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Climate/SDGs
debt swap mechanism

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Shared Prosperity **Dignified Life**

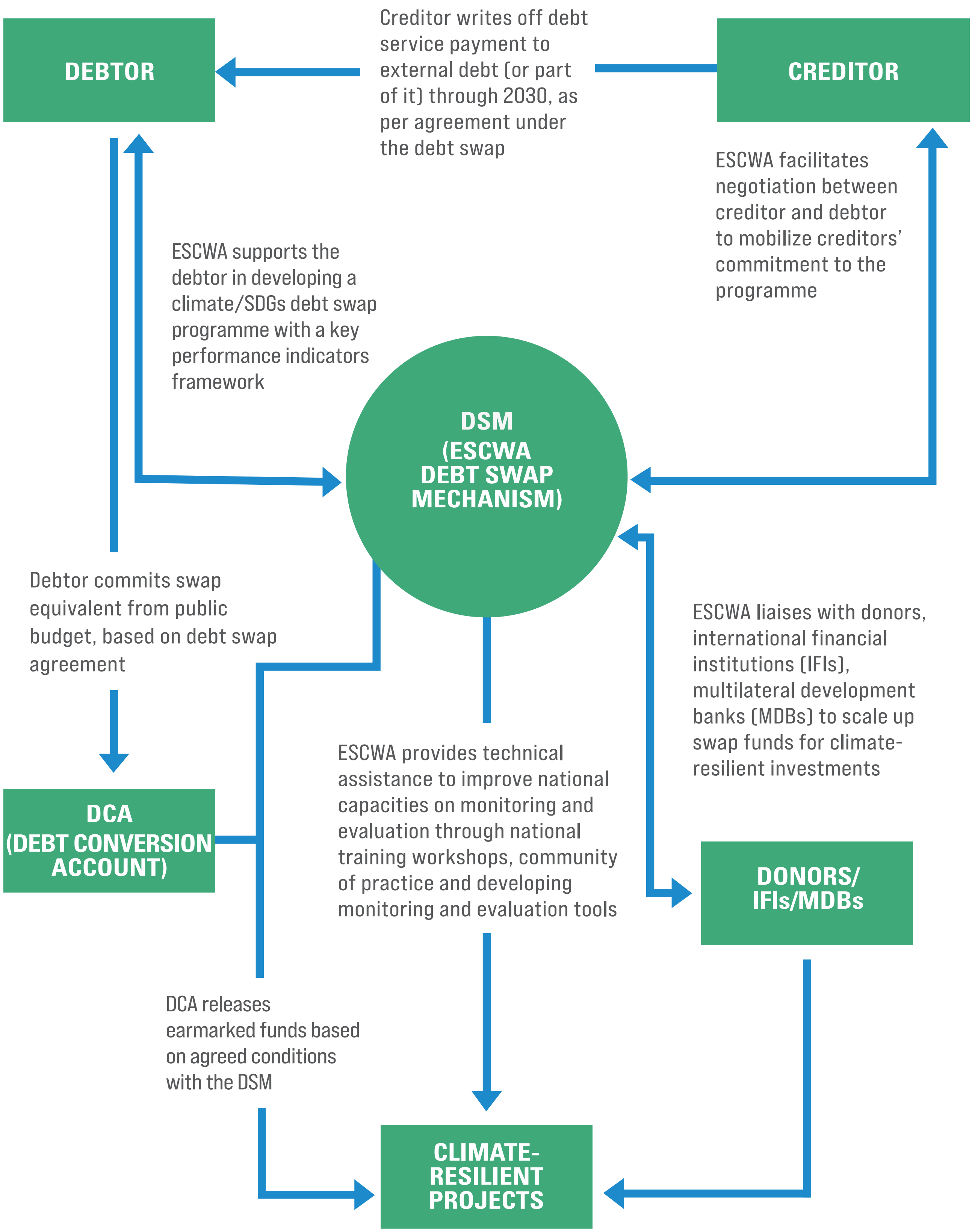
VISION

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.

Operationalizing the Climate/SDGs Debt Swap – Donor Nexus Initiative



I. The climate/SDGs debt swap mechanism

The proposed climate/SDGs debt swap mechanism, under the Climate/SDGs Debt Swap – Donor Nexus Initiative, developed by the Economic and Social Commission for Western Asia (ESCWA), converts national debt-servicing payments on foreign debt into domestic investment for implementing climate-resilient projects using a programmatic approach involving collaborative arrangements between debtors, creditors and donors. In contrast with project-based debt swaps, this mechanism supports programmatic debt swap transactions at a scale which addresses national priorities while contributing to achieving global climate objectives. The mechanism is operationalized[1] as follows.

