



(Re)orienting Sovereign Debt to Support Nature and the SDGs:

Instruments and their Application
in Asia-Pacific Developing Economies

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Brief Description of the Publication

Many Asia-Pacific low- and middle-income countries are facing the dual challenges of sovereign debt distress and climate and biodiversity breakdowns, while also lagging on Sustainable Development Goal (SDG) achievement. Competing financing priorities, along with sharp increases in the share of public debt held by bondholders and emerging bilateral creditors, complicate urgently needed agreements to restructure sovereign debt and reorient resources toward the SDGs, particularly climate and nature-positive actions. We propose additional means to manage sovereign debt and environmental distress, showing how debt-for-nature swaps have been successfully deployed in debt-reorganization packages. For illustrative purposes, we present rationales and possible roadmaps to deploy debt-for-nature swaps for a selection of Asia-Pacific economies: Lao PDR, Pakistan, the Maldives, and a group of Pacific Small Island Developing States. While the scale of such swaps has risen significantly in recent years, their contribution to debt reduction remains modest so far, hence stakeholders need to be realistic about the extent of the instrument's impact on debt sustainability. However, successful and relatively large-scale debt-for-nature swaps in Belize and Ecuador have given sovereign debtors a new impetus to explore them. We also show how sovereign borrowers have used – or could use – thematic bonds, sustainability-linked bonds, and other SDG-aligned instruments to raise new financing. We focus on the role China could play in the Asia-Pacific region, adding to knowledge about this comparatively less-understood emerging creditor. We conclude with four recommendations for how policymakers in creditor and debtor countries and other stakeholders can effectively engage in debt relief and reorientation arrangements to support the SDGs and global environmental commitments.

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Executive Summary

Looming crises: Debt and environmental sustainability at risk in the Asia-Pacific region

Many developing low- and middle-income countries (LMICs) in the Asia-Pacific region are confronted with the dual challenges of greater sovereign debt distress – exacerbated by global shocks including COVID-19 – and environmental risk through climate change and biodiversity loss. Without an effective solution to the debt crisis and significant additional financing and investment in Asia-Pacific LMICs, regional and global ambitions to meet the Sustainable Development Goals (SDGs) will become impossible to achieve.

Out of the world's 52 most debt-vulnerable economies, 12 are in the Asia-Pacific region (UNDP, 2023). Due to unaddressed debt distress and insufficient or non-existent access to external finance, these economies are at risk of being severely underinvested in social, economic and environmental development. At the same time, Asia-Pacific economies count among the most vulnerable to climate change, land and marine degradation, and subsequent biodiversity loss, all of which severely impact lives and livelihoods, the countries' debt-carrying capacity, and their short-, medium- and long-term development goals.

For these reasons, finance ministers from Asia-Pacific countries – members of the Vulnerable 20 (V20) coalition – have called for debt reorganizations and sustainable finance instruments, including swaps, grants, loans, or bonds linked to the climate and other SDGs, for enhanced resilience and green and inclusive recoveries (V20 Presidency 2021). This requires not only updating and expanding upon traditional debt treatments and instruments, but also managing an increasingly complex creditor composition.

New challenges and opportunities for debt reorganization in Asia-Pacific LMICs

Traditionally, to address sovereign debt issues, official multilateral and bilateral creditors (often coordinated by Paris Club members) have provided debt relief to low-income countries through concessional restructurings, including debt-for-development swaps. However, few standardized single- or multi-creditor interventions exist to address debt issues in middle-income countries, while even fewer interventions combine debt relief and SDGs related to the climate and nature.

An analysis of the 24 Asia-Pacific economies covered by the World Bank International Debt Statistics (IDS) (2022) database shows that:

- » **Bondholders** greatly expanded their total and relative exposure, and now hold 45.4 percent of total public and publicly guaranteed (PPG) external debt in the region.
- » The **World Bank** (16.9 percent) and the **Asian Development Bank** (11.2 percent) are the second and third largest creditors, respectively.
- » **Emerging bilateral creditors** are playing a greater role. China, for example, has significantly increased its total and relative external debt exposure to 7.1 percent of the total PPG debt exposure of Asia-Pacific countries analysed in this report, becoming the fifth largest creditor in the region.

Compared with past debt-crises negotiations, this significantly different creditor composition and the urgency of climate and biodiversity breakdowns require a more tailored application of treatments and instruments. For this reason, new and some less-frequently used instruments, such as SDG-aligned debt-for-development swaps, have attracted growing interest in recent years. In particular, two approaches to sovereign debt can improve both debt and environmental sustainability:

- » **Debt reorganization treatments** that convert and possibly forgive debt contracts for SDG and nature-positive development through debt-for-nature swaps and other SDG-conditional instruments.
- » **New SDG-aligned debt issuance** through thematic bonds, i.e., green or blue bonds, and sustainability-linked bonds and loans.

Nature-positive debt reorganizations would benefit sovereign debtors by freeing up resources used to pay debt service to instead invest in climate-resilient infrastructure, green productive capacity, and nature-based solutions that could stimulate employment and citizen wellbeing. Creditors, too, would benefit from positive effects, such as lower default risk, higher shareholder and stakeholder value, less litigation exposure, and greater portfolio diversification.

Debt-reorganization packages can involve more than one type of treatment and instrument to improve outcomes. Importantly, each treatment and instrument for reorganizing debt or issuing new debt can be applied to specific situations that have different underlying requirements and circumstances.

Possible applications in support of nature and the SDGs in Asia-Pacific LMICs

To illustrate how debt-for-nature swaps might be applied, this report provides rationales and possible roadmaps for a selection of Asia-Pacific economies: Lao People’s Democratic Republic (PDR), Pakistan, and a group of Small Island Developing States (SIDS). These economies have different creditor compositions, but share three important characteristics that apply to other Asia-Pacific LMICs:

- » High vulnerability to the effects of climate and biodiversity breakdowns, with knock-on implications for macroeconomic conditions and debt sustainability.
- » National priorities that include nature conservation, protection, and restoration for which securing financing at the required scale is extremely challenging.
- » A readiness to move forward with pertinent debt reorganization treatments, including exploring the potential for debt-for-nature swaps.

Lao People’s Democratic Republic (PDR) appears to have potential to engage with its bilateral creditors on a debt reorganization package. There has been some interest in understanding the operational aspects of debt-for-nature swap-type instruments. Lao PDR has prepared sustainable development plans that include additional forest protection projects, and it has the support of implementing agencies, including UNDP. In addition to the need for creditors’ willingness to participate in such an arrangement, Lao PDR would need to further strengthen its governance mechanisms through monitoring, reporting, and verification (MRV) systems to help ensure that projects funded from debt-for-nature swap proceeds deliver the desired outcomes.

Pakistan faces significant levels of debt and challenges for refinancing it, such as declining bond-market access. It is also facing an imperative to ensure climate-resilience and conservation. Against this background, Pakistan could explore new opportunities to use debt-for-development swaps, including -nature swaps, with major bilateral creditors, such as China. The debt-service savings or grant funding from such conversions could be used to support the SDGs, the 2022 flood reconstruction efforts, and climate-resilience and nature-conservation programmes. Governance, transparency, and accountability concerns could be addressed using an intermediary entity and multilateral technical advisory partners.

Asia-Pacific Small Island Developing States (SIDS) could benefit from debt reorganizations in single or multi-creditor arrangements that include debt-for-climate or -nature swaps or, if the strength of their economy allows, new financing through thematic and sustainability-linked bonds. The IMF believes that some debt reorganization instruments that consider nature outcomes “could be superior to grants when structured in a way to make the climate commitment senior to debt service” or in specific circumstances of debt restructuring (Chamon et al 2022).

Recommendations to accelerate debt reorganization and (re)orientation negotiations to benefit nature and the SDGs in the Asia-Pacific region

While debt-for-nature swaps could be feasible in Asia-Pacific LMICs and are potentially superior to some other instruments (Chamon et al 2022), they require creditors and sovereign debtors to undergo often complex negotiations to reorganize sovereign debt, ensuring both sufficient transparency and the confidentiality of market-sensitive information. Adding debt-reorientation ambitions to improve environmental or broader SDGs outcomes further complicates such

negotiations, although, as previous deals show, there is some potential to meet both sets of objectives in tandem. Learnings from the island nation of the Maldives are relevant. The report highlights the challenges encountered during the exploration of a Maldives' debt-for-nature swap in 2020 and provides lessons for sovereign debtors and their advisors. It is critical to enhance the understanding of creditors' roles and challenges as they voluntarily participate in single- or multi-creditor sovereign debt-relief treatments, or cash out through third-party-organized debt conversions, in order to accelerate negotiations. Following an extensive analysis, this report makes four recommendations:

1. **Creditors and sovereign debtors should exercise caution when choosing between or combining debt-relief treatments and instruments** to ensure that they are suitable for the sovereign debtor's specific situation and the creditor's interests and *modus operandi*.
2. **Asia-Pacific sovereign debtors should be prepared to understand and negotiate the implicit and explicit conditions of each type of creditor** – traditional, emerging, private – as they pertain to debt relief, debt-for-development swaps, debt-for-nature conversions, or new sustainable finance. Asia-Pacific economies aiming to engage with traditional Paris Club creditors should familiarize themselves with relevant policy frameworks, including those related to debt-for-development swaps. Asia-Pacific economies aiming to engage with China should build a solid understanding of Chinese overseas loans and lending governance.
3. **Asia-Pacific sovereign debtors should prepare for negotiations to (re)orient debt by developing a clear plan for the implementation of a debt-for-nature swap or other nature-aligned instrument and related project** in line with their national priorities. This includes identifying and engaging with domestic government officials, citizens, and civil society organizations; international institutions and nature conservancy groups for the provision of expertise; and bankers and development finance institutions for the provision of credit enhancements and other financing services. It also includes putting into place nature-project plans, managers, and monitoring, reporting and verification systems.
4. **Creditors should play an active role in helping Asia-Pacific economies manage sovereign PPG external debt and environmental and climate risks** by significantly expanding the scope for debt reduction and reorientation arrangements, and by making more extensive use of state-contingent debt instruments in their lending. In exchange for climate or nature protection benefits, traditional multi- and bilateral creditors can accelerate the deployment of their debt-relief and reorientation frameworks and mechanisms, provide credit enhancements, and participate in the equity of overleveraged debtor-state-owned enterprises. They can also evaluate and deploy non-traditional instruments, incentivize sovereign debtors to design and negotiate nature-positive debt reduction plans, and coordinate with other creditors. China, as a key emerging creditor, has an important opportunity to make a significant contribution to debt-relief and reorientation arrangements in Asia-Pacific LMICs and support partner countries' development priorities, while also demonstrating strong commitment to international environmental agendas. Similarly, private creditors can step up their participation in Asia-Pacific LMIC debt reorganization and reorientation arrangements, including by purchasing and holding nature-aligned sovereign bonds.

By following through on these four recommendations, Asia-Pacific LMICs and their creditors can overcome some of the limitations of traditional debt-reduction arrangements and also address debtor countries' vulnerabilities to climate and biodiversity breakdowns. SDG- and nature-aligned debt instruments could thus have the power to resolve the increasingly urgent crises of debt and environmental distress. That said, while the scale of such swaps has risen significantly in recent years, their contribution to debt reduction remains modest so far, hence stakeholders need to be realistic about the extent of the instrument's impact on debt sustainability. However, successful and relatively large-scale debt-for-nature swaps in Belize and Ecuador have given sovereign debtors a new impetus to explore them. The timely and deft deployment of SDG- and nature-aligned instruments, particularly of debt-for-nature swaps, could provide new momentum and some of the finance needed to realise global and regional ambitions to advance the SDGs.

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List of Acronyms

ADB	Asian Development Bank
BMZ	Bundeministerium für wirtschaftliche Zusammenarbeit (German Ministry for Economic Cooperation and Development)
CAD	Canadian dollar (currency)
CDB	China Development Bank
CHEXIM	Export-Import Bank of China
CIDCA	China International Development Cooperation Agency
CNY	Renminbi (Chinese currency)
DFI	Development finance institution
DNS	Debt-for-nature swap
DSA	Debt sustainability analysis
DSSI	Debt Service Suspension Initiative
ESG	Environmental, social and governance
EUR	Euro (European Union currency)
GDP	Gross domestic product
GNI	Gross national income
G20	Group of Twenty
HIPC	Heavily Indebted Poor Countries
ICBC	Industrial and Commercial Bank of China
IDA	International Development Association
IDS	International Debt Statistics
IMF	International Monetary Fund
KfW	Kreditanstalt für Wiederaufbau (Germany's state-owned development bank)
KPI	Key performance indicator
LIC	Low income country
LMIC	Low and middle income country

MDRI	Multilateral Debt Relief Initiative
MIC	Middle income country
MEE	Ministry of Environment and Ecology of the People's Republic of China
MOF	Ministry of Finance of the People's Republic of China
MOFA	Ministry of Foreign Affairs of the People's Republic of China
MOFCOM	Ministry of Commerce of the People's Republic of China
MRV	Monitoring, reporting and verification
NPB	Nature performance bond
NGO	Nongovernmental organization
ODA	Official development assistance
OECD	Organisation for Economic Cooperation and Development
PEBC	Preferential export buyer's credit
PKR	Pakistan rupees (currency)
PPG	Public and publicly guaranteed
SAFE	State Administration of Foreign Exchange
SDG	Sustainable Development Goal
SDR	Special drawing right
SIDS	Small Island Developing State
SLB	Sustainability-linked bond
SOE	State-owned enterprise
SOFI	State-owned financial institution
TNC	The Nature Conservancy
UN	United Nations
UNDP	United Nations Development Programme
U.S.	United States
US\$	United States dollar (currency)
V20	Vulnerable Twenty Group

CHAPTER 1

Introduction: The looming debt and environmental crises in the Asia-Pacific region

1.1 Overview

Many developing low- and middle-income countries (LMICs)¹ in the Asia-Pacific region² are confronted with the dual challenges of greater sovereign debt³ distress – exacerbated by global shocks including COVID-19 – and greater environmental risks through climate change and biodiversity loss. Without an effective solution to the debt crisis and significant additional financing and investment in Asia-Pacific LMICs, regional and global ambitions to meet the Sustainable Development Goals (SDGs) will become impossible to achieve.

