

# Debt for Climate Swaps: Caribbean Outlook

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Caribbean SIDS are among the most heavily indebted per capita developing countries in the world and are also highly vulnerable to the impacts of climate change. Public debt significantly restricts capacity and fiscal space to build resilience to climate change and thus undermines debt sustainability and economic growth. Caribbean SIDS are tasked with addressing low and stagnated growth, high public debt and vulnerabilities to climate change impacts. Debt for climate swaps may provide an avenue for SIDS to address debt challenges while also increasing resilience to climate change.

## Key Points

- In debt for climate swaps, bilateral and multilateral debt relief could enable developing countries, including SIDS, to reduce their external debt while investing the liberated funds in national climate adaptation and mitigation programmes.
- Due to SIDS' internationally recognized particular vulnerabilities to climate change, debt for climate swaps could in principle help to lift Caribbean SIDS and their special circumstances in the focus of the international debt relief debate.
- Debt for climate swaps belong to so-called alternative or innovative sources of financing for climate adaptation or development beyond existing bilateral and multilateral sources. Swaps have the potential to serve as an innovative instrument for mobilizing financing to tackle several of Caribbean States' challenges, in particular insufficient climate adaptation finance and debt sustainability.
- There is existing experience with debt for nature swaps in the Caribbean, with Jamaica, Haiti, Grenada and Antigua and Barbuda being involved in negotiating swaps, with various levels of success. The Commonwealth Secretariat, World Bank and ECLAC have also explored the potential of debt for climate swaps in the region.
- Key elements of success for debt for climate swaps include high-level political support, whole-of-government support from the debtor's government and anchoring adaptation or mitigation programmes in pledges outlined in national development plans, NAPs, NDCs and plans for securing low-carbon climate resilient economies.

- A strong starting point for debt for climate negotiations would be for Caribbean nations to consider a regionally crafted programme, with broad stakeholder engagement in the definition of clear rules and goals for adaptation targets and eligible projects.

## List of Acronyms

AOSIS	Alliance of Small Island States
CCRIF	Caribbean Catastrophe Risk Insurance Facility
CDEMA	Caribbean Disaster Emergency Management Agency
COP	Conference of the Parties
ECLAC	Economic Commission for Latin America and the Caribbean
EU	European Union
GCF	Green Climate Fund
GDP	Gross Domestic Product
HIPC	Highly Indebted Poor Countries Initiative
IMF	International Monetary Fund
INDC	Intended Nationally Determined Contribution
IPCC	Intergovernmental Panel on Climate Change
LDC	Least Developed Country
NDC	Nationally Determined Contribution
NGO	Non-Governmental Organisation
ODA	Official Development Assistance
OECD	Organisation for Economic Cooperation and Development
SDG	Sustainable Development Goal
SIDS	Small Island Developing States
SPREP	Secretariat of the Pacific Regional Environment Programme
TNC	The Nature Conservancy
UNDP	United Nations Development Programme
UNEP	United Nations Environment Programme
UNFCCC	United Nations Framework Convention on Climate Change
UNGA	United Nations General Assembly
UNISDR	United Nations International Strategy for Disaster Reduction
UNPR	Permanent Representative to the United Nations
USD	US Dollar
WB	World Bank

## 1. What is a Debt Swap?

A debt swap describes a scenario where a creditor (either a developed or developing country) forgives debt owed to them in exchange for a commitment by the debtor to use the outstanding debt service payments for a particular investment. Such an arrangement can be beneficial for both the debtor and the creditor, especially if the creditor has written off parts of the debt because they are not expecting full repayment by the debtor. The rationale of debt swaps is that the redemption of debt can be done at a discount. When creditors do not expect to recover the full nominal value of debts, they may be willing to forgive parts of the debt. In exchange for this partial cancellation of the debt, the debtor government commits to mobilise the equivalent of the reduced amount in local currency for agreed purposes on agreed terms.<sup>1</sup>

In 1985 the first debt for equity swap (commercial debt) occurred in Chile and then in 1987 the first debt for nature was completed as a form of debt for development in Bolivia. Subsequently, other sectors of debt for development followed: education, health, and the environment.

### 1.1 Debt for Nature and Debt for Climate Swaps

Since the 1980s, the practice of debt relief for environmental purposes has mainly included swaps for nature or conservation. Debt for nature swaps are agreements that reduce a developing country's debt stock or service in exchange for a commitment to protect nature. These are voluntary transactions whereby the donor(s) cancels some or all of the debt owned by a developing country's Government.<sup>2</sup>

**Debt for Climate Swap:** Debt for climate swaps are a variation of debt for nature swaps. In debt for climate swaps, bilateral and multilateral debt relief could enable vulnerable developing countries, including SIDS, to reduce their external debt while investing the liberated funds in national climate adaptation and mitigation programmes.

Traditionally debt for nature swaps have been negotiated on a bilateral level between a donor and debtor country (basic model: See Figure 1), often with a third non-governmental actor involved e.g. a nature conservation organisation (tripartite model, using the secondary debt market: See Figure 2). Debt for climate swaps are seen as an innovative means to tackle challenges related to insufficient climate finance but also debt sustainability by exploring alternative financing instruments.

