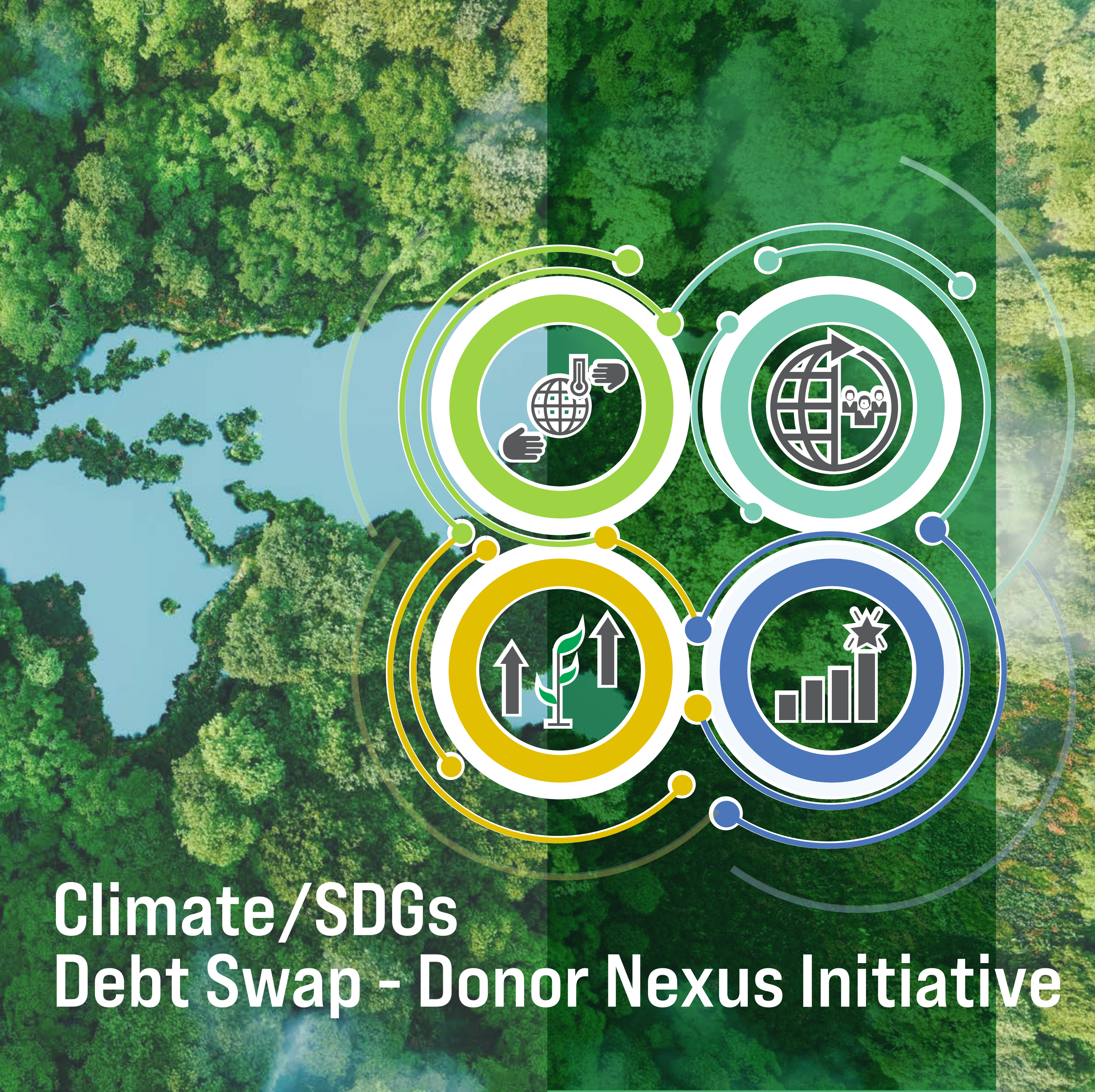

# Climate/SDGs Debt Swap - Donor Nexus Initiative

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Shared Prosperity **Dignified Life**

# 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 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 benefitial 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.