Traditionally, to address sovereign debt issues, official creditors⁴ have provided debt relief⁵ to low-income countries (LICs) through concessional restructurings.⁶ However, few standardized

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- 1 For the current 2023 fiscal year, the World Bank defines low-income economies are those with a gross national income (GNI) per capita (calculated using the World Bank Atlas method) of US\$1,085 or less in 2021. Middle income countries (MICs) are composed of lower middle-income economies, which are those with a GNI per capita between \$1,086 and \$4,255, and upper middle-income economies, which are those with a GNI per capita between \$4,256 and \$13,205. (World Bank 2023).
 - 2 The United Nations Development Programme (UNDP) Regional Bureau for Asia and the Pacific (RBAP), sponsor of this report, defines the Asia-Pacific region as comprising 36 developing countries: Afghanistan, Bangladesh, Bhutan, Brunei Darussalam, Cambodia, China (People’s Republic of), Fiji, India, Indonesia, Iran (Islamic Republic of), Kiribati, Democratic People’s Republic of Korea, Lao People’s Democratic Republic, the Maldives, Malaysia, the Marshall Islands, Micronesia (Federated States of), Mongolia, Myanmar, Nauru, Nepal, Niue, Pakistan, Palau, Papua New Guinea, the Philippines, Samoa, Singapore, the Solomon Islands, Sri Lanka, Thailand, Timor-Leste, Tonga, Tuvalu, Vanuatu, and Viet Nam (UNDP n.d.)
 - 3 Sovereign debt is debt that has been legally contracted by a national government, which is responsible for its repayment (IMF 2014, 247).
 - 4 Official creditors are public sector creditors, including multilateral development finance institutions (DFIs), such as the World Bank or Asian Development Bank, and bilateral DFIs and export credit agencies in individual countries. In general, official creditors provide loans and, in some cases, grants, to public bodies, although in some cases they may lend to other entities with a public guarantee. Such loans are usually but not always concessional, meaning the interest rate and/or other conditions are lower than prevailing market rates and conditions (World Bank 2022, 72).
 - 5 Debt relief results where there is (1) a reduction in the present value of these debt-service obligations; and/or (2) a deferral of the payments due, thus providing smaller near-term debt-service obligations (IMF 2014, 89).
 - 6 Debt restructurings with a reduction in present value of the debt service. Concessional or concessionary loans include a grant component, such as a delay in principal payments or a below-market interest rate (IMF 2014).

single- or multi-creditor interventions exist to address debt issues in developing middle income countries (MICs), and even fewer interventions support SDGs related to the climate and nature.⁷

For this reason, finance ministers from Asia-Pacific countries at the epicentre of these debt and nature crises – **members of the Vulnerable 20 (V20) coalition** – **have called since 2021 for debt reorganizations linked to climate and SDGs for a green and inclusive recovery from the COVID-19 pandemic and other shocks** (V20 Presidency 2021). Traditional⁸ official multi- and bilateral creditors are being encouraged to coordinate with emerging creditors,⁹ private creditors,¹⁰ and sovereign debtors to rapidly reduce short- and medium-term public and publicly guaranteed (PPG) external debt¹¹ burdens and reorient public finance to put developing Asia-Pacific economies on a genuinely sustainable path for human development.

This report provides an understanding of the opportunities and processes needed to simultaneously address sovereign debt and environmental risks and to scale SDG-aligned sustainable finance instruments for Asia-Pacific economies.

This chapter highlights the dual challenges of debt and environmental distress in Asia Pacific LMICs. **Chapter 2** reviews debt reorganization treatments, instruments, and mechanisms that can be deployed to direct debt contracts toward funding climate-and-nature SDGs. This includes instruments that raise new capital for sustainable development and debt-reduction treatments that purely focus on reorganizing and reorienting existing debt. **Chapter 3** looks at three representative Asia-Pacific economies – Lao PDR, Pakistan, and a group of Asia-Pacific Small Island Developing States (SIDSs) – where single- and multi-creditor debt-relief treatments and climate and nature-aligned financing could apply, and evaluates each country’s interest in and preparation for debt-for-nature swaps. **Chapter 4** analyzes the opportunities and constraints for sovereign debt reorganization and reorientation treatments from the creditors’ perspective. It also provides new insights into China’s role as one of the more important and less understood partners in the Asia-Pacific region. In conclusion, **Chapter 5** provides recommendations for sovereign debtors and their creditors. Figure 1.1 outlines the chapters’ progression.

7 In its most narrow categorization, climate refers to SDG 13 Climate Action, and nature refers to SDG 14 Life Below Water and SDG 15 Life on Land (UNDESA 2015).

8 By traditional official creditors, we mean multilateral public DFIs, such as the World Bank, and bilateral public DFIs and agencies, such as those of country-members of the Organisation for Economic Cooperation and Development Development Assistance Committee (OECD DAC) (see OECD n.d.) and the permanent members of The Paris Club (see Paris Club n.d.).

9 By emerging creditors, we mean non-OECD-DAC and non-Paris-Club member-countries, such as China, India, Indonesia, Saudi Arabia, Singapore, and Thailand.

10 Private creditors include bondholders and commercial banks, suppliers, trade creditors, contractors and individuals. PPG external debt from private creditors includes bonds that are either publicly issued or privately placed; commercial bank loans from private banks and other private financial institutions; and other private credits from manufacturers, exporters, and other suppliers of goods, and bank credits covered by a guarantee of an export credit agency. Bondholders include institutional investors (investment funds, insurance companies, retirement funds, bond funds) and other investors that buy sovereign bonds (Bucheit et al 2018, 3).

11 Public and publicly guaranteed (PPG) external debt includes loans from foreign governments and their agencies (including central banks and DFIs), loans from autonomous bodies, and direct loans from official export credit agencies to sovereign creditors or their beneficiaries, which includes debt that was originally owed to private creditors but that is guaranteed by a public entity in the same economy as the creditor (IMF 2014).

This report is targeted at stakeholders in Asia-Pacific economies' sovereign-debt sustainability, including policymakers in debtor and creditor countries, creditors, financial institutions, and intermediaries. Each chapter provides knowledge and analyses that can help Asia-Pacific LMICs accelerate negotiations that will lead to debt and environmental sustainability.

FIGURE 1.1 Chapter subjects



Source: Authors

1.2 The physical risks of environmental change amplify financial risks for sovereign debtors and creditors

Climate and biodiversity breakdowns negatively impact lives, livelihoods and economic development. Many Asia-Pacific LMICs count among the most vulnerable to climate change impacts, land and marine degradation, and subsequent biodiversity loss, which severely impacts their short-, medium- and long-term development goals and debt-carrying capacity. For example, the 2022 WorldRisk Index ranks the Philippines, Indonesia, and Papua New Guinea among the “most susceptible” to disaster risk from extreme natural events and negative climate change impacts (Atwii et al 2022). These and other Asia-Pacific LMICs also have a large risk of further biodiversity loss: Fiji, Lao PDR, the Maldives, and Myanmar, for example, have protected less than 20 percent of their priority biodiversity areas (Nedopil et al 2022).

Notably, climate and biodiversity breakdowns almost always combine and amplify the negative effects of each, affecting each country differently through common risks such as rising sea levels, stronger and more frequent rain storms, soil and barrier-reef erosion, food and water pollution or shortages, and infrastructure damage and destruction (UNESCAP 2022). In Pakistan, for example, more than 33 million people were affected by the catastrophic 2022 floods that destroyed more than two million homes (World Bank 2022a). The floods’ intensity was directly related to climate change and biodiversity loss, with more intense precipitation that overwhelmed the water-absorption capacity of floodplains, wetlands, and soils degraded by clearing, construction and impermeable coverings (Clark et al 2022). These and other physical and climate risks can have significant impacts on macroeconomic conditions, including debt sustainability and sovereign and corporate risk ratings (Maldonado and Gallagher 2022).

Without significant additional investments, global and regional ambitions to meet the SDGs are

becoming impossible to attain. Financing climate and nature-related programmes such as the low-carbon energy transition,¹² climate-change mitigation and adaptation, and biodiversity protection, conservation and restoration will require trillions of dollars (Fouad et al 2021; UNEP 2022). The Asia-Pacific SIDS members of the Pacific Island Forum¹³ alone would need about US\$1 billion in climate finance annually, a significant amount of which would need to be public finance. However, public finance commitments are currently estimated to be only \$220 million – less than 25 percent of the required amount (Citi Global Insights 2019).

In addition to lacking sufficient or accessible external finance, governments may reduce domestic funding for climate and nature-related programmes because they face high debt-service obligations and struggle to allocate scarce resources, sometimes diverting funds from long-term programmes. This has already happened in Lao PDR, for example, where the budget allocation to the Lao Forest Protection Fund was more than \$700,000 in 2017; by 2021, it had fallen to around \$170,000 even though the need for protection had increased (UNDP 2021).

Attaining the SDGs and addressing existential environmental risks will require dedicated funding drawn from a variety of providers and a combination of debt relief and sustainable-finance instruments, such as SDG-aligned grants, loans, bonds, and swaps. This requires updating and/or expanding upon traditional debt instruments and treatments and managing a more complex creditor composition.

1.3 A complex creditor composition complicates SDG-aligned debt reorganization efforts

A particular challenge for solving the sovereign debt crisis in Asia-Pacific LMICs lies in the growing complexity of the creditor composition in many developing countries. Significantly different characteristics from past debt crises require a more tailored application of instruments for debt reduction and reorientation.

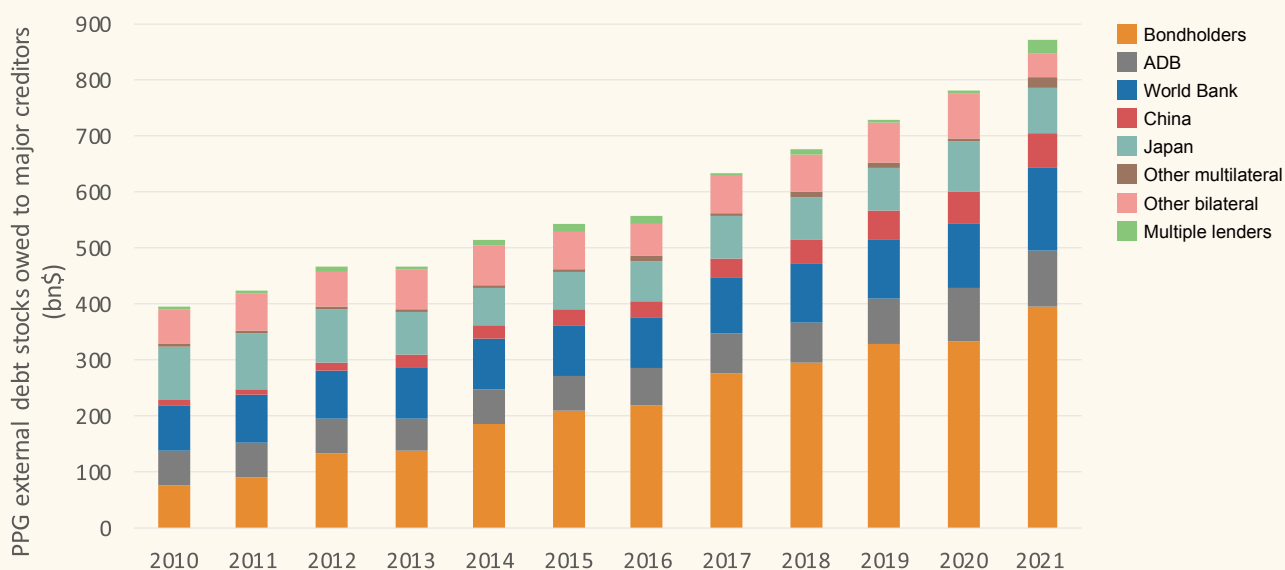
Since 2010, the composition of PPG external debt creditors and the extent of their holdings have evolved across 24 developing Asia-Pacific economies,¹⁴ with private and emerging creditors

12 While reducing sovereign debt levels is important for freeing up resources to finance the energy transition, governments have also been encouraged to reduce non-efficient-energy expenditures, including fossil fuel subsidies, to improve fiscal space (G20 2022).