1 OECD, 2007 "Lessons Learnt from Experience with Debt-for-Environment Swaps in Economies in Transition." pg. 39

2 UNDP. 2018. <http://www.undp.org/content/sdfinance/en/home/glossary.html>

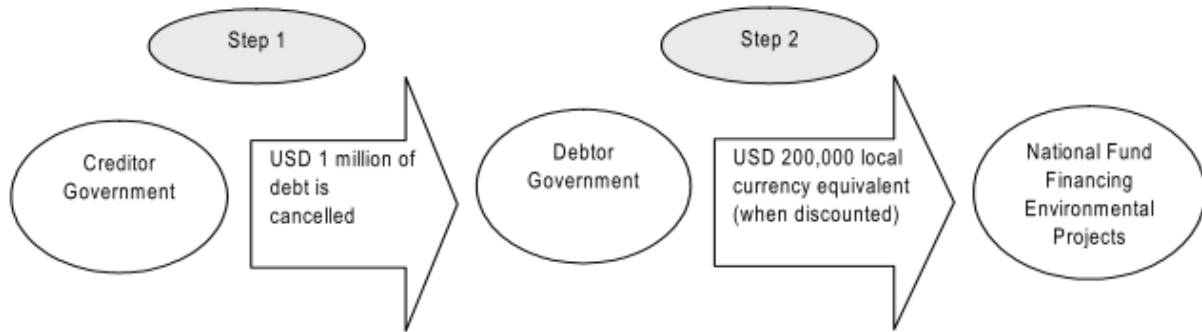
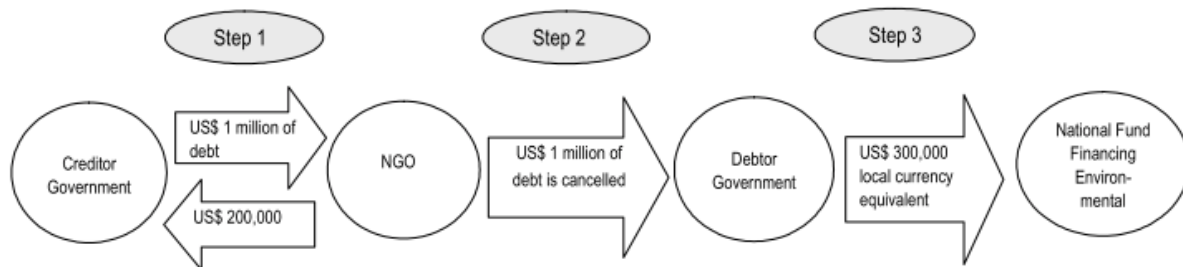


Figure 1: Debt for Nature Swap Basic Model<sup>3</sup>



Note: Assumptions: 20% debt purchase price, 30% payment in local currency.

Figure 2: Debt for Nature Swap Tripartite Model<sup>4</sup>

## 1.2 Debt Sustainability

The IMF defines debt sustainability as a situation in which a borrower is expected to be able to continue servicing its debts without an unrealistically large future correction to the balance of income and expenditure. Sustainability rules out any of the following: a situation in which a debt restructuring is already needed (or expected to be needed); a situation where the borrower keeps on indefinitely accumulating debt faster than its capacity to service these debts is growing; or a situation in which the borrower lives beyond its means by accumulating debt in the knowledge that a major retrenchment will be needed to service these debts (even if nothing in the external environment changes).

<sup>3</sup> OECD (2007) "Lessons Learnt from Experience with Debt-for-Environment Swaps in Economies in Transition." pg. 39

<sup>4</sup> Ibidem

## 2. Caribbean SIDS, Debt and Climate Change

In 2016, Caribbean SIDS showed an average gross external debt of 71% of GDP<sup>5</sup>, between 12-35% higher than the average for Pacific Islands, developing countries and other Latin American and Caribbean economies<sup>6</sup> (See Figures 3 and 4). However, despite high levels of debt, only three countries in the region were eligible for the long-running debt relief initiative for Heavily Indebted Poor Countries (HIPC), discontinued in 2017. Most Caribbean States did not fulfil the initiative’s eligibility requirements because of their relatively higher income levels, which was a reflection on the current status quo rather than an assessment on whether these countries had the ability to maintain such levels of wealth in the face of new climate-related stresses. Caribbean SIDS are also ranked relatively highly on UNDP’s Human Development Index, thereby limiting those countries from accessing concessional loans that are extended at below-market rates.