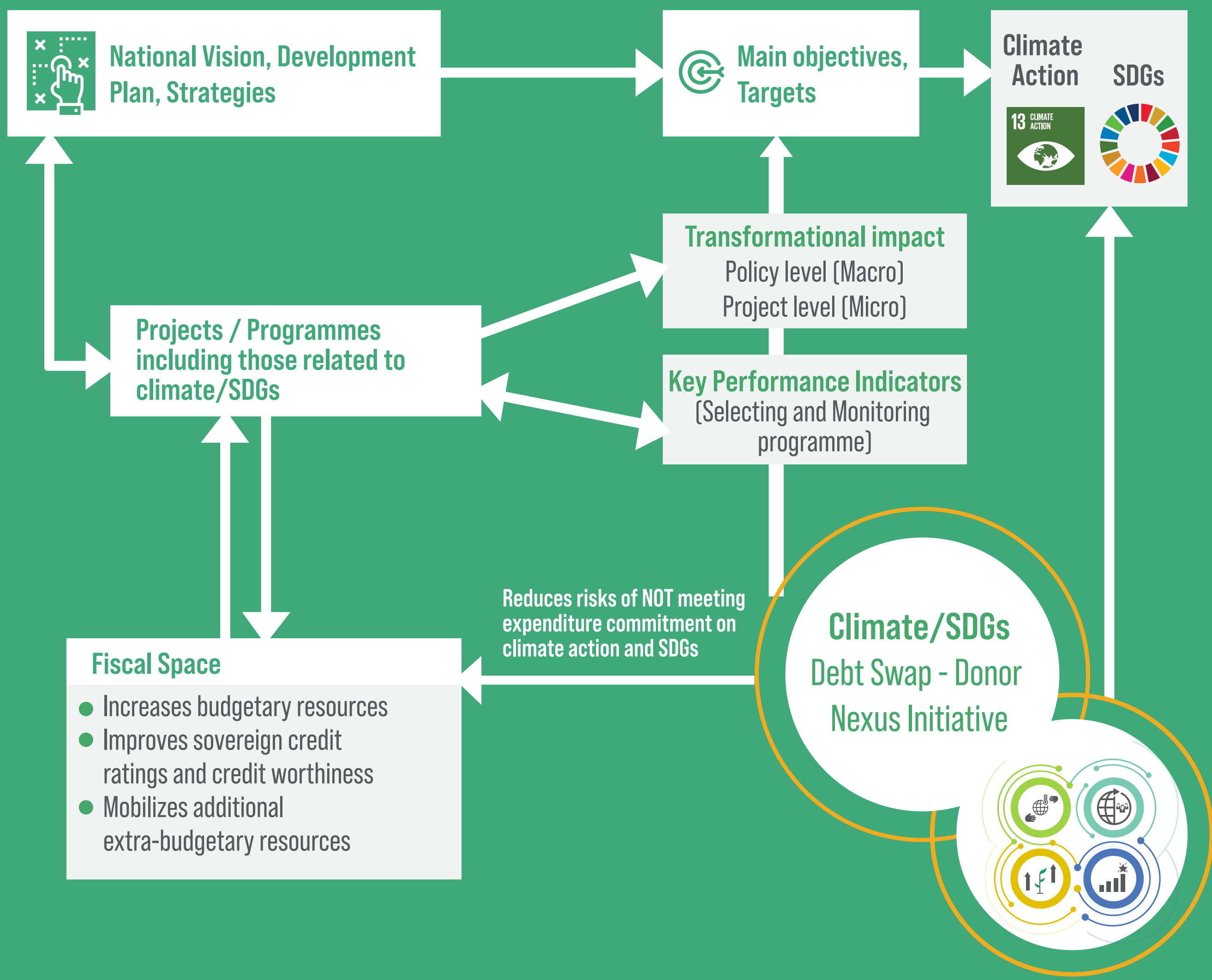
**Liquidity constraints, high debt burden, declining share of concessional finance, low and inadequate climate finance grants drive three major challenges:**

- **Debt service payments put at risk the ability to meet expenditure commitments and allocate additional resources for climate/SDGs.**
- **Costs of new borrowings and sovereign risks tend to go up.**
- **Economic growth and sustainable and inclusive recovery from COVID-19 are weakened.**