13 The Pacific Island Forum has 16 members: Australia, the Cook Islands, Federated States of Micronesia, Fiji, Kiribati, Nauru, New Zealand, Niue, Palau, Papua New Guinea, Republic of the Marshall Islands, Samoa, the Solomon Islands, Tonga, Tuvalu, and Vanuatu.

14 Here we refer to 24 Asia-Pacific LMICs that are included in the World Bank International Debt Statistics (IDS) database (World Bank IDS 2022). We do not include the People's Republic of China (China) because it is one of the region's largest creditors. The 24 countries include Afghanistan, Bangladesh, Bhutan, Cambodia, Fiji, India, Indonesia, Iran (Islamic Republic of), Lao People's Democratic Republic (PDR), the Maldives, Mongolia, Myanmar, Nepal, Pakistan, Papua New Guinea, the Philippines, Samoa, the Solomon Islands, Sri Lanka, Thailand, Timor Leste, Tonga, Vanuatu and Viet Nam.

FIGURE 1.2: Major creditors by the value of PPG external debt for 24 Asia-Pacific developing economies, 2010-2021 (current \$ billion)

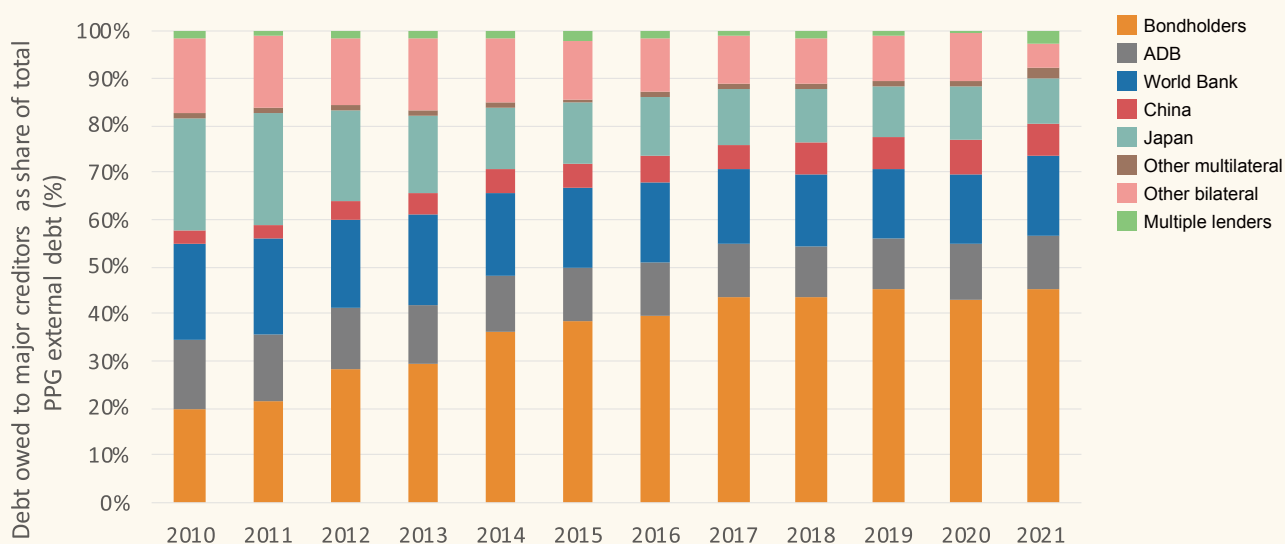


Note: China, Japan and other bilateral include official and nonofficial debt stocks. Multiple lenders is an undefined category.

The 24 countries: Afghanistan, Bangladesh, Bhutan, Cambodia, Fiji, India, Indonesia, Iran (Islamic Republic of), Lao PDR, Maldives, Mongolia, Myanmar, Nepal, Pakistan, Papua New Guinea, Philippines, Samoa, Solomon Islands, Sri Lanka, Thailand, Timor Leste, Tonga, Vanuatu and Viet Nam.

Source: Authors based on World Bank IDS (2022)

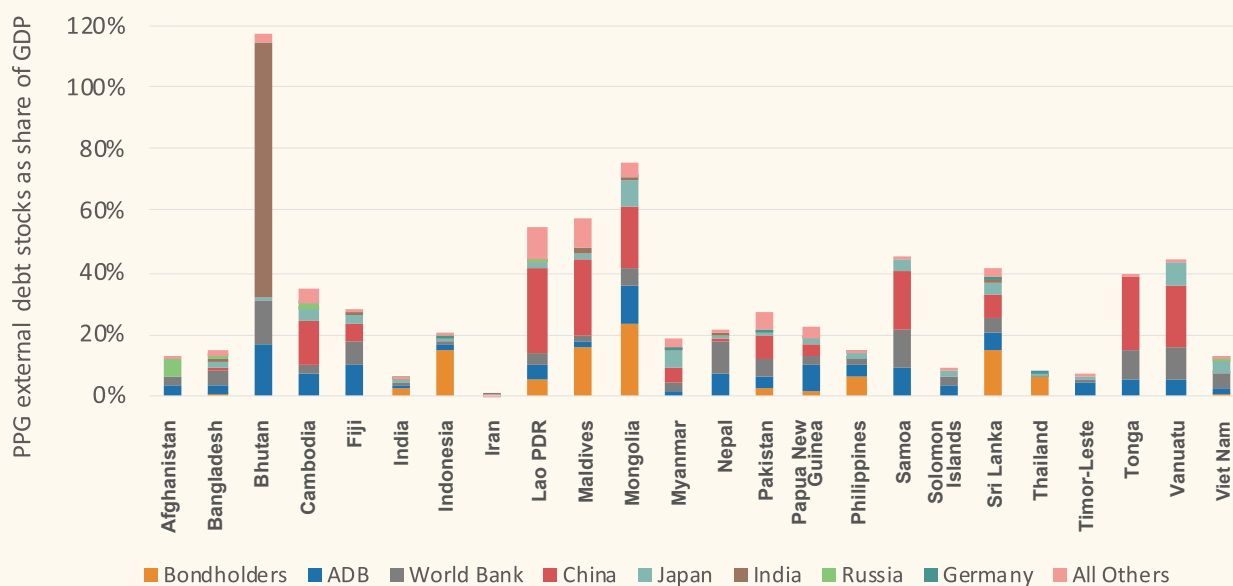
FIGURE 1.2a: Major creditors by share of PPG external debt for 24 Asia-Pacific developing economies, 2010-2021 (%)



Note: China, Japan and other bilateral include official and nonofficial debt stocks. Multiple lenders is an undefined category.

Source: Authors based on World Bank IDS (2022)

FIGURE 1.3: Major creditors' share of PPG external debt in each of 24 developing Asia-Pacific economies, 2021 (% of GDP)

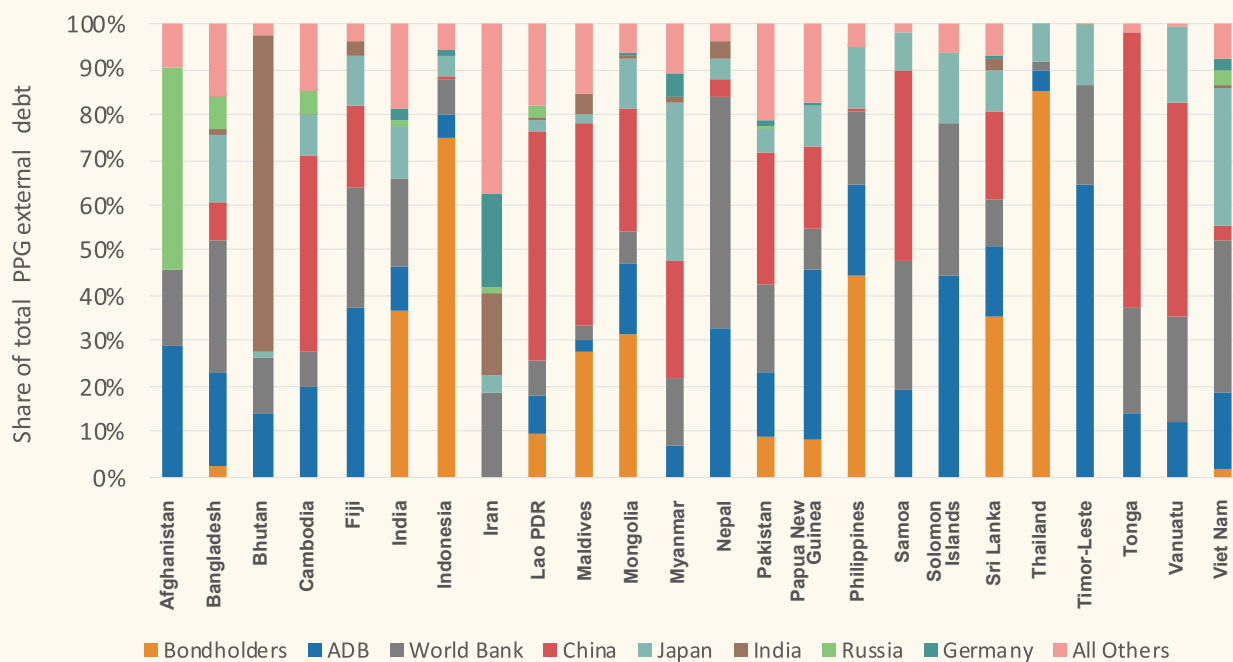


Note: China, Japan, India, Russia and Germany include official and nonofficial debt stocks.

The 24 countries: Afghanistan, Bangladesh, Bhutan, Cambodia, Fiji, India, Indonesia, Iran (Islamic Republic of), Lao PDR, Maldives, Mongolia, Myanmar, Nepal, Pakistan, Papua New Guinea, Philippines, Samoa, Solomon Islands, Sri Lanka, Thailand, Timor Leste, Tonga, Vanuatu and Viet Nam.

Source: Authors based on World Bank IDS (2022)

FIGURE 1.3a: Major creditors' share of PPG external debt in each of 24 developing Asia-Pacific economies, 2021 (%)



Note: China, Japan, India, Russia and Germany include official and nonofficial debt stocks.

Source: Authors based on World Bank IDS (2022)

outpacing traditional multi- and bilateral creditors (Figure 1.2 and Figure 1.2a). Three issues stand out:

- » **Bondholders** greatly expanded their total and relative exposure from \$77.7 billion in 2010 (19.4 percent of total PPG external debt) to \$396.1 billion in 2021, accounting for 45.4 percent of total external debt in the region.
- » **The World Bank** (16.9 percent) and the **Asian Development Bank** (11.2 percent) are the second and third largest creditors, respectively. Since 2010, most traditional multi- and bilateral creditors only slightly increased their total exposure while decreasing their relative exposure.
- » **China** significantly increased its total and relative external debt exposure from \$9.9 billion (2 percent) in 2010 to \$62 billion (7.1 percent) by 2021, becoming the fifth largest creditor in the region after Japan (9.4 percent).

Part of the complexity of designing and implementing debt-reduction treatments stems from the differences in each creditor's share of each country's PPG external debt, and partly from the increase of emerging creditors and their different interests, perspectives, and capacities (Figure 1.3 and Figure 1.3a). For example, Bhutan's PPG external debt represents 118 percent of its GDP: emerging creditor India holds debt worth 82 percent of Bhutan's GDP, while traditional multilateral creditors hold 31 percent. Similarly, as noted earlier, emerging creditor China has outpaced the World Bank to be the largest single creditor for Pakistan. China is also the single largest creditor for seven Asia-Pacific MICs: Cambodia, Lao PDR, the Maldives, Pakistan, Samoa, Tonga and Vanuatu.

Adding further to the debt complexity is the increase of so-called 'hidden debt', where many loans are believed to not be captured in the World Bank's International Debt Statistics (IDS) (Horn et al 2019). Hidden debt undermines debt sustainability assessments necessary for debt reorganization and market confidence (UNDP 2023).