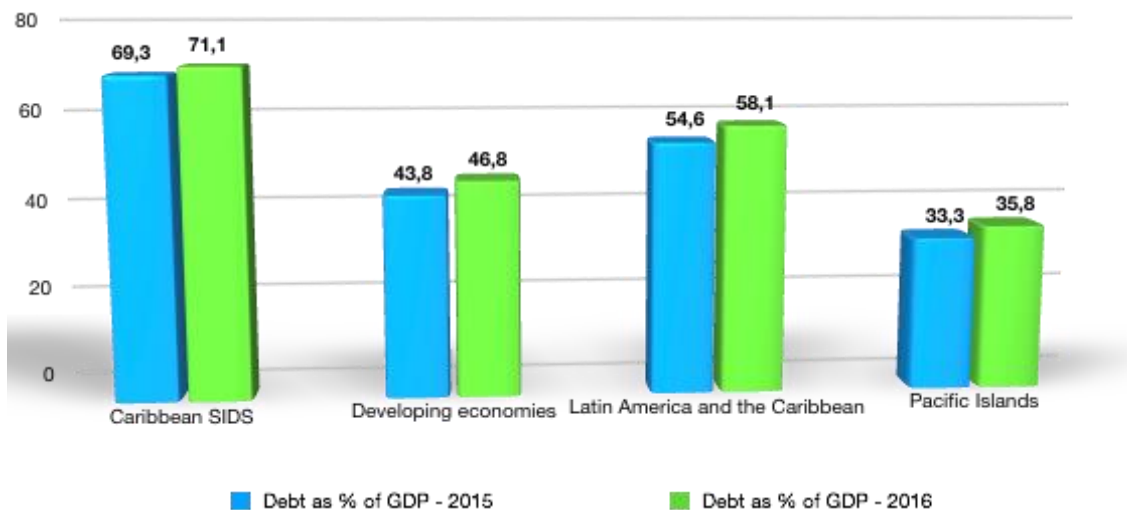


Figure 3: External Debt as % of GDP<sup>7</sup>

<sup>5</sup> IMF database (2018), considering available data for Antigua and Barbuda, Bahamas, Barbados, Belize, Dominica, Dominican Republic, Grenada, Guyana, Haiti, Jamaica, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Suriname, Trinidad and Tobago

<sup>6</sup> IMF’s Dataset classification for regional groupings.

<sup>7</sup> IMF database (2018)

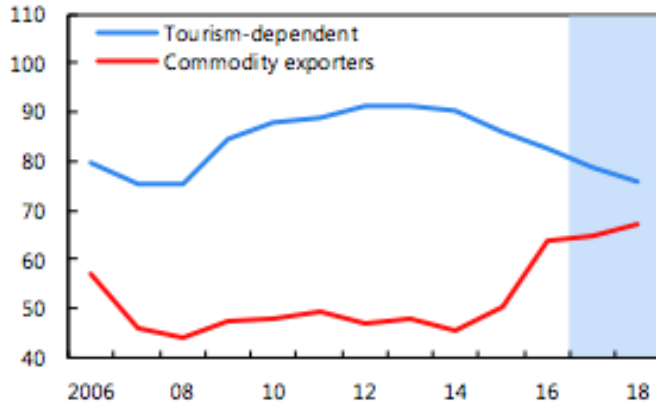


Figure 4: Total Caribbean Government Debt (% of fiscal year GDP) <sup>8</sup>

## 2.1 Effects of Climate Change on GDP Growth and Debt

Using temperature variation within countries as control for excluding other biases, Dell et al.<sup>9</sup> demonstrated that higher temperatures have clear negative effects on national economic performance. Such results were confirmed by findings in 28 Caribbean-basin countries that higher temperatures produced output losses not only in agricultural production (-0.1%/+1°C), but particularly in non-agricultural production (-2.4%/+1°C), due to the response of workers to thermal stress.<sup>10</sup> Temperature increases are expected to hamper economic output and affect GDP growth. Thus, countries with existing elevated public debt are likely to be most affected by such increases, as demonstrated by IMF Projections (See Figure 5).

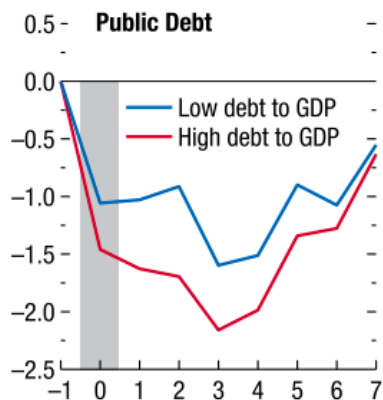


Figure 5: Short to medium-term effects of temperature on per capita output (Percent; years on x-axis)<sup>11</sup>

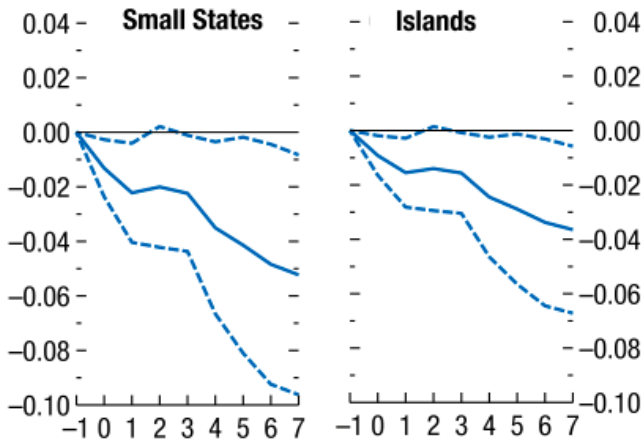
<sup>8</sup> IMF (2017) Western Hemisphere Region: Regional Economic Outlook Update – Latin America and the Caribbean, <https://www.imf.org/en/Publications/REO/WH/Issues/2017/10/11/wreo1017>

<sup>9</sup> Dell, M., Jones, B. F. and Olken, B. A. (2012) 'Temperature shocks and economic growth: Evidence from the last half century', *American Economic Journal: Macroeconomics*, 4(3), pp. 66–95

<sup>10</sup> Hsiang, S. M. (2010) 'Temperatures and cyclones strongly associated with economic production in the Caribbean and Central America', *Proceedings of the National Academy of Sciences*, 107(35), pp. 15367–15372