- ESCWA holds dialogues with member States to develop a nationally owned climate/SDGs debt swap programme comprising several projects. The selection of the programme is based on national priorities, drawn from the nationally determined contributions (NDCs) and other national development plans. An inter-ministerial taskforce, established by the government, contributes to identifying projects using a programmatic approach, based on technical assistance from ESCWA. The programme establishes a key performance indicators framework for monitoring and evaluation to assess impacts at project level and programme level with a transformational impact on climate and the SDGs toward accelerating implementation of the 2030 Agenda for Sustainable Development and the Paris Agreement.

- ESCWA provides support in liaising between debtors and creditors to mobilize creditors' commitment to climate/SDGs debt swap programmes.

- A bilateral creditor agrees to a climate/SDGs debt swap programme proposal. They agree to write down debt service (or a part of it) on external debt up to 2030 in return for a commitment by the debtor country to deposit the equivalent amount in domestic currency[2] in a dedicated debt conversion account to finance the climate/SDGs debt swap programme.

- The debtor agrees with the creditor on the debt swap arrangement, including conditions and remedies.

- ESCWA plays a valuable role in mobilizing support from donors, international finance institutions and multilateral development banks to scale up funds for the earmarked climate/SDGs debt swap programme.

- ESCWA also plays a pivotal role in improving national capacities on monitoring and evaluation through national training workshops involving relevant national stakeholders, community of practice, and developing monitoring and evaluation tools.

[1] For more details of the initiative, see the ESCWA Discussion Paper: "Debt Swap for Climate and SDGs Finance in the Arab Region".
[2] The exchange rate date can be determined through the agreement.

II. Main stakeholders engaged in the climate/SDGs debt swap mechanism

DEBTORS: Middle-income countries in the Arab region that face external liquidity challenges, suffer high debt burdens, and spend a significant share of their revenues on interest payments/debt servicing in foreign currencies. These countries are committed to honouring debt repayments, which constrains their fiscal space for investing in climate action and the SDGs.

CREDITORS: Bilateral creditors which have significant outstanding loans with the debtor country and which are committed to the implementation of the 2030 Agenda and the Paris Agreement.

DONORS AND IFIs: International donor organizations, multilateral development banks and international financial institutions (IFIs), which can scale up the debt swap proceeds by financing climate-resilient projects at scale, through credit enhancements, guarantees, concessional finance and grants for the mutual benefit of achieving the SDGs and climate objectives.

ESCWA: A United Nations regional commission 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 reach an agreement that serves the common agenda of member States in advancing climate action and the SDGs.

III. Key features of the mechanism

The mechanism of the programmatic debt swap is designed to:

- Implement a multi-year programme with a pipeline of projects (not one project only).
- Allow for a more extensive and strategic impact across multiple sectors, in contrast to traditional project-based swaps.
- Ensure addressing national priorities while contributing to achieving global climate objectives.
- Measure outcomes through key performance indicators (KPIs) for the programme and for each project, measuring progress on climate action and SDG indicators.
- Reduce transaction costs in operationalizing the programme.
- Provide an opportunity to improve sovereign credit ratings.

IV. Benefits to stakeholders

BENEFITS TO DEBTORS

- **Contributes to debt refief/fiscal benefits;**
- Releases liquidity from external debt repayment toward investment into climate resilient projects;
- **Provides an opportunity for improving sovereign credit ratings;**
- Supports national adaptation and mitigation commitments/targets;
- **Promotes economic transformation/ diversification/private sector opportunities;**
- Increases job creation;
- **Improves livelihoods and reduces inequality;**
- Advances local community development and women's empowerment.

BENEFITS TO CREDITORS

- **Advances meeting global adaptation/mitigation targets;**
- Improves operational efficiencies;
- **Reduces transaction costs associated with conventional project-based swaps;**
- Ensures effective implementation through measuring progess on KPIs at project and programme levels;
- **Reduces risk of moral hazard and fungibility of investments;**
- Ensures debtor's expenditure commitment to climate action/ SDGs through public budgets with clear additionality;
- **Demonstrates financial innovation by structuring a programme-based debt swap in contrast to traditional project-based swaps.**

BENEFITS TO DONORS

- **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.**

V. Challenges and mitigation

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

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

Conditions related to the use of swap funds;

such risks are low since ESCWA will assist the member State in developing monitoring and evaluation frameworks to oversee the use of funds and the impact of the projects.

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

however, ESCWA will ensure that climate-resilient projects remain relevant by ensuring their alignment with national development plans, NDCs, and SDG commitments.

A larger volume of debt swap could send negative signals to the market;

however, bilateral debt swaps do not enter into the assessment of sovereign ratings. The proposed debt swap would have a neutral or marginally positive impact on sovereign credit ratings.

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