1.4 The sovereign debt outlook sees rising risks

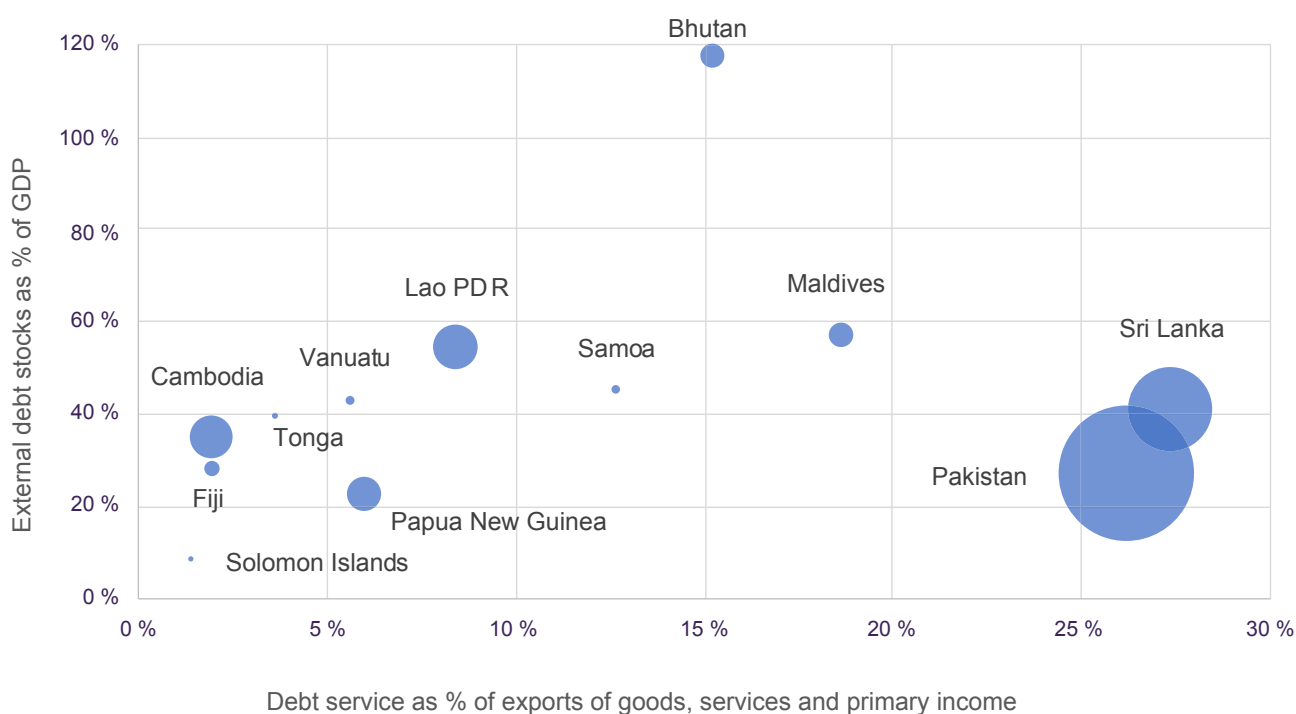
An economy's debt outlook depends on a variety of domestic and international factors. Debt sustainability¹⁵ depends, in part, on the debtor being able to service the debt, which is often denominated in foreign currencies, particularly the U.S. dollar. Thus, an influx of foreign currency, such as through export sales, can be seen as a positive indicator for debt sustainability. A higher debt-sustainability capacity allows debtor countries to raise funds on international capital markets or from international partners. For example, Lao PDR has a higher PPG external debt-to-GDP ratio of 54.5 percent, and a relatively higher (8.4 percent) debt-service ratio compared to Cambodia, which has both a lower debt-to GDP ratio (35.1 percent) and debt-service ratio (1.9 percent), as shown in

15 In general, the IMF defines a country's public debt as "sustainable" if the government is able to meet all its current and future payment obligations without exceptional financial assistance or going into default (Hakura 2022).

Figure 1.4.¹⁶

A report by UNDP (2023) found that of 12 debt-vulnerable economies in the Asia-Pacific region,¹⁷ the three that have access to international bond markets had credit ratings that ranged from “highly speculative” for Pakistan, to “substantial risk” for the Maldives, to “high risk of distress” for Lao PDR, effectively locking those countries out of tapping international capital markets for new financing. Furthermore, the remaining nine economies had a Debt Sustainability Analysis (DSA) rating of “high risk of distress”.¹⁸

FIGURE 1.4: Debt-service ratios and PPG external debt-to-GDP ratios of select Asia-Pacific LMICs (2021)



Note: Bubble size reflects the country’s total PPG external debt volume.

Source: Authors based on World Bank IDS (2022)

The sovereign debt outlook in Asia-Pacific countries risks becoming more complex due to various global economic factors (Guénette et al 2022):

¹⁶ Author’s analysis based on World Bank IDS (2022).

¹⁷ Afghanistan, Kiribati, Lao PDR, the Maldives, the Marshall Islands, Micronesia (Federated States of), Pakistan, Samoa, the Solomon Islands, Sri Lanka, Tonga and Tuvalu.

¹⁸ Jointly with the World Bank, the International Monetary Fund (IMF) conducts a public and external DSA to evaluate country’s capacity to finance its policy objectives and service the ensuing debt (IMF 2014, 165).

- » **Inflation** has increased significantly because of supply-side disruptions in agricultural products, energy, and other commodities due to the war in Ukraine (Reuters 2022).
- » **Economic growth outlooks** remain uncertain, reflecting uncertainty about the strength of global economy (World Bank 2022b).
- » **Currencies** of many emerging markets have depreciated against the U.S. dollar due to rising central bank interest rates in developed countries. Asia-Pacific countries that have borrowed in foreign currencies are seeing their debt-service payments sharply increase (World Bank 2022c).
- » **Bond spreads** have widened between developed and developing countries. Close to one-third of developing economies included in the global emerging market bond index (EMBI Global) trade at more than 10 percentage points above similar maturity U.S. Treasury bonds, effectively locking them out of international capital markets (UNDP 2023).
- » **Interest rates have increased** and Asia Pacific countries seeking refinancing or new borrowing must confront higher interest rates impacted by developed-country central banks' monetary policy decisions, scarce concessional finance from development finance institutions (DFIs), risk-averse private creditors, and wider bond spreads.

1.5 Enhanced linkages between debt, climate-and-nature SDGs, and all types of creditors could benefit all

The sovereign debt crises affecting many Asia-Pacific LMICs require decisive single- and multi-creditor actions by traditional creditors, private creditors and emerging Asia-Pacific creditors.

Since the dual challenges of debt unsustainability and environmental unsustainability will reinforce each other if not addressed immediately, creditors and debtor countries can benefit most by simultaneously reducing and reorienting existing debt and directing new financing toward the SDGs, particularly nature and climate-related programmes.

Sovereign debtors would benefit from seeing resources currently used to pay debt service freed up to invest in climate-resilient infrastructure, green productive capacity, and nature-based solutions that could stimulate employment and citizen wellbeing, among other positive effects. **Creditors, too, would benefit** from positive effects, such as lower default risk and higher shareholder and stakeholder value, less exposure to litigation, and greater portfolio diversification (Table 1.1).

For these reasons, all major creditors should either participate in or if a major single creditor, spearhead efforts to reduce sovereign debtors' debt and environmental distress. Traditional multi- and bilateral creditors have studied and implemented a variety of multi- and single-creditor arrangements to provide debt relief, sometimes in support of the SDGs. Describing and building

on their experience, the next chapter presents a more detailed description of how a selection of sustainable-finance instruments have been or could be used by sovereign debtors and creditors – singly or collectively – to either raise new climate-and-nature SDG-aligned and sustainability-linked funding or reorganize and reorient debt, possibly with the help of DSAs for specific debtor countries, such as the Asia-Pacific SIDS (UNESCAP 2022).

TABLE 1.1: The positive effects of orienting debt toward nature-and-climate SDGs

For sovereign debtors	For creditors
» Lowers debt levels and debt-service obligations	» Reduces the risk of uncontrolled default events
» Creates fiscal space to invest in greater resilience and lower loss and damage costs	» Creates new investment opportunities in debtor country
» Stimulates employment in new, often locally-owned, green and nature-positive ¹⁹ industries and services	» Diversifies investment portfolio for bond investors through thematic bonds
» Increases green productive capacity, citizen wellbeing, and GDP	» Reduces exposures to litigation risks
» Presents less moral hazard risk than simple debt forgiveness ²⁰	» Reduces shareholder and stakeholder risk due to decreased portfolio uncertainties and improves public opinion
» May lower sovereign credit risk (Chamon et al 2022)	» Helps to achieve SDG or environmental, social and governance (ESG) targets

Forges partnerships and strengthens relationships
Enhances long-term economic stability
Protects the climate and nature as global goods

19 The term ‘nature positive’ refers to “actions that increase resilience of the planet and biodiversity, as well as societies, with the aim of creating a paradigm shift to reduce the loss of nature, secure nature’s contributions critical for humanity, and enhance sustainable socio-economic development” (UNDP et al 2021, 18).

20 Moral hazard occurs when a debtor country has an incentive to take on more debt, knowing that it will not bear the full cost of the debt if, for example, such debt will be forgiven in exchange for nothing. In a debt-for-nature swap, the debtor country must provide value in exchange for the debt reduction, such as by protecting, restoring or conserving its natural resources.

CHAPTER 2

SDG-aligned sovereign debt-management measures applicable to Asia-Pacific LMICs

Asia-Pacific LMICs facing the dual challenges of debt and environmental distress can address them through domestic reforms and policy (Dalio 2022). They may also deploy effective climate-and-nature SDG-aligned debt-management measures with benefits for both creditors and debtors.

Since traditional multi- and bilateral creditors, bondholders, and emerging Asian-Pacific creditors provided much of the existing credit to Asia-Pacific LMICs, they all have a more pronounced responsibility in addressing short- and long-term repayment risks.

This chapter introduces various debt-reorganization treatments, financial instruments, and mechanisms that have the potential to turn the sovereign Asia-Pacific LMIC debt crisis into an opportunity for accelerating sustainable development, or at least avoiding further deterioration of the situation. They build on more than 60 years of traditional Paris Club creditors' experience managing external debt crises in emerging economies (Box 2.1).

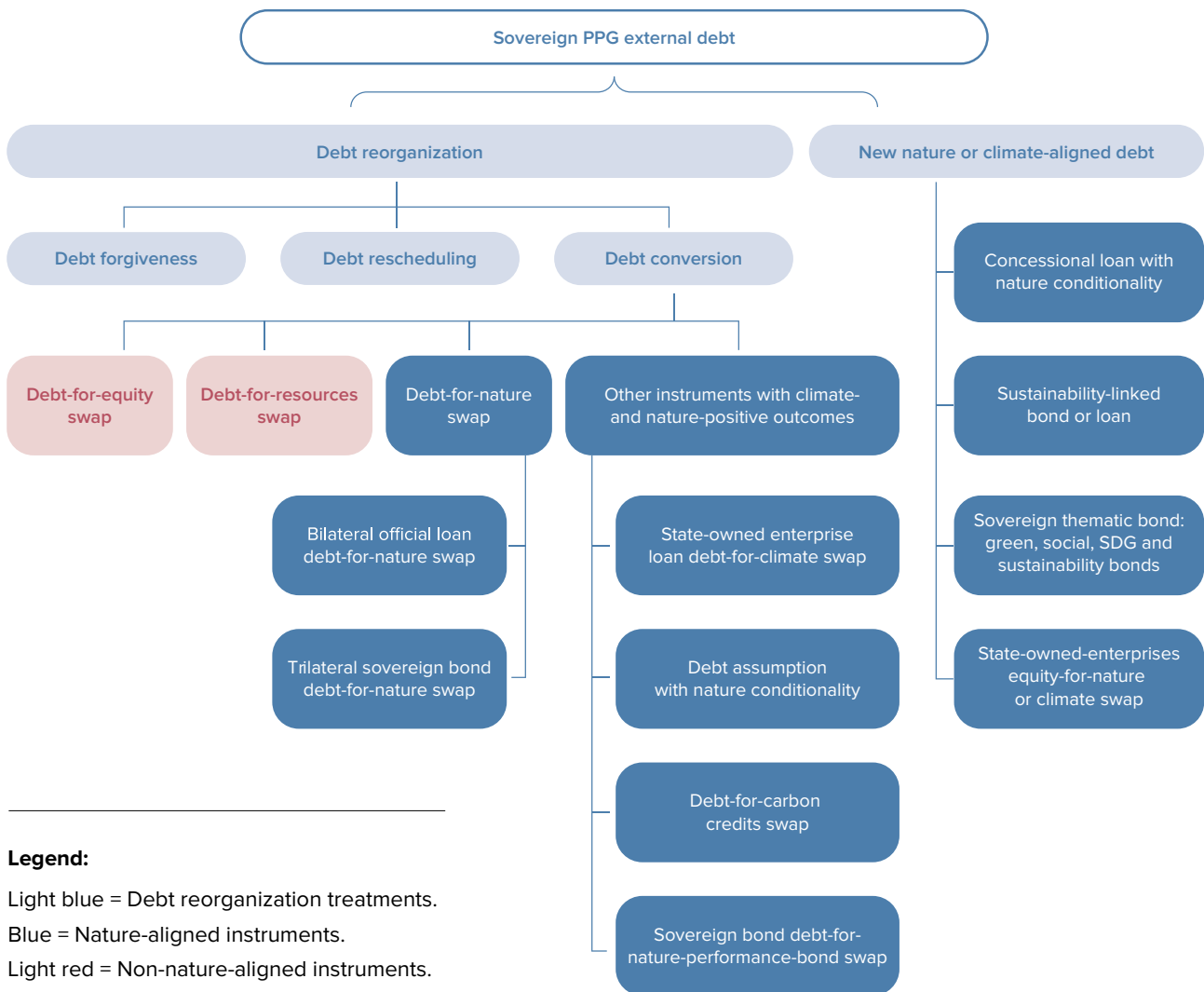
Box 2.1. Past traditional creditor debt reorganization efforts

- » **Paris Club** arrangements by traditional creditors evolved from rescheduling debt repayments in the 1960s to providing liquidity under the Toronto terms in the 1980s to cancelling debt for poorest and most heavily indebted countries, then to the London and Naples terms to broaden eligibility criteria for debt cancellation (Paris Club n.d.a).
- » The **Brady Plan** used credit enhancements provided by developed countries or DFIs to encourage private creditors (mostly U.S. commercial banks) to sell non-performing developing-country sovereign loans to the market at a discount in order to reduce loan principal and interest (EMTA 2023).
- » **Debt-for-nature swaps** gained momentum in the 1980s and 1990s to convert debts that Latin American countries owed to Paris Club members into commitments to implement nature conservation plans in the debtor country (Essers et al 2021).
- » **Heavily Indebted Poor Countries (HIPC) Initiative** was launched by the International Monetary Fund (IMF) and the World Bank in the 1996; it aimed to ensure that no poor country would face a debt burden that it could not manage (IMF 2023).