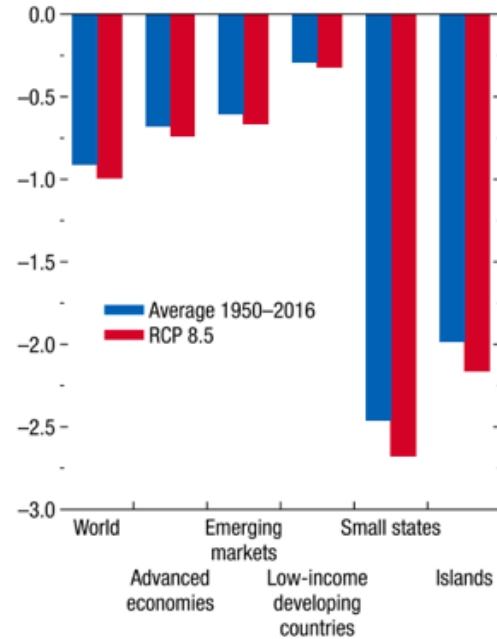
<sup>11</sup> IMF, *World Economic Outlook* (2017)

The Caribbean region is also more exposed to higher risks of flooding and erosion due to sea-level rise, given that sea level rises around the equator are expected to be unevenly higher than the global mean<sup>12</sup>, affecting GDP development. Tropical cyclones have effects that are in addition to temperature effects, and can be felt over 20 years after a storm hits a country (See Figures 6 and 7).<sup>13</sup>



Source: IMF staff calculations.  
Note: Cumulative impact of a one-knot increase in tropical cyclone winds on real GDP per capita. Horizon 0 is the year of the shock.

Figure 6: Effect of Tropical Cyclone Exposure on Real GDP per Capita (%; years on x-axis)<sup>1</sup>



Source: IMF staff calculations.  
Note: Cumulative effect after seven years on real GDP per capita of the average tropical cyclone that each country group is exposed to in terms of maximum wind speed, exposed population, and exposed time endowment. RCP = Representative Concentration Pathways.

Figure 7: Cumulative effect of average tropical cyclone on real GDP per capita after seven years (%)<sup>11</sup>

In a business as usual scenario, more indebted countries present higher risks of defaulting. This negative assessment is compounded when coupled with financial and physical risks from climate change and their effects on GDP.

Moody's, a credit rating company, assessed that small islands could have GDP levels 4% lower by 2030 compared to a world with no climate change. Financial considerations of exposure to climate risks and resilience to climate change are often debated on the firm level, as means to

<sup>12</sup> Wong, P. P. et al. (2014) 'Coastal Systems and Low-Lying Areas', in Climate Change 2014 Impacts, Adaptation, and Vulnerability. Cambridge, New York: Cambridge University Press, pp. 361–410.

<sup>13</sup> IMF (2017) World Economic Outlook

inform investors. However, as these indicators become more refined and more broadly accepted, they start to make their way into countries’ sovereign ratings. Moody’s informed investors in 2017 about the inclusion of climate risks into Small Islands’ sovereign ratings, which although currently based only in the medium-term, should include other longer-term risks as they become more apparent.

With exception of Bahamas, all Caribbean Island States are already rated below investment grade by Moody’s (See Table 1). This rating makes it difficult for countries to maintain and attract new investments. Prospects that Island States’ sovereign ratings might be downgraded over time due to climate risks and impacts put these countries in a type of “financial trap”, leading to increasing vulnerabilities to climate change, inability to manage national finances and dependence on foreign aid. Higher sovereign risks relate to difficulties in accessing funds from international commercial markets, making these Island States less able to improve resilience on their own. In addition, the occurrence of climate-related impacts negatively affects both the real economy and the short to long-term public budget. This then forces affected countries to resort to more emergency and reconstruction funds, which also results in increased premiums for insurance schemes. This debt increase leads to higher interest repayments, which then lowers the capacity to invest in necessary adaptation for climate change. This cycle can be seen as a *downward financial trap* caused by the interactions between climate change and public debt.

Country	Grade	
The Bahamas	Baa3	Lower medium grade
Barbados	Caa3	Substantial risks
Belize	B3	Highly speculative
Dominican Republic	Ba3	Non-investment grade speculative
Jamaica	B3	Highly speculative
St. Vincent and the Grenadines	B3	Highly speculative
Suriname	B1	Highly speculative
Trinidad and Tobago	Ba1	Non-investment grade speculative

Table 1: Moody’s Caribbean Investment Grades<sup>14</sup>

<sup>14</sup> Moody’s. 2018. <https://www.moodys.com/researchandratings/region/latin-america-caribbean/004002/004002/-/1/0/-/0/-/1/en/global/rr>



### 3. Progress on Debt for Climate Swaps in SIDS

Many institutions have been involved in the discussion of debt for climate swaps within SIDS and specifically within the Caribbean, including the Commonwealth Secretariat, the World Bank and ECLAC. Caribbean countries share similar physical vulnerabilities to climate change, signalling the first reason for a concerted regional approach to debt for climate swaps. Physical risks and impacts, however, are only part of the equation, since they trigger other geographically dependent socio-economic trends and cyclical processes that are only expected to increase in time.