# II. Climate/SDGs Debt Swap - Donor Nexus Initiative:

## What is this initiative?

### A. Accelerating Climate Action and Implementation of the SDGs



## 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:**

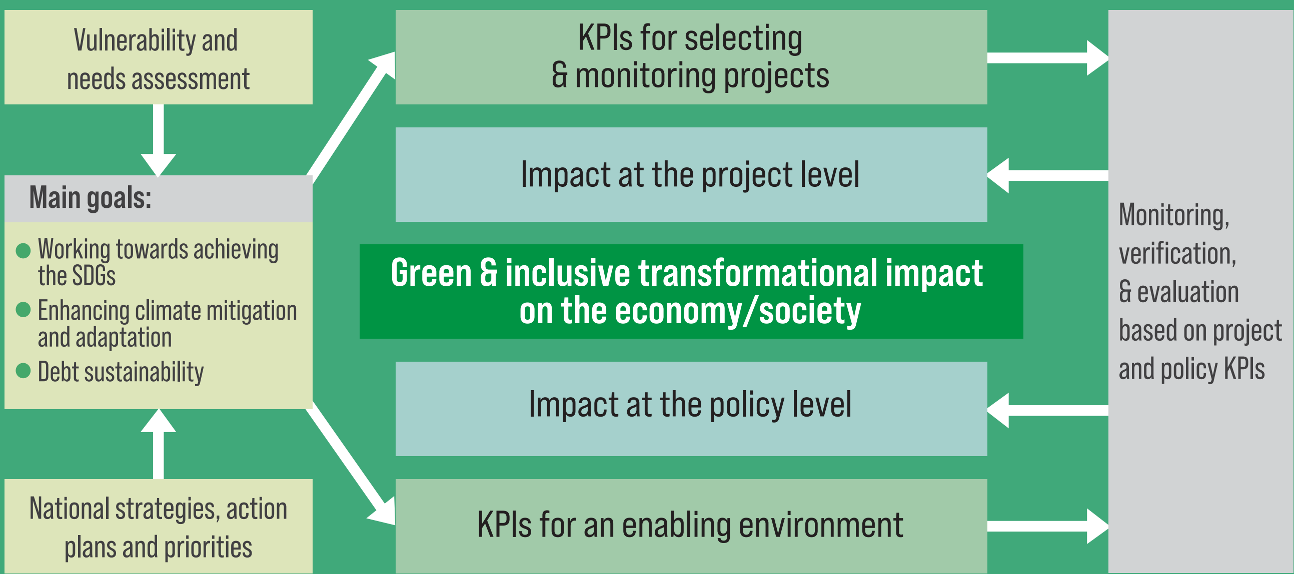
A results-based programme with Key Performance Indicators (KPI) for selection and monitoring of projects financed through national budgets, linking national development plans and climate commitments

- 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):

| | |
|---|---|
| Average real GDP growth (%) | General government debt/revenue (%) |
| Nominal GDP ($ billion) | Foreign currency debt/general government debt (%) |
| GDP per capita (PPP, Intl$) | General government interest payments/revenue (%) |
| GDP per capita (current USD) | General government interest payments/GDP (%) |
| Consumer inflation | Current account balance |
| General government fiscal balance/GDP | Reserves ($Bn) |
| Gross government debt/GDP | Short term external debt (USD Bn) |

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




**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**

# 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

| Indicators | | Aggregate Impact |
|---|---|---|
| Improves expenditure commitment of debtor from public budgets to climate action/SDGs | ↑ | 0.8 per cent increase in the ratio of public climate/SDGs expenditure to total public expenditure, on average |
| Increase in creditor's commitment to improving climate finance | ↑ | $12.5 billion increase in creditor's commitment |
| Increase in grant amount from X creditor | ↑ | $5.7 billion in increase in grant amount |
| Enhance adaptive capacity and climate resilience in the water and agriculture sector until 2030 | ↑ | • Integrate climate considerations in water sector policies<br>• Adopt a vulnerability approach to determining priority areas and target communities for water interventions<br>• Improve adaptive capacity of water utilities<br>• Enhance the use of non-conventional water sources<br>• Improve water distribution efficiency<br>• Improve water demand management and water use efficiency |
| Contributes to emission reductions, toward achieving NDC targets | ↓ | Per cent reduction in CO2 emissions |
| Enhances disaster preparedness and management | ↑ | Enhanced food security<br>Enhanced health outcomes *(per cent reduction in diseases related to lack of access to safe water)* |