- » **Multilateral Debt Relief Initiative (MDRI)** was proposed by the Group of Eight finance ministers in 2005; it delivered debt relief worth \$3.4 billion to an initial group of 19 countries when the IMF, World Bank, and African Development Bank forgave their loans. The mechanism is intended to help qualifying countries advance toward the Millennium Development Goals (MDGs) (IMF n.d.).

Figure 2.1 highlights climate and nature-aligned instruments described in the following sections that can be used to reduce sovereign PPG external debt or to raise new financing to manage the dual challenges of debt and environmental distress.

FIGURE 2.1: Sovereign external PPG debt reorganization treatments and financing instruments



The figure does not present an exhaustive list of sustainable-finance instruments or debt-reduction treatments since it does not include, for example, budget reforms. Asia-Pacific governments have considerable opportunities to consolidate their expenditures to find the fiscal space needed to support the SDGs and climate and nature programmes. One such opportunity would be to reduce or cancel environmentally harmful subsidies that are estimated to cost governments between \$500 billion to \$1 trillion per year (UNEP 2022), an action agreed in the 2022 Kunming-Montreal Global Biodiversity Framework (SCBD 2022). The fiscal space generated from reorienting some of that expenditure could be used to support the energy transition, fight climate change, and ramp up social and natural-resource protections.

2.1 Debt-reorganization treatments

This section describes the six treatments used in a debt reorganization, as defined by the IMF (2014, 89-91).

- » **Debt forgiveness** takes place when a creditor voluntarily reduces or cancels all or part of a debt obligation's principal and interest arrears via a contractual arrangement. In the case of a bond restructuring (rather than an official bilateral loan) the amount of the bond's market value that a bondholder agrees to forgive (or write off unilaterally outside of a reorganization) is known as a haircut.²¹
- » **Debt rescheduling** changes the terms and conditions of an existing debt contract by extending repayment periods, reducing the interest rate, adding or extending grace periods for principal repayment, fixing a foreign exchange rate, and/or rescheduling interest arrears.
- » **Debt refinancing** partially or fully replaces one or more existing debt instruments and arrears, such as a loan, bond, or export credit, with one or more new instruments of the same or different types. Refinancing may or may not change the principal or interest due.
- » **Debt conversion** exchanges an external debt for a nonexternal debt claim that has economic value, or for counterpart funds that can be used to finance a particular project or policy, in the debtor's country. This might include debt-for-equity swaps or debt-for-nature swaps.
- » **Debt prepayment** is the repurchase of a debt obligation before it is due, usually at a discount (in which case prepayments are referred to as buybacks) by a debtor or by a third party on the debtor's behalf.
- » **Debt assumption** is an agreement where a new debtor assumes the former debtor's outstanding liability to the creditor along with all relevant obligations.

Importantly, debt-reorganization packages can involve more than one type of treatment. The

21 See UNCTAD (2011) for further discussion of the additional complexity of including private creditors (bondholders) in multi-creditor reorganizations.

treatments applied may also depend on the type of creditor involved. For example, many traditional multi- and bilateral debt-reorganization packages that involve debt forgiveness often only cancel part of a debt rather than 100 percent of it, so the packages also involve rescheduling the remaining portion of the debt. Furthermore, different treatments – or combinations of treatments – may or may not provide debt relief or direct support to specific SDGs, as shown in the following sections.

2.1.1 Debt relief through forgiveness

Forgiveness occurs when the present value of a debt is reduced. It serves as means to quickly reduce sovereign debt risk. It can be negotiated on a bilateral or multilateral basis and has been applied in high debt-distress situations (Box 2.2).

After a debt is forgiven, a sovereign debtor may apply all or part of the funds previously dedicated to debt service to investment in development priorities, including environmental policies or programmes, depending on the fiscal space created. However, without a specific commitment, agreement or amendment that sets out such a condition, the debtor is not obligated to do so. Therefore, without such a commitment, debt relief through forgiveness does not require strong environmental governance capacities in the debtor country.

Box 2.2: Single or multiple creditors can apply debt forgiveness

Bilateral single-creditor forgiveness: In August 2022, China announced it would cancel interest-free loans for 17 (unspecified) African countries that were due to be repaid at the end of 2021 (Hwang and Moses 2022).

Bilateral multi-creditor forgiveness: Sudan's main Paris Club creditors – Austria, France and the United States – agreed to cancel \$14 billion of debt and reorganize the remaining more than \$23 billion in 2021 (Paris Club 2021).

Credit rating considerations are usually an element of concern for debtor countries. It often happens that a sovereign debtor achieving debt relief through forgiveness (or any other type of debt reorganization) may have already lost credibility among international credit rating agencies, thereby triggering a downgrade (lowering) of its sovereign credit rating. Conversely, debt relief through forgiveness reduces debt levels and thereby improves debt sustainability, which may lead to a higher sovereign credit rating.

In summary, debt forgiveness is the most direct means of reducing a sovereign creditor's debt distress, and may play an important role in a debt-reorganization-and-reorientation package. Box 2.3 sets out some challenges and success factors that pertain to a simple (non-SDG-conditional) debt-cancellation treatment. Figure 2.2 summarizes its key elements by characteristics of debt, debtor and creditor, as well as highlighting benefits for different focus areas: environment, social

and short- and long-term debt. In the case of debt forgiveness, no key requirements, such as access to capital markets or existing sustainable development plans, are required for debtor countries. On the creditor side, political buy-in would be necessary, while partner countries would need to meet eligibility criteria. **Without a specific commitment, no direct social or environmental benefits are attached to this type of mechanism.**

Box 2.3: Success factors and challenges of debt forgiveness





Factors behind feasibility:

- » Creditor willingness to provide relief and a policy to justify direct debt reduction.
- » Minimal requirements for debtor country to have special governance, institutions, and laws compared with other reorganization treatments, such as debt-for-nature swaps.
- » Relatively easy to implement compared to other reorganization treatments.

Challenges:

- » Might require joint agreement with one or more other creditors to avoid moral hazard.
- » Might set a precedent and/or be copied by other sovereign debtors and thus undermine creditor’s ability to collect on other debts in full.
- » Sovereign debtor may fear a credit-rating downgrade.

FIGURE 2.2: Elements of non-conditional debt relief through forgiveness

	Type of debt			Debtor characteristics				Creditor characteristics			Other
	Main creditor type	Debt level	Debt trading below face value	Debtor has access to capital markets	Sustainable development plan developed	Sustainable projects for swap identified	MRV governance	All major participating creditors need to agree	Political buy-in or debt reorientation framework required	Requires debtor to meet eligibility criteria	Implementation support required
Debt forgiveness	Bilateral or Multilateral DFI	High to very high	No	No	No	No	Any	No	Yes	Yes	No
	 Environmental benefits			 Social benefits				 Short-term debt relief			
								 Long-term debt relief			

Source: Authors

2.1.2 Debt relief through debt rescheduling

Like debt forgiveness, debt rescheduling can quickly reduce sovereign debt risk and can be negotiated on a bilateral or multilateral basis. As with forgiveness, a sovereign debtor can reorient debt-service funds to support the environment, but is not obligated to do so without a specific commitment, and doesn't require relevant capacities unless the rescheduling agreement carries an environmental conditionality.

Unlike a debt forgiveness agreement that cancels all or part of a principal obligation, debt rescheduling does not reduce the overall PPG external debt principal, but can reduce the debt-service payment amount and therefore the overall debt obligation. If state-contingent debt clauses are included, debt can be rescheduled automatically if a specific contingency occurs, such as a natural disaster or other crises (Box 2.4).

Box 2.4: Three types of debt rescheduling applications

- 1. Bilateral multi-creditor rescheduling without a conditionality:** Paris Club creditors France, Italy, Israel, Sweden and the Netherlands agreed to restructure Suriname's external debt in 2022 so that all existing arrears as of end-2021 would be repaid in two instalments in 2022 and 2024 (UNCTAD 2022).
- 2. Multi-creditor rescheduling with a conditionality:** The Debt Service Suspension Initiative (DSSI) established by the Group of Twenty (G20) member countries was in effect from May 2020 to December 2021 to postpone but not reduce eligible countries' debt-service payments to official and private creditors. Of 73 eligible countries, 48 participated, including nine Asia-Pacific countries.²² In all, the DSSI postponed \$12.9 billion of payments. However, only one private creditor participated (World Bank 2022d). The DSSI debt-service deferrals had several requirements:
 - » Debtors had to formally join the initiative.
 - » Debtors had to make several commitments, including to use the fiscal space created for social, health or economic expenditures related to COVID-19 pandemic response.
 - » Debtors had to negotiate with each creditor individually, although Paris Club members agreed their terms as a bloc.
- 3. Automatic rescheduling:** State-contingent debt instruments (SCDIs) contain a trigger mechanism that automatically defers debt-service payments that fall due during a crisis of a specified type.²³ The French DFI, Agence Française de Développement (AFD), has offered countercyclical loans since 2007 and has participated in significant official-creditor lending with state-contingent clauses that extend additional conditionality following a trigger event, usually related to a trade shock (Espinosa and Nagoski 2016).

22 Afghanistan, Fiji, the Maldives, Myanmar, Nepal, Pakistan, Papua New Guinea, Samoa, and Tonga (World Bank 2022d).

23 For a more comprehensive analysis of how state-contingent debt instruments could be deployed, see Jensen (2022).

It appears difficult to engage private creditors in this type of debt reorganization (World Bank 2022d). Also, creditors may fear that the sovereign debtor will use their rescheduled payments to pay other creditors, without any benefit to the debtor country. Box 2.5 sets out some challenges and success factors that pertain providing debt relief through a (non-SDG-conditional) debt-rescheduling treatment and Figure 2.3 summarizes its key elements by characteristics of debt, debtor and creditor, as well as highlighting benefits for different focus areas, in this case only for the short-term debt outlook.

Box 2.5: Success factors and challenges of debt relief through rescheduling





Factors driving feasibility:

- » Temporary and minimal harm to creditors since they maintain their claims.
- » Minimal requirements for debtor country to have special governance, institutions, and laws compared with other reorganization treatments, such as debt-for-nature swaps.

Challenges:

- » The sovereign debtor may fear a credit-rating downgrade.
- » Difficult to engage private creditors.
- » Does not reduce outstanding principal if limited to payment moratoriums or interest rate reductions.
- » Creditors fear unfair use of debt-service savings.

FIGURE 2.3: Elements of non-conditional debt relief through rescheduling

	Type of debt			Debtor characteristics			Creditor characteristics			Other	
	Main creditor type	Debt level	Debt trading below face value	Debtor has access to capital markets	Sustainable development plan developed	Sustainable projects for swap identified	MRV governance	All major participating creditors need to agree	Political buy-in or debt reorientation framework required	Requires debtor to meet eligibility criteria	Implementation support required
Debt rescheduling	Bilateral or Multilateral DFI	Very high	No	No	No	No	No	Yes	Yes	Yes	No
	 Environmental benefits			 Social benefits			 Short-term debt relief			 Long-term debt relief	

Source: Authors

2.1.3 Debt relief through debt conversions, in particular debt-for-nature swaps

As seen in Section 2.1., a debt conversion is the exchange of a debt contract for a new debt claim. The new contract may be another type of debt, such as exchanging a loan for a bond (known as a debt-for-debt swap); or for equity, commodities, resources or other exports (e.g., debt-for-equity swap); or for domestic currency, such as might be used for projects in the debtor country (IMF 2014, 89-91).

Most types of debt conversion treatments do not automatically or usually include an SDG conditionality. For example, a standard debt-for-resources swap gives the creditor country access to resources such as forests, mines, or gas fields in the debtor country, and a debt-for-equity swap confers to the creditor some level of ownership (equity) of debtor-country physical assets, such as infrastructure.

Neither do debt conversions automatically provide debt relief. Debt relief occurs only if the new contract forgives all or part of the value of the original debt contract.

Debt conversions include debt-for-development swaps, where economic value is provided by the debtor to the creditor for use in development projects in the debtor's economy. Such swaps may include a conditionality to support sustainable development or specific SDGs.