The Commonwealth Secretariat has been advocating since 2010 for the implementation of a proposal for multilateral debt swap for mitigation and/or adaptation and has published several discussion papers outlining some of the operational features of the proposal. The Commonwealth's proposal "requires donors to write off small states' multilateral debt using their climate finance pledges, in exchange for donor investment in climate change adaptation and mitigation projects."<sup>15</sup> Elements of the proposal that are relevant to this policy paper have been included in Section 4 below.

After years of work on the issue within the region, in 2017 the sub-regional headquarters of ECLAC for the Caribbean established a task force to advance ECLAC's '*Debt for Climate Adaptation Swap Initiative*' and on 24 November 2017, the task force held their first meeting in Port of Spain, Trinidad and Tobago. Many key stakeholders from the region were in attendance at this meeting, including the CARICOM Secretariat, the Organization of Eastern Caribbean States, the CARICOM Development Fund, the Eastern Caribbean Central Bank, as well as representatives from national institutions like the Planning Institute of Jamaica. This task force has now met twice and is intending to brief the Caribbean Development Roundtable in March 2018 on progress of the task force to date and recommended next steps.

While many Caribbean countries have been proponents of debt swaps since the 1990s with varying levels of success, they have rarely resulted in contributing to debt sustainability or a significant reduction in debt across the region. For example, in 2012 Antigua and Barbuda negotiated a 'debt for climate adaptation with coastal zone management swap' with Brazil for \$18 million USD. This however did not come to fruition due to delays within the Brazilian Parliament.

Through debt restructuring efforts in Grenada in 2016, a "natural disaster clause" was included so that, subject to certain conditions, Grenada would be able to capitalise interest and defer principal maturities due on the bonds if adversely affected by major natural disasters.

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<sup>15</sup> Commonwealth (March, 2015) "Debt Swaps for Climate Change Adaptation and Mitigation: A Commonwealth Proposal"

### *Jamaica*

Since the 1990s, Jamaica has had experience with the modalities of debt swaps and therefore has some supporting existing processes and structures institutionalised. The Environmental Foundation of Jamaica (EFJ), which was created through the signing of two Enterprise for the Americas Initiative<sup>1</sup> (EAI) agreements in August 1991 and January 1993, was capitalized with \$21.5 million over a period of 19 years to support environmental activities, child survival and child development programs as per the EAI's core agenda. In September 2004, the government of Jamaica concluded a debt for nature swap agreement with the government of the United States and The Nature Conservancy (TNC), which is anticipated to generate \$16 million over a period of 20 years for forest conservation activities and was made possible by the contribution of \$6.5 million from the US government and \$1.3 million from TNC. These funds and projects are managed by the EFJ and their Board and as per the agreement with the EAI, the majority of the Board membership is comprised from the NGO community with permanent membership for the governments of Jamaica and the US and for TNC. The EFJ has also served as the fund manager for the Bernard Van Leer Foundation and has had co-funding initiatives with the Global Environment Facility and the Forest Conservation Fund. Building on these past experiences and established procedures and mechanisms already in place, the EFJ is well placed to play a significant role in either framing or participating in any debt swap proposals being put forward in Jamaica in the future.

In Haiti, total debt cancellation by the World Bank, supported by Belgium, Canada, Finland, France, Germany, Ireland, Italy, Japan, The Netherlands, Norway, Spain, Sweden, and Switzerland, followed the devastating earthquake that hit the country in 2010.<sup>16</sup>

While there is still a significant amount of work and negotiations to be done regarding the relationship between debt for climate swaps and international climate finance commitments, there already are some examples to draw from that occurred over the fast-start climate finance period. Over the period of 2010 to 2012, we have the examples of debt swaps by two developed countries towards the fulfilment of their fast-start climate (FSF) finance commitment. The US provided USD 32 million via a debt for nature swap under its Tropical Forest Conservation Act (c).<sup>17</sup> Further, Italy fulfilled EUR 38 million of its fast-start finance commitments via debt for nature swaps in Vietnam, Ecuador and the Philippines. Compared to the overall size of the FSF commitment of USD 30 billion, the volumes delivered through debt swaps have been relatively small, but nonetheless the move was significant.

<sup>16</sup> The World Bank (2010) World Bank Announces Total Cancellation of Haiti's Total Debt. Available at: <http://www.worldbank.org/en/news/press-release/2010/05/28/world-bank-announces-total-cancellation-of-haitis-debt> (Accessed: 15 March 2018).

<sup>17</sup> Fenton et al. (2014) Debt relief and financing climate change action. *Nature Climate Change*, 4(8), 650.

One of the most recently successful and innovative approaches to debt swap in a SIDS is taking place with the Seychelles. In 2017, the Seychelles announced the successful conclusion of negotiations for a debt for adaptation swap under the tripartite model (See Figure 8). After the conclusion of the Seychelles’ debt swap, TNC has announced that they expect to replicate this model in Grenada for a \$60m debt swap and then other Caribbean islands in the coming years.