Source: ESCWA staff calculations

## B. Fiscal benefits

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

Source: ESCWA staff calculations

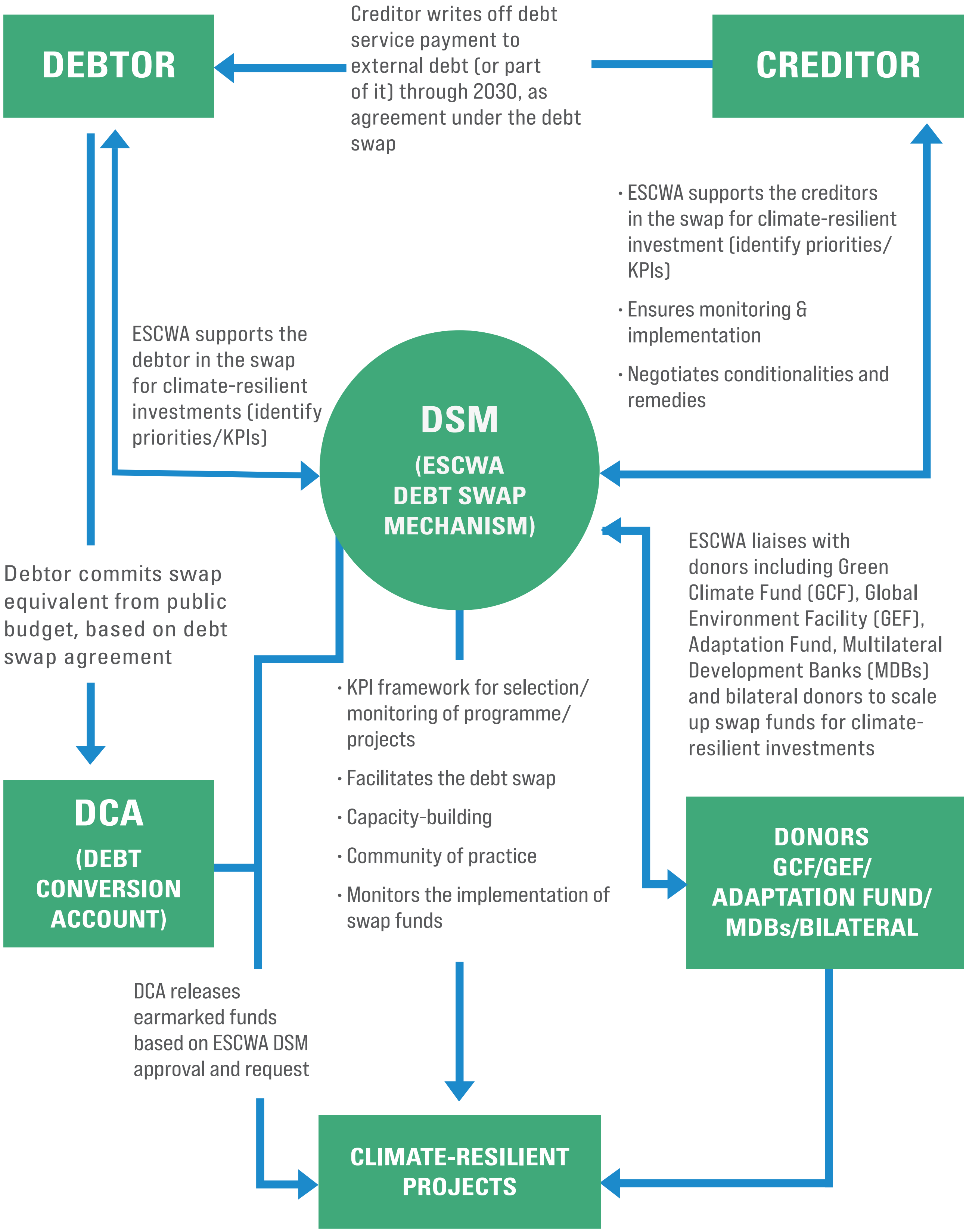
# IV. Operationalizing the Initiative at the Country Level

## How will we achieve this?

1. **Establish an interagency taskforce at national level** (national ownership and cooperation across line ministries)
2. **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)
3. **Identify the priority sectors and programme/projects** (helps implementing the 2030 Agenda and the Paris Agreement)
4. **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)
5. **Design the financial conditionalities** (helps better understanding the incentives, risks and obligations and implications on budgeting exercise)
6. **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)
7. **Mobilize support from creditors and donors** (helps improving scaling up funds mobilization)

With ESCWA's support and technical assistance to member States towards achieving the milestones

# Operationalizing the Climate/SDGs Debt Swap – Donor Nexus Initiative



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