SDG-aligned debt-for-development swaps have attracted growing interest in recent years. This is on the back of the dual crises Asia Pacific LMIC and many other developing countries face: debt and environmental distress. Such swaps exchange external debt and divert debt-service funding for a commitment to invest in climate, nature, health or education policies or programmes in the debtor country. In the case of bilateral loans, these SDG-aligned debt-for-development swaps, including debt-for-climate swaps, debt-for-nature swaps, and so forth, typically provide debt relief and can be considered under debt forgiveness because full counterpart funds are not provided to the original creditor (IMF 2014, 91 note 5).

Debt-for-nature swaps have been successfully deployed to convert traditional creditors' official bilateral loans and to refinance sovereign bonds. Debt-for-nature swaps (and debt-for-climate swaps) combine the benefits of reducing the twin risks of debt distress and environmental breakdown: they are of particular interest to Asia-Pacific LMICs, as seen in Chapter 1. In other regions, debt reorganizations through climate-and-nature debt swaps have already been conducted for both official bilateral loans and sovereign bonds using different instruments and partners.

While in the past, debt-for-nature swaps have provided debt relief and, in the case of Belize, improved a sovereign credit rating (Box 2.9), their limited application and relatively short history leave their long-term effect on a sovereign debtor's economy unproven. Appendix 1 presents a table that summarizes the known benefits of debt-for-nature swaps compared to four other debt-reduction treatments.

One common critique of debt-for-nature swaps is that they have been relatively small scale in absolute terms. However,

- » Following the 2021 Belize debt-for-nature swap, deal size is trending upward. Ecuador recently announced the largest debt-for-nature swap to date. The deal included a buyback of \$1.6 billion worth of Ecuador’s dollar-denominated bonds, equivalent to around 10 percent of the outstanding amount, and a new issuance insured by the U.S. International Development Finance Corporation. The Ecuadorian government committed \$18 million annually for 20 years to nature conservation programmes in the Galapagos (Reuters 2023).
- » Even small debt-for-nature swaps can contribute significantly to biodiversity protection (Box 2.6) and possibly contribute to climate adaptation, such as by preserving mangroves.
- » In a small country like Belize, a debt-for-nature swap reduced PPG external debt by 10 percent of GDP (Box 2.9).
- » New approaches are being developed to further scale debt-for-nature swaps to much larger levels, but have yet to be implemented (Patel 2022).

In addition to examining questions of scale, sovereign debtors need to consider the relative complexity and requirements of implementing debt-for-nature swaps compared to, for example, asking for conditional or non-conditional loan forgiveness, grants or concessional reschedulings:

- » Debt-for-nature swap negotiations require an additional amount of time and expertise to set up and complete.
- » The debtor country needs to commit to and have a plan to manage the potential nature or climate policy or programme.
- » The debtor country needs a system for monitoring, reporting and verification (MRV)²⁴ indicators related to nature outcomes.
- » The effectiveness of a debt-for-nature swap to reduce debt and improve debt sustainability depends on the creditor composition and debt conditions, the opportunity to buy back bonds at a discount in the case of a trilateral debt conversion arrangement (as in Belize and the Seychelles), and credit enhancements for new debt issuance, if needed. A concessional loan from a single official bilateral creditor may not be worth converting since debt-service savings may be small if the loan is not fully forgiven, while a non-concessional loan might contribute more savings.

The next sections describe two debt-for-nature arrangements. Box 2.6 and Figure 2.4 highlight a trilateral official loan debt-for-nature swap from traditional bilateral creditors and Box 2.9 and Figure 2.7 feature a trilateral sovereign bond debt-for-nature swap. To learn from challenges, Box 2.10 presents a case of a sovereign bond debt-for-nature swap that was initiated but not completed. In addition, Box 2.7 and Figure 2.5 describe how two traditional creditors converted official loans into debt-for-health swaps.

24 MRV systems collect qualitative and quantitative evidence on the impact of policies or projects and financing, and report progress.

1. *Bilateral or trilateral official loan debt-for-nature swaps*

A bilateral or trilateral official loan debt-for-nature treatment can be initiated by either a debtor or creditor country and will typically follow the creditor country's specific policy framework, including in the case of traditional Paris Club creditors who follow the bloc's general rules for voluntary debt swaps. Examples of national frameworks include the United States Tropical Forest and Coral Conservation Act (TFCCA), Germany's Debt for Nature and Debt4Health Programmes, and France's Debt Reduction-Development Contract (C2D). Appendix 2 gives more detail on typical official bilateral creditor frameworks for the United States, Germany, France and Japan.

An official loan debt reorganization that uses debt-for-nature swaps may be arranged and funded by a single creditor in a bilateral debt-for-nature swap. More often, a trilateral debt-for-nature swap is arranged by a third party, such as a nature-conservation organization, that manages -- and can potentially provide -- special nature-conditional funding.

Traditional bilateral official creditors have supported LMICs and climate-and-nature SDGs by exchanging their loans for commitments to protect or restore nature. The agreement for a debt-for-nature swap entails two main outcomes that are conditional on each other:

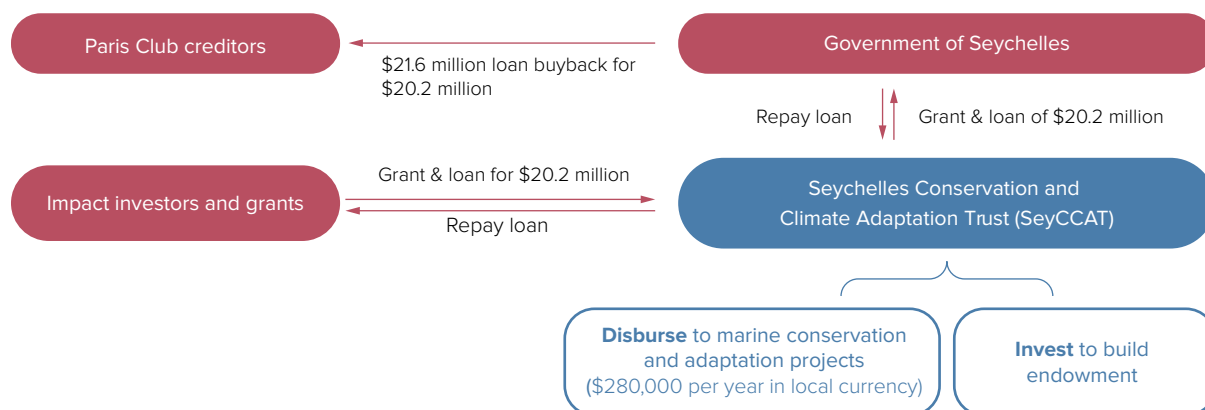
1. The creditor agrees to convert all or part of an official loan's principal and/or its debt service into a local-currency grant and/or a refinancing instrument, and thus effectively forgives that part of the loan.
2. The sovereign debtor contractually agrees to engage in domestic nature-positive policies or programs and to redirect, if applicable, all or part of the forgiven share of -debt-service payments to nature-positive projects.

Box 2.6: The Seychelles trilateral official loan debt-for-nature swap

In 2015, The Nature Conservancy through NatureVest, its in-house investing team, provided the Seychelles government with a new \$15.2 million impact loan and \$5 million worth of grants from various foundations via a trust fund. This financing enabled the Government of Seychelles to purchase \$21.6 million of the Seychelles' debt from traditional European creditors at a discounted rate of 93.5 cents to the dollar. In exchange, the Government of Seychelles agreed that it would set some of the debt-service savings aside in the trust fund and disperse about \$280,000 in local currency annually for marine conservation and climate adaptation (Figure 2.4).

The Seychelles Conservation and Climate Adaptation Trust (SeyCCAT) manages the flow of funds and ensures that the Government of Seychelles adheres to nature-conservation targets and the refinancing agreement. With support from the World Bank, SeyCCAT also set up a monitoring and evaluation system to provide oversight and report on the nature conservation programme (SeyCATT n.d.; Silver and Campbell 2018).

FIGURE 2.4: The Seychelles trilateral official loan debt-for-nature swap diagram



Source: Adapted from Silver and Campbell (2018)

Box 2.7: Germany and Spain swap official loans for health in six countries, managed by the Global Fund

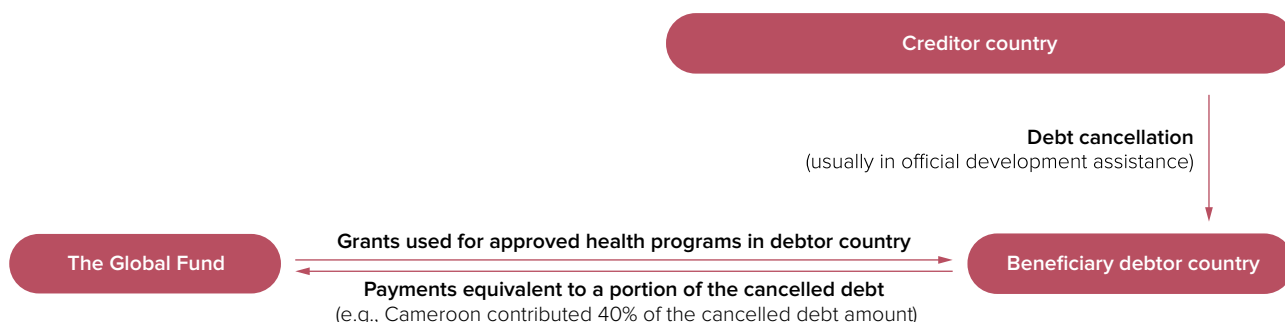
In 2008, Germany forgave EUR 40 million of **Pakistan’s** debt on condition that Pakistan invested EUR 20 million in domestic health programmes managed by the Global Fund under its Debt2Health initiative. This debt-for-health swap enabled Pakistan to free up resources to fight HIV/AIDS, tuberculosis, and malaria instead of paying debt service, while also strengthening its health system (The Global Fund 2008).

In 2017, Spain cancelled EUR 36 million in outstanding debts owed by **Cameroon**, the **Democratic Republic of the Congo**, and **Ethiopia**, in exchange for EUR 15.5 million in investments in domestic health programmes managed and monitored by the Global Fund. As a result, Cameroon was able to reorient EUR 9.3 million from debt service to HIV/AIDS programmes, the Democratic Republic of Congo applied \$3.4 million to malaria programmes, and Ethiopia reoriented EUR 3.2 million to strengthen its health system.

In 2021, Germany worked with the Global Fund on two Debt4Health initiatives. Germany forgave a EUR 50 million loan to **Indonesia** in a debt-for-health swap in exchange for Indonesia’s commitment to fight tuberculosis and invest in public health programmes. Germany conducted a similar deal with **Sri Lanka**, swapping \$16 million worth of debt for resilient and sustainable systems for health programs.

Sources: Türkelli (2021) ; The Global Fund (n.d.)

FIGURE 2.5: Bilateral official loan debt-for-health swap diagram



Source: Adapted from Türkelli (2021); The Global Fund (n.d.)

Although debt-for-nature swaps have so far seen only limited application to official bilateral loans, we summarize some of the success factors and challenges of deploying them in Box 2.8 and depict their elements in Figure 2.6.

FIGURE 2.6: Elements of an official bilateral loan debt-for nature swap

	Type of debt			Debtor characteristics			Creditor characteristics			Other	
	Main creditor type	Debt level	Debt trading below face value	Debtor has access to capital markets	Sustainable development plan developed	Sustainable projects for swap identified	MRV governance	All major creditors need to agree	Political buy-in or debt reorientation framework required	Requires debtor to meet eligibility criteria	Implementation support required
Debt conversion	Bilateral DFI	High to very high	n/a	n/a	Yes	Yes	Strong	No	Yes	Yes	Yes
	Environmental benefits			Social benefits			Short-term debt relief			Long-term debt relief	

Source: Authors

Box 2.8: Success factors and challenges in reorganizing and reorienting official bilateral loans via debt-for-nature swaps

Factors behind feasibility:

- » The official bilateral creditor has political support and, ideally, an established framework for debt-for-nature swaps.
- » Swap value counts as part of the official bilateral creditor's official development assistance (ODA) budget.
- » The official bilateral creditor has a better opportunity to align the debtor's nature-positive commitments with the creditor's national development priorities than if the debtor country used a sustainability-linked instrument that provides more implementation flexibility for the debtor country to prioritize growth over nature (see Section 2.2.2).
- » Different types of reorganization and instruments may be applied or combined, such as debt conversions, forgiveness, prepayments or grants and other financing instruments.
- » The sovereign debtor commits to implementing the nature-positive policy and/or programme conditions set out in the swap contract.
- » The swap contract needs to specify that the sovereign's investments in nature are senior debt or else the sovereign will be forced to use swap proceeds to pay creditors that did not participate in the swap.

