilateral cooperation.

DONOR: International donor organizations operating at the global and regional levels, which can scale up the debt swap by financing climate-resilient projects at scale, for the mutual benefit of achieving the SDGs and the Paris Agreement. Such organizations include the Green Climate Fund, the Global Environment Facility, the Adaptation Fund, multilateral development banks, and bilateral donors.

ESCWA: ESCWA is a United Nations regional commission that is mandated to provide technical assistance to member States to advance and accelerate progress towards the SDGs and climate action, including through its Arab Centre for Climate Change Policy. ESCWA has the convening power to liaise with member States and has detailed knowledge of national and regional development challenges. Its standard operating procedures are applied in accordance with United Nations rules and regulations, which establish ESCWA as a credible institution that the debtor, creditor and donor can trust to monitor and implement the swap funds in a transparent and accountable manner.

GAINS OF THE PROPOSED DEBT SWAP

Many Arab countries are facing fiscal stress from high and increasing debt, which consequently drains a large share of revenues to cover debt servicing that could have been spent on financing the SDGs and climate-resilient projects. Moreover, limited fiscal space puts the region at risk of being unable to recover from the COVID-19 pandemic.[2] International action to support debt relief is imperative, especially to enable countries to build forward better after the pandemic. This can be achieved by improving the macroeconomic conditions of debtor countries in the short term to manage their outstanding debt liabilities. Debt swaps are a negotiated instrument that can provide debt relief and generate liquidity to fiscally stressed debtor countries to invest in climate-resilient projects, which can also benefit creditor countries. The gains of the proposed debt swap include the following:

Climate/SDGs debt swaps can be an effective instrument providing win-win results for debtor and creditor countries.

For debtor countries, it generates a direct resource effect by providing relief from the payment of interest on external debt, while increasing sustainable public investment in climate-resilient projects that advance the SDGs and the Paris Agreement. In addition, it has positive net indirect effects when such investments lead to higher net aggregate flows from donors, and from private and public sources, to climate-resilient projects. Other important socioeconomic benefits include job creation, advancing local community development, and promoting women's empowerment that all contribute to bridging inequality gaps;

Debt swap is also beneficial for bilateral and multilateral creditors, since the amount of the debt swap allocated for climate-resilient projects increases ODA disbursement/climate finance pledges that accelerate the implementation of SDGs and the Paris Agreement, without adding extra burdens on their budgets. Furthermore, long-term climate-resilient projects will likely boost economic transformation and future economic growth of debtor countries and crowd in complementary grants and investments, which in turn facilitate the repayment of outstanding debt stocks.

[2] ESCWA, Limited fiscal space puts the Arab region recovery from COVID-19 at risk, 2020.

Climate/SDGs debt swaps provide a unique opportunity for creditors and donors to show solidarity in assisting developing countries to recover better from the COVID-19 pandemic, and strengthen development cooperation to accelerate the achievement of the SDGs and the Paris Agreement.

The 2020 United Nations High-level Meeting on Financing for Development set out several options for consideration by Heads of State and Government, advocating for the use of debt swaps, particularly to assist countries that are highly indebted but do not have unsustainable debt burdens.[3] Such debt swaps would channel debt service payments into SDG and climate-resilient investments. Among Arab developing countries that are highly indebted, Egypt has called for debt swaps to help meet financing needs to mitigate the impact of the pandemic, and to finance projects that can positively impact progress towards the SDGs. Jordan, Morocco and Tunisia are also candidates for debt swaps, as they are facing increasing debt service burdens that put their recovery from the pandemic at risk, but they are committed to mobilizing resources for climate-resilient projects and investments. Developing a well-strategized debt swap mechanism can support countries in building forward better, boosting economic transformation, and accelerating the achievement of the SDGs and the Paris Agreement;

A well-strategized national-cum-regional integrated debt swap mechanism can deliver results at the national and regional levels, while reducing intermediary transaction costs for creditors and donors related to monitoring the use of funds.

