Climate/SDGs
Debt Swap - Donor Nexus Initiative
Climate/SDGs Debt Swap – Donor Nexus Initiative
I. The Case for Climate/SDGs Debt Swaps

Why is this initiative important for the region?

COVID-19 has pushed gross public debt in the Arab region to a historic high of $1.4 trillion, equivalent to 60% of its GDP. Middle income countries (MICs) of the region have public debt of 92% of GDP on average.

Public budgets of the MICs are squeezed with external debt service consuming over $20 billion, about 11% of their exports earnings as compared to 6.5%, on average, for the MICs globally. With increasing debt service due to recent interest rate hikes, inflationary pressures and the Russia-Ukraine war, public budgets are squeezed further for meeting essential expenditures on public services as well as meeting commitments to climate related expenditures.

Climate finance flows to the region falls severely short of needs. The Arab Region received 8.5 times more debt than grants, and adaptation finance remained at less than 30 per cent of total flows, although it is a priority for the region. Tightened fiscal space risks allocations to climate related expenditures especially for countries that honour debt service payments.

Meeting climate finance needs through issuance of green bonds are temporary fixes to raise money, but such a strategy risk in generating more debt burden for the future. Some of the MICs in the region have resorted to raising finance through issuance of green bonds or they are working out sustainability-linked bonds. These instruments are helpful in raising private finance; however, those do not tackle the challenge of increasing sovereign debt burden, rather those additional borrowings contribute to generating more debt burden though at a relatively cheaper rate of interest.

Planned climate/SDG debt swaps are debt reducing and beneficial to both debtor and creditor countries as a wholesale programme to accelerate climate action and SDG achievement. ESCWA has developed climate/SDGs debt swap – donor nexus initiative to address the challenge of reducing debt burden, improving climate finance and accelerating Implementation of the Paris Agreement and the 2030 Agenda. ESCWA is piloting with countries such as Jordan and in discussion with Egypt and other countries in the region for operationalization of the initiative.
II. Climate/SDGs Debt Swap - Donor Nexus Initiative:
What is this initiative?

A. Accelerating Climate Action and Implementation of the SDGs

- National Vision, Development Plan, Strategies
- Main objectives, Targets
- Projects / Programmes including those related to climate/SDGs
- Fiscal Space
  - Increases budgetary resources
  - Improves sovereign credit ratings and credit worthiness
  - Mobilizes additional extra-budgetary resources

- Transformational impact
  - Policy level (Macro)
  - Project level (Micro)

- Key Performance Indicators
  (Selecting and Monitoring programme)

- Reduces risks of NOT meeting expenditure commitment on climate action and SDGs

- Climate/SDGs Debt Swap - Donor Nexus Initiative
B. Innovative Features of the Initiative

Debtor:
Middle-Income country, committed to honour debt repayments during 2022-2030
- NOT at high risk of default of debt service, as in conventional debt swaps;
- Neutral or rather positive impact on sovereign credit rating

Creditor:
Bilateral creditor having significant loan outstanding with the debtor country
- Bilateral debt swaps doesn’t require any third-party transactions;
- Improves budgetary commitments/pledges to finance SDGs/climate action.

Scale and Terms:
A planned medium to long-term debt swap, such as at least swapping interest/debt service payments from 2022 to 2030
- Enables implementing a programme;
- Increased commitment to invest in climate action/SDGs;
- Economies of scale in terms of transaction costs;
- Improves sovereign credit worthiness of the debtor.

Transformational Impact:
A results-based programme with Key Performance Indicators (KPI) for selection and monitoring of projects financed through national budgets, linking national development plans and climate commitments
- A wholesale programme with KPIs at project and policy levels;
- Accelerate policy reforms;
- Ensures additionality;
- Incentivises donors to scale up the climate-resilient programmes.
C. Potential positive impacts on selected indicators of sovereign credit rating monitored by credit rating agencies (CRAs):

<table>
<thead>
<tr>
<th>Potential positive impacts on selected indicators</th>
<th>CRAs:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average real GDP growth (%)</td>
<td>General government debt/revenue (%)</td>
</tr>
<tr>
<td>Nominal GDP ($ billion)</td>
<td>Foreign currency debt/general government debt (%)</td>
</tr>
<tr>
<td>GDP per capita (PPP, Intl$)</td>
<td>General government interest payments/revenue (%)</td>
</tr>
<tr>
<td>GDP per capita (current USD)</td>
<td>General government interest payments/GDP (%)</td>
</tr>
<tr>
<td>Consumer inflation</td>
<td>Current account balance</td>
</tr>
<tr>
<td>General government fiscal balance/GDP</td>
<td>Reserves (SBn)</td>
</tr>
<tr>
<td>Gross government debt/GDP</td>
<td>Short term external debt (USD Bn)</td>
</tr>
</tbody>
</table>

D. Transformational Impact: A Key Performance Indicators (KPI) Framework for selecting and monitoring the projects

- Vulnerability and needs assessment
- Main goals:
  - Working towards achieving the SDGs
  - Enhancing climate mitigation and adaptation
  - Debt sustainability
- National strategies, action plans and priorities

KPIs for selecting & monitoring projects

- Impact at the project level
- Green & inclusive transformational impact on the economy/society
- Impact at the policy level

KPIs for an enabling environment

Three overarching selection criteria for the climate/SDGs projects and policies that can have transformational impact:

1. Accelerates climate adaptation and/or mitigation actions
2. Targets vulnerable populations and locations – support the achievement of selected SDGs
3. Scales up long-term finance - improves debt sustainability

Monitoring, verification, & evaluation based on project and policy KPIs
E. Climate/SDGs Debt Swap – Donor Nexus Initiative: Benefits to Creditors, Debtors and Donors

**CREDITOR’S BENEFIT**
- Supports accelerating the implementation of SDGs and the Paris Agreement;
- Advances meeting global adaptation/mitigation targets;
- Reduces risk of default on other debts due to the ‘feel good factor’;
- Reduces risk of moral hazard and fungibility of investments;
- Ensures debtor’s expenditure commitment to climate action/SDGs through public budgets;
- Enhances socioeconomic stability.