Challenges:

- » The sovereign debtor must have the requisite good governance and institutions necessary to achieve the swap's nature objectives, such as the capacity to implement nature conservation programmes.
- » Swaps often require a lengthy negotiation and preparation period, particularly compared to a simple cancellation or haircut, because the debtor and creditor(s) need to agree on the non-financial commitments and sovereign debtors might need to agree to outside oversight and other conditionalities.
- » Agreeing on nature-related key performance indicators (KPIs) may be difficult. The sovereign debtor and its relevant ministries need a feasibility study on the impact of the swap's nature commitments, such as the designation of no-take zones, to understand the economic and non-economic costs of reorganizing and reorienting the debt via a swap.
- » Risk of sovereign credit-rating downgrades.

2. Trilateral sovereign bond debt-for-nature swaps

Sovereign debtors can work with private investors and third parties to convert sovereign bonds into financing for nature and climate. In a market-based debt swap, the sovereign debtor country buys its bonds back at a discount and issues new bonds at more favourable terms. This type of swap is brokered by a third-party organization, similar to the trilateral official loan debt-for-nature

swap discussed above. The third party arranges the new financing at more favourable terms, such as through a DFI-provided credit guarantee. Sometimes, it also arranges the new debt funding, such as through an impact bond, on condition that the sovereign debtor will use part of the difference in repayment amounts between the old and new debt for nature-positive projects or programmes. Such transactions reduce debt levels, and, depending on the nature of the swap and market conditions, debt-service costs.

The growing interest in trilateral sovereign bond debt-for-nature swaps is supported by the IMF (Georgieva et al 2022) and the successful completion of one in Belize (Box 2.9 and Figure 2.7).

Box 2.9: Belize’s sovereign bond debt-for-nature swap, bond buyback and related blue bond issuance

In 2021, Belize used a \$364 million loan from The Nature Conservancy to buy back all of its outstanding sovereign bonds (eurobonds) from bondholders at a 45 percent discount over the bonds’ \$553 million face value – an amount equivalent to 30 percent of Belize’s GDP (Figure 2.9).

This prepayment reduced Belize’s eurobond debt service obligation by \$200 million over 20 years. The Nature Conservancy financed its \$364 million loan to Belize by issuing \$364 million in higher-rated blue bonds in a sale arranged and underwritten by Credit Suisse, a commercial bank engaged by the Belize Blue Investment Company (BBIC), a subsidiary of The Nature Conservancy.

The U.S. International Development Finance Corporation, a DFI, provided political risk insurance that allowed the blue bonds to receive a strong investment-grade Aa2 credit rating. The arrangement incorporated commercial parametric insurance coverage from Munich RE to mitigate the financial impact of natural disasters on Belize’s debt repayments (The Nature Conservancy 2022).

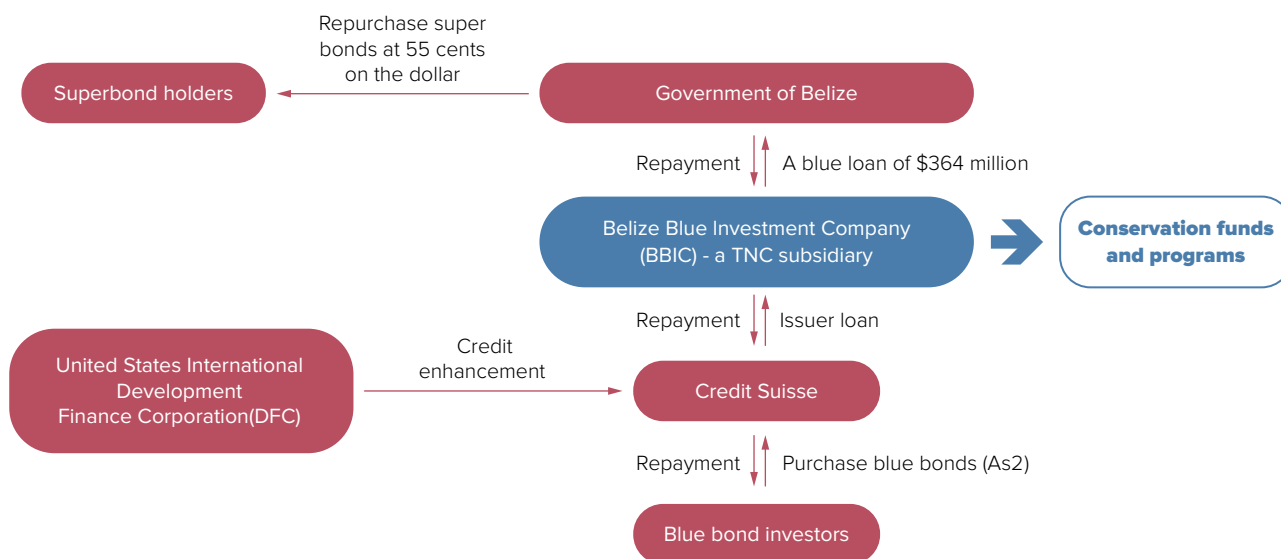
The eurobond conversion reduced the country’s PPG external debt by 10 percent of GDP (Owen 2022).

In return for this trilateral debt conversion and financing arrangement, Belize made several commitments. It agreed to repay the loan to The Nature Conservancy over 19 years at a yield of 6.1 percent. Belize also committed to spend some of the debt service savings, about \$4 million a year, on marine conservation until 2041 and to expand its protected area network to 30 percent by 2026, encompassing barrier islands, coral reef systems, mangrove forests and sea grass beds. Belize will also establish an endowment fund of \$23.5 million to finance conservation after 2040 and work with The Nature Conservancy to develop a Marine Spatial Plan.

Should any of these commitments not be met by Belize within the agreed timeframe, which allows for two six-month extensions at most, Belize will make extra payments into an escrow account that will be disbursed back to the government or into a marine conservation fund once Belize meets the commitments (The Nature Conservancy 2022).

As an additional benefit of this debt reorganization and reorientation arrangement, Standard and Poor’s raised Belize’s credit rating (S&P Global 2020).

FIGURE 2.7: Belize sovereign bond debt-for-nature swap, bond buyback and related blue bond issuance



Source: Adapted from Green Finance Institute (2022)

The successful and relatively large-scale Belize debt-for-nature swap has given sovereign debtors a new impetus to explore the instrument. For example, the island nation of the Maldives explored a debt-for-nature swap in 2020, but aborted the negotiations and issued a standard bond instead. Box 2.10 highlights the challenges encountered and provides lessons for sovereign debtors and their advisors.

Box 2.10: The experience of the Maldives and UNDP in exploring a potential sovereign bond debt-for-nature swap

UNDP and an experienced third party explored the feasibility of a potential debt-for-nature swap for the Government of the Maldives to consolidate the country’s fiscal outlook.

The targeted debt for this transaction was a \$250 million eurobond maturing in June 2022 that was trading at a steep discount. It was assumed the government could buy back the bond at a lower price with funding from a third party to receive debt relief in exchange for a legal commitment to designate up to 30 percent of the Maldives’ territorial waters as marine protected zones and to implement of a Marine Spatial Plan (MSP).

Initial estimates projected that a trilateral debt-for-nature swap would reduce the Maldives’ debt stock by 5 percent of 2021 GDP. In addition to reducing its debt, the government could aim to address the immediate liquidity risks posed by the bond’s maturity in a swift and efficient manner so that it could maintain its credit strength and access to international markets.

It proved challenging to complete a successful deal within less than a year because of the extensive time

required to fulfil environmental cost-benefit assessments and answer the following primary questions:

- » What was the value of the debt-for-nature swap, including transaction costs, compared to other debt reduction and refinancing instruments?
- » What would be the long-term socioeconomic impacts of designating no-take zones that would limit commercial activities, such as fishing, in 30 percent of the Maldives' ocean territory?
- » What would be the cost of effective Marine Spatial Plan implementation, conservation enforcement, and target monitoring and verification to comply with the legal requirements of the debt-for-nature swap?

This UNDP-Maldives experience revealed factors that enhance or stymie debt-for-nature swap arrangements:

- » The starting point entails the sovereign debtor's strong commitment to nature conservation at the highest policy and political levels. The Government of Maldives was interested in ocean conservation and had prepared ambitious Nationally Determined Contribution (NDC) targets for climate adaptation and mitigation.
- » The sovereign debtor needs the right kind of debt to convert: In the Maldives, this was a eurobond trading at a discount. Other cases may require a loan that can be wholly or partially forgiven.
- » Adequate time must be available and committed to by all parties – particularly the debtor country – to study, discuss and understand the financial, legal, and nonfinancial implications of nature commitments; capacity gaps; and socioeconomic impacts of completed debt-for-nature swap transactions.
- » Multiple debtor-country ministries and government stakeholders must work together, preferably with input from citizen stakeholders.
- » The sovereign debtor and its technical partners need to invest in project management, coordination, and facilitation as soon as a decision to seek debt relief is taken.
- » Partners should include advisors with the right mix of talent and resources to effectively exploit regional and global policy and expert-partner networks.

In summary, sovereign bond debt-for-nature swaps can play an important role in reorganizing and reorienting sovereign debt in Asia Pacific LMICs. However, they require a more complex set of treatments and instruments, including bond buybacks and thematic bond issuances, and can only apply for Asia-Pacific MICs with strong enough economies to have issued bonds in the first place: they also need to have strong environmental governance, including relevant nature conservation plans and MRV systems. **Nevertheless, such arrangements can play an important role in reorganizing and reorienting sovereign debt** by addressing the dual goals of debt and environmental sustainability.

Box 2.11 summarizes some of the success factors and challenges of deploying sovereign bond debt-for-nature swaps and Figure 2.8 summarizes their elements.

Box 2.11: Success factors and challenges in reorganizing and reorienting sovereign bonds via debt-for-nature swaps and bond buybacks

Factors behind feasibility:

- » Original sovereign bonds need to be repurchased from the market below face value.
- » For the issuance of new bonds, a strong underwriter needs to be involved to attract sufficient new investors.
- » Credit risk and/or other guarantees from an internationally trusted source are required to improve the new issue's credit rating and/or to secure favourable loan terms, and/or a third party is required to fund the bond buy-back via a concessional loan.
- » The involvement of trusted international organizations, which historically have been innovative environmental organizations, is required to guarantee the nature-positive aspects of the new financial instrument.
- » The sovereign debtor commits to implementing the nature-positive policy and/or programme conditions set out in the swap contract.

Challenges:

- » Requires bonds trading at discount.
- » Requires a lender to provide a concessional loan to fund the bond buy-back.
- » Requires strong engagement from multiple specialists, such as a bond underwriter, credit-risk insurance provider, and environmental organization.
- » The sovereign debtor must have the requisite good governance and institutions necessary to achieve the swap's SDG objectives, such as the capacity to implement nature conservation programmes.
- » Swaps often require a lengthy negotiation and preparation period; the debtor and creditor(s) need to agree on the non-financial commitments and sovereign debtors might need to agree to outside oversight and other conditionalities.
- » Agreeing on nature-related key performance indicators (KPIs) may be difficult. The sovereign debtor and its relevant ministries need a feasibility study on the impact of the swap's nature commitments, such as the designation of no-take zones, to understand the economic and non-economic costs of reorganizing and reorienting the debt via a nature-positive swap.
- » Risk of a sovereign credit-rating downgrade.

FIGURE 2.8: Elements of a sovereign bond debt-for-nature swap

	Type of debt			Debtor characteristics			Creditor characteristics			Other	
	Main creditor type	Debt level	Debt trading below face value	Debtor has access to capital markets	Sustainable development plan developed	Sustainable projects for swap identified	MRV governance	All major participating creditors need to agree	Political buy-in or debt reorientation framework required	Requires debtor to meet eligibility criteria	Implementation support required
Debt conversion	Private, such as bondholders	High to very high	Yes	Yes	Yes	Yes	Strong	Yes	No	No	Yes
	Environmental benefits			Social benefits			Short-term debt relief			Long-term debt relief	

Source: Authors

2.1.4 Lesser known debt-reorganization instruments with nature-positive outcomes

In addition to the preceding commonly discussed and applied debt reorganization and reorientation treatments in support of nature-positive outcomes, **some lesser known swap arrangements and instruments have been suggested or pioneered by official, emerging and private creditors and investors.** Four such debt-for-climate or debt-for-nature arrangements are outlined below:

1. State-owned enterprise loan debt-for-climate swap

Several emerging creditor state-owned enterprises (SOEs) have been involved in developing projects in Asia Pacific LMICs, for example in energy or transport infrastructure. The projects are owned by a consortium in which the SOEs participate. Loan financing for these projects, guaranteed by the debtor country’s government, can come from the creditor countries’ export credit agencies or from state-owned financial institutions (SOFIs) to support the SOEs’ international expansion.

One untraversed avenue for a debt-for-climate swap is to use the creditor-country SOEs to accelerate the retirement of SOE-owned polluting assets in the overseas country, such as coal-fired power plants (Benoit 2022). Doing so would require the creditor country’s export credit agency or SOFI, and possibly the SOE owner, to simultaneously agree on a pro-rata basis to reduce the amount of the financial obligation guaranteed by the overseas country.

For example, a 15- or 20-year loan to the SOE for a coal-fired power plant could be cancelled by the export credit agency or SOFI after five to 10 years on condition that replacement electricity would be generated through renewable energy. Thus, in exchange for a climate contribution, the overseas country would be relieved of the debt it had guaranteed.