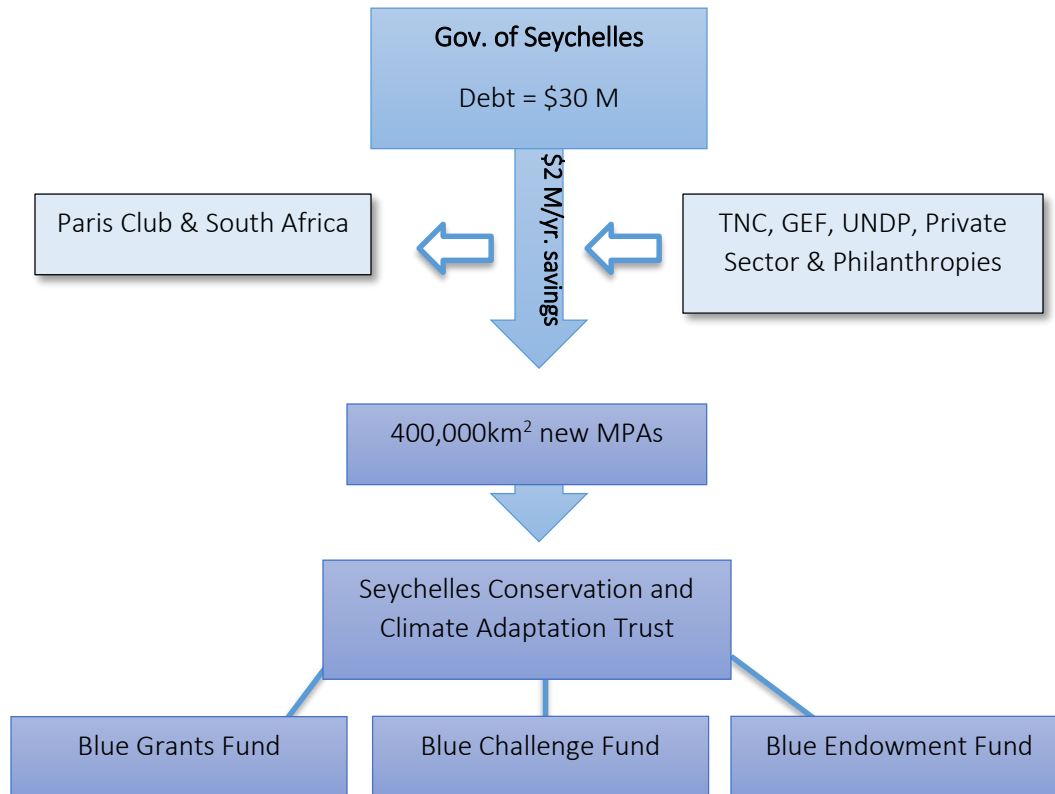


Figure 8: Key elements of Seychelles’ debt for adaptation swap<sup>18</sup>

<sup>18</sup> Full list of collaborators are Governments of Belgium, France, Italy, the Republic of South Africa, the United Kingdom of Great Britain and Northern Ireland, the UNDP, the GEF and the Global Island Partnership and the full list of funders includes the China Global Conservation Fund, the Jeremy and Hannelore Grantham, Environmental Trust, Lyda Hill and the Lyda Hill Foundation, Oak Foundation, Oceans 5, Purnbull Burnstein Family Charitable Fund and the Waitt Foundation.

## 4. Approaches for a Caribbean Debt for Climate Swap

A debt for climate swap is appealing for countries with high levels of debt that face challenges servicing that debt, but the solution is not a one-size-fits-all. Any debt for climate swap is complex with varying circumstances. The priorities, design, circumstances, government buy-in and long-term commitment, negotiations, partners, debt structure and implementation are all differentiating factors making a singular approach or mechanism difficult to formulate. This has been long advocated by the Caribbean, however any such arrangement at the regional level should implicate in several layers of additional complexities. While ECLAC's task force has made some significant progress on this, there is no agreed approach yet, and how this will interact with multilateral climate finance is yet to be seen.

While negotiating a debt swap frees up a significant amount of funds within the core national budget, it is in no way meant to be a replacement for budget in these areas. It provides additional means of reaching commitments and objectives that have been laid out in national development plans, NAPs, NDCs and in securing low-carbon climate resilient economies.

Caribbean States' debts have a mixed nature, with countries like Jamaica, Barbados, Trinidad and Tobago and Suriname holding higher shares of domestic debt, and Belize, Guyana and Haiti presenting a larger proportion of external debt.<sup>19</sup> Since debt swaps can only be applied to long-term external debt, a regional restructuring plan would present varied relevance and effects to different countries in the region.

### 4.1 Potential Approaches

On the creditor side, the World Bank (WB), the Inter-American Development Bank (IDB) and the Caribbean Development Bank (CDB) are the main multilateral development banks active in the region (See Figure 9).

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<sup>19</sup> Caribbean Development Bank (2013) Public Sector Debt in the Caribbean: An Agenda for Reduction and Sustainability. Wildey, Barbados

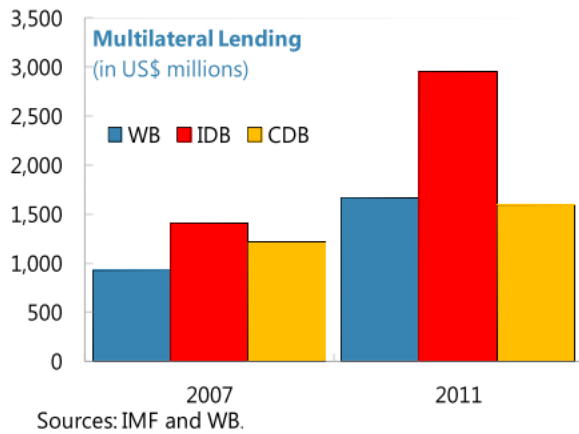


Figure 9: Composition of multilateral lending to Caribbean countries<sup>20</sup>

These development banks may negotiate on a bilateral basis for debt for climate swaps whenever an extreme natural event takes place.