**DEBTOR’S BENEFIT**
- Debt relief/fiscal benefits;
- Increases investment in climate resilient projects;
- Accelerates SDGs and the Paris Agreement implementation;
- Supports national adaptation and mitigation commitments/targets;
- Increases donor’s support for 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’s empowerment.

**DONOR’S BENEFIT**
- Increases opportunity to provide grant support toward achieving climate/SDGs – related actions;
- Avoids transaction costs related to 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-resilience projects and SDG actions;
- Increases partnership opportunity for climate/SDG actions with public and private actors.
III. Macro Level Benefits:

What is the impact of this initiative?

Aggregate benefits for Egypt, Jordan, Morocco, and Tunisia, based on preliminary estimations (2022-2028)

A. Climate/SDG benefits

<table>
<thead>
<tr>
<th>Indicators</th>
<th>Aggregate Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>Improves expenditure commitment of debtor from public budgets to climate action/SDGs</td>
<td>0.8 per cent increase in the ratio of public climate/SDGs expenditure to total public expenditure, on average</td>
</tr>
<tr>
<td>Increase in creditor’s commitment to improving climate finance</td>
<td>$12.5 billion increase in creditor’s commitment</td>
</tr>
<tr>
<td>Increase in grant amount from X creditor</td>
<td>$5.7 billion in increase in grant amount</td>
</tr>
<tr>
<td>Enhance adaptive capacity and climate resilience in the water and agriculture sector until 2030</td>
<td>Per cent reduction in CO2 emissions</td>
</tr>
<tr>
<td>Contributes to emission reductions, toward achieving NDC targets</td>
<td>Enhanced food security Enhanced health outcomes (per cent reduction in diseases related to lack of access to safe water)</td>
</tr>
<tr>
<td>Enhances disaster preparedness and management</td>
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</tbody>
</table>

Source: ESCWA staff calculations
## B. Fiscal benefits

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<tbody>
<tr>
<td><strong>Reduction in gross public debt to GDP ratio</strong> (assuming a 50 per cent haircut/debt relief of principal repayment)</td>
<td>0.7 per cent (approx. $5.7 billion)</td>
</tr>
<tr>
<td><strong>Reduction in debt service</strong> <em>(share of external debt service, public and publicly guaranteed (PPG))</em></td>
<td>16.6 per cent (approx. $18.1 billion)</td>
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<tr>
<td><strong>Reduction in interest payment</strong> <em>(share of external interest payment, PPG)</em></td>
<td>24.5 per cent (approx. $6.8 billion)</td>
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<tr>
<td><strong>Improves external liquidity</strong></td>
<td>At least 18.14 billion (approx. 8 month of agri. &amp; food imports)</td>
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</tbody>
</table>
| **Growth, employment and income** *(employment including direct project effects as well as economic growth induced permanent jobs)* | 0.1 per cent growth improvement  
*543,000* jobs created of which 110,000 benefiting women  
0.1 per cent increase - per capita GDP                                  |

Source: ESCWA staff calculations
IV. Operationalizing the Initiative at the Country Level

How will we achieve this?

1. Assess the sovereign debt repayments over the medium to long term by type of creditors (helps identifying the scale/amount of debt release and selecting the creditors)

2. Establish an interagency taskforce at national level (national ownership and cooperation across line ministries)

3. Develop a results-based framework for monitoring and evaluation (helps structuring the KPIs and their linkage to climate action and SDGs with the use of debt swap proceeds)

4. Identify the priority sectors and programme/projects (helps implementing the 2030 Agenda and the Paris Agreement)

5. Design the financial conditionalities (helps better understanding the incentives, risks and obligations and implications on budgeting exercise)

6. Mobilize support from creditors and donors (helps improving scaling up funds mobilization)

7. Communicate with credit rating agencies and market participants and national stakeholders (improves sovereign credit worthiness, access to borrowing from capital market, builds trust of investors and people)

With ESCWA’s support and technical assistance to member States towards achieving the milestones
Operationalizing the Climate/SDGs Debt Swap – Donor Nexus Initiative

DEBTOR

CREDITOR

ESCWA supports the creditors in the swap for climate-resilient investment (identify priorities/KPIs)

• Ensures monitoring & implementation
• Negotiates conditionalities and remedies

ESCWA supports the debtor in the swap for climate-resilient investments (identify priorities/KPIs)

• KPI framework for selection/monitoring of programme/projects
• Facilitates the debt swap
• Capacity-building
• Community of practice
• Monitors the implementation of swap funds

Debtor commits swap equivalent from public budget, based on debt swap agreement

DCA releases earmarked funds based on ESCWA DSM approval and request

DONORS
GCF/GEF/ADAPTATION FUND/MDBs/BILATERAL

CLIMATE-RESILIENT PROJECTS

DSM
(ESCWA DEBT SWAP MECHANISM)

ESCWA liaises with donors including Green Climate Fund (GCF), Global Environment Facility (GEF), Adaptation Fund, Multilateral Development Banks (MDBs) and bilateral donors to scale up swap funds for climate-resilient investments

Creditor writes off debt service payment to external debt (or part of it) through 2030, as agreement under the debt swap

DEBT CONVERSION ACCOUNT

DCA

Climate/SDGs Debt Swap – Donor Nexus Initiative