Donors and creditors can reduce the risk of moral hazard and fungibility of investments by entrusting ESCWA to monitor and implement swap-related investments. ESCWA has the mandate and convening power to liaise with national Governments to advance the SDGs and climate-resilient investments, in accordance with member States' priorities, national development plans and nationally determined contributions (NDCs). Setting up conditionalities, remedial measures, and monitoring and implementation mechanisms would ensure that domestic investments are channeled to the desired sectors on climate/green projects. In addition, ESCWA can liaise with donors to contribute matching finance (that is external or part of the swap) through DSM, and to scale up swap investment in the climate-resilient projects in multiple Arab countries to achieve better results at the national and regional levels;

The gains of debt swap are higher if the swap is undertaken at scale.

To achieve greater impact and clearer results, debt swaps can be part of larger multi-year projects that involve complementary components. Proposals that are large and visible are more likely to convince creditor countries, and demonstrate predicable finance flows and commitment to project implementation, while providing substantial debt relief to debtor countries. In building larger projects, debtor countries may also set targets for reducing debt stock based on strong performance, such as reducing debt by X per cent by 2030 against the baseline, or improving expenditure on climate-resilient projects by X per cent of GDP by 2030 against the baseline. Impact indicators and adaptation metrics identified by ESCWA can encourage performance and progress. Climate-resilient projects supported by a debt swap can also be upscaled through contributory or complementary projects and investments pursued by public and private actors.

3 United Nations, Financing for Development in the Era of COVID-19 and Beyond: Menu of Options for the Consideration of Heads of State and Government, Part II 2020. Available at www.un.org/sites/un2.un.org/files/financing_for_development_covid19_part_ii_hosg.pdf.

BENEFITS OF STAKEHOLDERS

BENEFITS TO DEBTORS

- Relief from interest payment on external debt;
- Increased investment in climate resilient projects;
- Accelerated SDGs and Paris Agreement implementation;
- Support for national adaptation and mitigation commitments/targets;
- Increased donor support towards climate/green investments;
- Increased sustainable public investment without additional pressure on public budgets;
- Enhanced economic transformation/ diversification/private sector opportunities;
- Increased job creation;
- Improved livelihoods and reduced inequality;
- Advances in local community development and women's empowerment.

BENEFITS TO CREDITORS

- Increased ODA disbursements/ climate finance pledges;
- Strengthened ability to leverage donor finance to DSM;
- Support for accelerating the implementation of the SDGs and the Paris Agreement;
- Advances in meeting global adaptation/mitigation targets;
- Reduced risk of default on other debts owing to the 'feel good factor';
- Reduced risk of moral hazard and fungibility of investments;
- Enhanced socioeconomic stability.

BENEFITS TO DONORS

- Greater opportunities to provide grant support toward achieving climate and SDG-related actions;
- No transaction costs related to the complex process of engaging with national stakeholders;
- No direct monitoring of grant implementation;
- Reduced risk of moral hazard and fungibility of grants;
- Scaled-up resources for climate-resilient projects and SDGs actions;
- Increased partnership opportunities for climate/SDGs actions with public and private actors.

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BENEFITS TO ESCWA MEMBER STATES

- Accelerating SDGs and Paris Agreement implementation;
- Acting as an innovative catalyst for achieving a just and prosperous society;
- Enhancing North-South and triangular cooperation;
- Creating a repository of knowledge, capacity and development tools.

CHALLENGES AND MITIGATION

Creditors and debtors must agree to terms, which can take time and resources;

however, ESCWA will use its existing institutional arrangements to expedite negotiations.

Conditionalities on the use of swap funds;

such risks are low since ESCWA is entrusted to monitor and implement swap investments.

Debt swaps could undermine country ownership and autonomy if they include restrictive conditionalities;

ESCWA will ensure the relevance of climate-resilient projects through alignment with national development plans, NDCs, and SDG commitments.

A voluntary swap debt could send negative signals to the market;

however, the credit quality of the borrower going forward will be improved.

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