Another alternative would be a concerted and cohesive approach in the form of a regional debt for climate swap scheme proposal. This approach would be based on the Caribbean’s specific vulnerabilities to climate events and the threat that these risks pose to national budgets for mobilizing the means to improve resilience. A concerted programme of this kind could be focused on the three multilateral creditors as a group, or to each of them individually.

Another option, as part of a broader regional programme or tried out in parallel, is to seek negotiation with Paris Club members and non-members as a block of vulnerable countries (See Table 2). The Seychelles is a successful example of an Island State that has recently been able to negotiate an early repayment scheme for US\$30 million worth in debts with Paris Club members and South Africa, in a swap mechanism bundled with the country’s commitment to marine conservation efforts. A strong starting point for negotiations, building on The Seychelles experience, would be for Caribbean islands to consider a regionally crafted programme, with broad stakeholder engagement in the definition of clear rules and goals for adaptation targets and eligible projects.

<sup>20</sup> Acevedo, S., Cebotari, A. and Turner-Jones, T. (2013) Caribbean Small States: Challenges of high debt and low growth.

Debtor countries	ODA	NODA	TOTAL
Antigua and Barbuda	3	118	121
Barbados	2	0	2
Cuba	184	5627	5811
Dominica	28	10	38
Dominican Republic	716	38	755
Grenada	4	5	9
Jamaica	87	3	90
Sao Tome and Principe	1	19	20
St Kitts and Nevis	2	0	2
St Lucia	5	0	5
St Vincent and the Grenadines	5	0	5
Suriname	40	0	40
Trinidad and Tobago	0	80	80

Table 2: Paris Club's claims by debtor country (31 Dec 2016) in USD million<sup>21</sup> Source: Club de Paris (2017)

Pragmatically from a creditor perspective, swapping debts for climate mitigation and adaptation objectives in lieu of investing directly in the project-basis' conceptualisation, implementation and monitoring of such programmes might erode donors' power to tie bilateral investments to certain national priorities, oftentimes commercial ones. One way around the argument of "oversight gap by donors" would be to build a strong science-based regional debt swap programme that states clear goals and anticipates questions regarding the compliance and effectiveness of freed budget towards projects. The case's strength might be improved by stating a credible process for projects' selection, such as including renowned regional and national NGOs as partners in selecting projects against pre-defined criteria. Ensuring transparency and indicating a clear phased implementation and monitoring plan, as well as committing beforehand to certain outputs, to be measured on the grounds of effectiveness against pre-established indicators, would also strengthen this approach. Such outputs could work as justification for the debt swap, since they should rationalise projects that will make Caribbean Island States' budgets less vulnerable to further indebteding due to climate impacts. In order to be effective, mitigation and/or adaptation goals should also be linked to some degree of risk-sharing and finance provisions on loss and damages, otherwise the "financial trap" might be slowed down, but not stopped or reverted.

<sup>21</sup> Club de Paris (2017) 'The Paris Club releases comprehensive data on its claims as of 31 December 2016'. Paris

## 4.2 Key Elements for Success

Given the significant experience to date on debt swaps at the global level and within SIDS, there are several common threads that contribute to their success, some of which are outlined below:

1. It is always beneficial to show SIDS' leadership, where the most vulnerable are taking charge of their ability not only to survive, but also to thrive through viable mitigation and adaptation measures, turning the daunting issue of debt into opportunity. This is not only relevant to donors, but also beneficial to other creditors and for the country's perception for future funding opportunities.
2. There must be high-level political support and whole-of-government support from the debtor's government. Without this, there is high possibility of discontinuation or stalling the negotiations in case of change of government or lack of buy in for the activities' added value.
3. Buy in is also necessary from civil society and NGOs within the debtor country. It allows for the success of a swap, since the majority of adaptation activities involve local communities and stakeholders. The Seychelles provided a good example in which buy in for the activities doubled due to leveraging additional funding.
4. Encouraging participation from the private sector through incentives allows for additional funding sources. For example, Seychelles' SeyCCAT can be the recipient of donations from large national corporations and, as a result, those corporations can receive an "offset of 0.25% of their CSR tax liability against donations or sponsorships."
5. If commitment to the mitigation or adaptation activity is anchored in the country's pledges outlined in NAPs or NDCs, there is much greater buy in and a higher chance of follow through on pledges. It is also crucial to link any plan with the SDGs and their targets and commitments under the Addis Ababa Action Agenda of the Third International Conference on Financing for Development (AAAA), bringing in issues related to national development progress, access to future funding and reporting at the international level.
6. The agreement should be structured in a way to allow and intent for attracting additional funds. For example, in the Seychelles, the initial agreement between the TNC, Paris Club, South Africa and the Seychelles government allowed for buy in and leveraging of funds from a large range of other sources, all of which are outlined in Section 3.
7. The projects or activities being put forward for the proposed swap should be tangible or palatable to a donor. Donors are accountable to their taxpayers and must validate with their parliaments the signing off of a portion or all of any public debt. This is easier to do so with a project that is more relatable to the public of the donor country.
8. Creditor must be willing to donate or sell debt at a discount from face value and/or the debt must be available and eligible for conversion.
9. Most donors prefer when there is a neutral and experienced third party involved in the governance structure of the swap, usually a non-governmental organization, e.g. the TNC. The involvement of the third party has proven to facilitate trust building within the swap mechanism.
10. Many donors prefer when the swap puts in place or utilises a separate Fund that is clearly and legally independent from the government's core budget, such as the EFJ in Jamaica

or the SeyCCAT in the Seychelles. In many cases a number of seats or membership are set aside for the donor, debtor country and third party allowing for transparency, trust building and accountability of financing. A good example of this is the composition of the Board of the EFJ in Jamaica.

### 4.3 Main Challenges

There are many elements that may impede or contribute to the failure of debt for climate swaps, some of which include the following:

1. Lack of high-level political leadership and advocacy from the debtor government.
2. Lack of common understanding and buy in from all the partners – creditors, debtor government or third party.
3. Lack of good governance and enabling environments of debtor government, leading to low buy in from the creditor for the debt swap.
4. Weak monitoring and oversight systems in place, leading to a lack of transparency or accountability of project activities.
5. Change of political leadership of debtor government causing discontinuity in the swap negotiations or implementation.
6. Lack of capacity and incentives to leverage funding from other sources.
7. Lack of long-term vision and a structured approach for debt sustainability.
8. Lack of an integrated approach with the national development plan, national adaptation plan, NDC or SDGs.
9. Lack of involvement of civil society, NGOs and private sector.

### 4.4 Climate Finance Considerations

Caribbean States and other SIDS' particular vulnerability to the adverse impacts of climate change have been recognized internationally since the Rio Earth Summit in 1992. The Paris Agreement explicitly recognizes the priorities and needs of SIDS for public and grant-based resources for adaptation in the context of the “provision of scaled up financial resources”.<sup>22</sup>

However, globally there is still a major gap in available adaptation funding with the majority of climate finance being directed to mitigation. Additionally, accessing financing is a key challenge for many Caribbean countries, which have limited access to concessional finance because of their ‘middle income’ classification. This increases their levels of debt, much of it incurred through investment in recovery and resilience.

The majority of Caribbean countries are not eligible for debt relief provided under existing international initiatives, which are often targeted at countries that have been classified as low income under World Bank or IMF criteria. Hence debt for climate swaps have the potential to

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<sup>22</sup> Article 9.4



serve as an innovative instrument for mobilizing financing to tackle several of Caribbean states' challenges, in particular insufficient climate adaptation finance and debt sustainability.

After the particularly intense Atlantic hurricane season across the Caribbean region in 2017, the financing challenge of Caribbean States has been lifted to the focus of the international debt relief debate. UN Secretary General recognised the need to for “a new and better deal” for climate resilience in the Caribbean.<sup>23</sup> This context provides an opportunity to implement innovative financing structures to address the dual challenge of debt sustainability and financing for climate resilience.

In general, while debt for climate swaps offer clear potential in terms of financial and climate benefits for both debtors and creditors involved, the model does not represent “new and additional” climate finance in the traditional sense or the initial spirit of the UNFCCC. In the case of a swap, the resources used for the climate project are not transferred from developed to developing countries or from North to South. Debt for climate swaps therefore belong to so-called alternative or innovative sources of financing for climate adaptation or development beyond existing bilateral and multilateral sources. The Paris Agreement provides an important international context for any regional debt swap initiative. In particular, Article 9.3 stipulates that “as part of a global effort, developed country Parties should continue to take the lead in mobilizing climate finance from a *wide variety of sources, instruments and channels, noting the significant role of public funds, through a variety of actions*, including supporting country-driven strategies, and taking into account the needs and priorities of developing country Parties. Such mobilization of climate finance should represent a progression beyond previous efforts” [emphasis added].

In this context, one question is whether the creditors would be able to report their writing off of debt as part of their climate finance contributions. This could be an advantage for donors and could help convincing their governments and parliaments. One key advantage for the recipient country is that local currency does not leave the country to earn hard currency for the purpose of multilateral debt service. Instead it can be invested to provide public goods in line with national and regional climate change adaptation priorities.

Further potential climate finance benefits include:

- Predictability: financing for longer-term projects (e.g. 10 to 15 years) through a stable stream of revenues to address climate change at national/regional level;
- Possible additional source for capitalizing national climate funds;
- Improvement of external debt balance (although technically the process of repaying the debt is not yet finished)

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<sup>23</sup> <https://news.un.org/en/story/2017/11/636862-new-and-better-deal-needed-climate-resilience-caribbean-un-chief-tells-donor#.WhWNJapOmaP>

Main concerns and risks of debt swaps in the context of climate financing:

- **Additionality:** Is funding provided through debt swaps additional to existing ODA and public climate financing? The credit to be relieved may have been already counted as ODA. The recipient country has to provide resources from domestic budgets instead of benefitting from new sources of financing or debt relief.
- **Country ownership:** the design of any debt swap initiative and funded national/regional climate adaptation projects has to ensure full country-ownership.