2. *Debt assumption with nature conditionality*

A sovereign creditor, private investor or donor may, under certain circumstances, arrange to assume a sovereign debtor's debt obligations, on condition that the latter commits to strategic cooperation or development targets. These could include nature conservation or climate change mitigation and adaptation programmes and projects.

3. *Debt-for-carbon credits swap*

Many Asia-Pacific LMICs have large nature-based carbon sinks, such as Mongolia's grasslands and Lao PDR's forests. Some observers suggest that sovereign debtors could monetize the protection or expansion of their carbon sinks by issuing voluntary carbon credits, which direct financing to climate-friendly projects that would not otherwise receive sufficient funding.

The carbon credits could be swapped to multilateral official and nonprofit, emerging, and private creditors in exchange for their debt; some observers think that even bilateral official creditors might participate in such arrangements (Zettermeyer et al 2022).

Importantly, the credits must be additional compared to business-as-usual in terms of (i) avoiding emitting more carbon dioxide or greenhouse gases, or (ii) removing carbon from the atmosphere. Avoidance carbon credits may be issued for projects that incentivize leaving certain fields fallow or forests intact, while removal carbon credits may be issued for regenerating forests and wetlands.

Debt-for-carbon credits swaps need to overcome specific implementation challenges, such as an immature global voluntary carbon market and a broad distrust of carbon-credit additionality, which is hard to prove. For example, it is difficult to prove the claim that a forest would have otherwise been deforested or, even worse, the promise of creating more carbon credits might incentivize burning a forest in order to replant it.

4. *Sovereign bond debt-for-sovereign nature performance bond swap*

A nature performance bond (NPB) is a type of sustainability-linked bond (SLB), a standardizable sovereign debt instrument with performance-based incentives (see Section 2.2.2). With a sovereign NPB, the issuer can receive reductions in coupon payments and principal adjustments if it achieves nature-based outcomes, such as wetland restoration or forest, wildlife and plant species protection. NPBs were originally designed as a bilateral debt instrument that provided concessional terms if a sovereign debtor committed to negotiated sustainability performance indicators and targets. NPBs can also be designed as a market-based and traded

instruments for private investors (Finance for Biodiversity 2020).

Bondholders participating in a debt reorganization could swap their market-rate sovereign bonds for concessional sovereign NPBs to alleviate debt distress and help to put the sovereign debtor on a path to sustainable growth in a fiscally sound and financially stable manner (Chamon et al 2022).

2.2 Sources of new SDG-aligned sovereign debt

Asia-Pacific LMICs can raise new sovereign debt using a growing number of SDG-aligned debt instruments, including for nature-positive outcomes, from traditional, emerging and private sources.

These instruments include concessional loans that have a climate or nature conditionality; they often provided by bilateral or multilateral official creditors. Asia-Pacific LMICs with good credit ratings and access to international capital markets can also issue sovereign fixed-income instruments, such as thematic or sustainability-linked bonds targeted at a growing pool of private investors that integrate ESG considerations.

2.2.1 Concessional financing with a nature conditionality



Concessional loans are provided by traditional multi- and bilateral creditors and the policy banks of emerging creditors. Accordingly, their provision depends on the political decision-making in these institutions and eligibility criteria, such as a country's level of development. Concessional financing can create immediate fiscal space – a prerequisite for development – but might not require specific SDG outcomes from the debtor country.

Some creditors, however, include explicit sustainable development targets in their lending objectives and/or risk assessment frameworks (Cevek and Jalles 2021). For example, the Asian Development Bank (ADB) has pledged that by 2030, at least 75 percent of its loan commitments (on a three-year rolling average) will support climate-change mitigation and/or adaptation (ADB 2022). This creditor orientation requires the debtor to agree to and measure climate and environmental outcomes.



Appendix 3 summarizes some relevant financing mechanisms offered by the IMF and the World Bank and Figure 2.9 summarize elements of concessional financing.

FIGURE: Elements of concessional financing



Concessional financing	Type of debt			Debtor characteristics			Creditor characteristics			Other
	Main creditor type	Debt level	Debt trading below face value	Debtor has access to capital markets	Sustainable development plan developed	Sustainable projects for swap identified	MRV governance	All major participating creditors need to agree	Political buy-in or debt reorientation framework required	Requires debtor to meet eligibility criteria
Bilateral or Multilateral DFI	High to very high	No	No	No	No	Any	No	Yes	Yes	No



Environmental benefits

Social benefits

Short-term debt relief

Long-term debt relief

Source: Authors

2.2.2 Sovereign sustainability-linked debt instruments

Sustainability-linked bonds (SLBs) and sustainability-linked loans may be issued if the sovereign issuer explicitly commits to meeting certain key performance indicators (KPIs) and targets, such as a reduction of emissions or improvement of environmental outcomes, for one or more sustainable outcomes within a predefined timeline. If the KPIs are met, the interest rate on specific payments, such as the final ones, or even the principal might be lowered within a predefined range.

An SLB does not place any restriction on the use of proceeds. Rather, as an ex-post instrument that measures the final outcomes of the KPI, it provides the debtor country flexibility in choosing to either meet the KPIs for a discount or forgo this discount and potentially incur a penalty by using the debt for other purposes, such as accelerating economic growth without meeting the environmental KPIs. Beyond the flexibility of use of proceeds and the favourable market terms, an SLB also offers governments a strong evidence-based tool to demonstrate sustainability ambitions as KPIs are met.

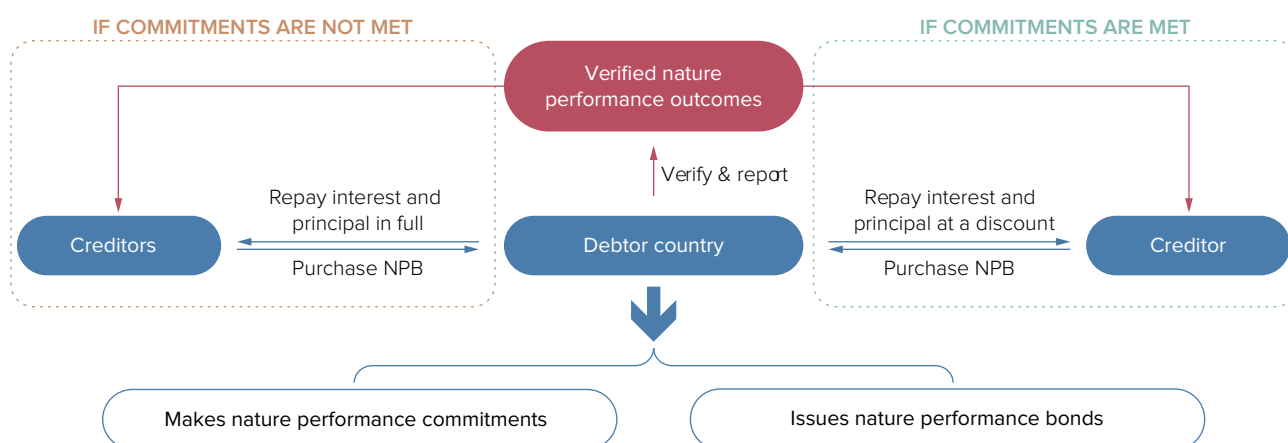
Box 2.12 presents some parameters for two sovereign sustainability-linked bond issuances. Figure 2.10 diagrams how an NPB works. The feasibility factors of SLBs and NPBs are summarized in Box 2.13 and their elements in Figure 2.11.

Box 2.12: The first sovereign sustainability-linked bonds were issued in 2022

In March 2022, **Chile** issued the world’s first sovereign sustainability-linked bond. The \$2 billion bond carried a 4.35 percent rate, 200 basis points above 20-year U.S. Treasury notes (Sy 2022). The bond’s sustainability targets align with Paris Agreement climate-change goals, including that Chile will emit no more than 95 metric tonnes of carbon dioxide-equivalent (MtCO₂e) by 2030 and 60 percent of its electricity production will be renewable by 2032 (Sy 2022). The coupon step-up (increase) will be a maximum of 25 basis points if both the CO₂e emission and renewable-production targets are missed, or 12 basis points if one target is missed (Cheng et al 2022). Chile’s success in this unprecedented issuance stemmed in part from the country having both a green bond and sustainability-linked bond framework in place.

In October 2022, **Uruguay** issued a \$ 1.5 billion bond under its new Sovereign Sustainability-Linked Bond (SSLB) framework (Government of Uruguay MOEF 2023). The framework links the government’s bond-financing strategy to the climate and nature targets set out in its Nationally Determined Contribution (NDC). The innovation of the Uruguay SSLB was the inclusion of both a step-up and a step-down mechanism for coupon repayments from October 2027 to maturity in 2034. The 5.75 percent coupon will step-down (decrease) by up to 30 basis points if Uruguay overperforms on the bond’s two climate-related sustainability performance targets (SPTs), as defined by the SSLB framework. The decrease will be limited to 15 basis points if Uruguay overperforms on only one SPT. On the other hand, the coupon will step-up (increase) by up to 30 basis points if Uruguay underperforms on both SPTs, or the coupon will remain the same if compliance is mixed or if the SPTs are narrowly met (Fitch Ratings 2022).

FIGURE 2.10: How a sovereign nature performance bond works



Source: Adapted from Finance for Biodiversity (2020)

Box 2.13: Success factors and challenges for sovereign sustainability-linked debt instruments









Factors behind feasibility:

- » Sovereign issuer has supporting policies and frameworks for sustainability-linked debt instruments.
- » Sovereign promises to hit sustainability targets are credible.
- » KPI statistics are transparent and in line with international standards to gain investors' trust.

Challenges:

- » Sovereign issuer needs to have established standards and policies for monitoring, reporting and verifying KPIs.
- » In practice, penalties are not high enough to create material financial incentives for meeting sustainability targets (Berrada et al 2022).
- » Risk of sovereign debtor backtracking from sustainability goals in changing political contexts before reaching the end of the long maturity period.

FIGURE 2.11: Elements of sovereign sustainability-linked debt instruments

Sustainability-linked instruments	Type of debt			Debtor characteristics			Creditor characteristics			Other
	Main creditor type	Debt level	Debt trading below face value	Debtor has access to capital markets	Sustainable development plan developed	Sustainable projects for swap identified	MRV governance	All major participating creditors need to agree	Political buy-in or debt reorientation framework required	Requires debtor to meet eligibility criteria
Private	Medium-high	No	Yes	Yes	No	Strong	No	No	No	Ideally
<div style="display: flex; justify-content: space-between; align-items: center;"> <div style="text-align: center;">   Environmental benefits </div> <div style="text-align: center;">   Social benefits </div> <div style="text-align: center;">   Short-term debt relief </div> <div style="text-align: center;">   Long-term debt relief </div> </div> <p style="text-align: center; margin-top: 10px;">* Benefits may or may not materialize</p>										

Source: Authors

2.2.3 Sovereign thematic bonds: Green, social, SDG and sustainability bonds

While sustainability-linked bonds or loans are outcome specific, such as targeted emissions reductions, **any type of bond where the proceeds or an equivalent amount will be exclusively applied to finance or refinance sustainable-development projects is known as a thematic bond.** Such bonds cover various aspects of sustainable development, include bonds related to the environment (green), water and ocean (blue), and social (broader sustainable outcomes). A newer debt instrument, SDG bonds, also aim to serve sustainable-development purposes. The use of proceeds of these bonds is often defined by green-finance or SDG-finance taxonomies.²⁵

While the cumulative issuances of thematic bonds reached \$3.5 trillion by September 2022 (the green bond market hit \$2 trillion) (CBI 2022), the market share of sovereign thematic and bonds is relatively small. At the same time, of the 40 sovereigns that issued thematic bonds between December 2016 and September 2022, 18 were LMICs (World Bank 2022e). For example, green bonds have been issued by Chile (2019-2021), Egypt (2020), Fiji (2017), Hungary (2020), Indonesia (2018-2020), Nigeria (2017, 2019), Poland (2016, 2018-2019), the Seychelles (2018), Thailand (2020, 2022), and Serbia, Benin, and Uzbekistan (2021) (OECD 2021; Fatin 2021). Box 2.9 describes how a blue bond to benefit marine resources played a role in a debt-for-nature swap conducted by Belize. Box 2.14 presents features of the first SDG bond issuance in Southeast Asia, followed by a summary of thematic bonds' feasibility factors (Box 2.15) and their elements (Figure 2.12).

Box 2.14: In 2021, Indonesia launched the first sovereign SDG bond in Southeast Asia

In September 2021, Indonesia became the first country in Southeast Asia to issue an SDG bond, raising EUR 500 million (\$584 million). The 12-year bond carries a coupon rate of 1.3 percent—the lowest rate for a 12-year tenor. Its proceeds will enable the Indonesian government to finance social and environmental projects, focusing on healthcare, education, and information and telecommunications infrastructure. The bond was issued under Indonesia's 2021 SDG Government Securities Framework, which identifies eligible expenditures across green, blue and social categories in support of SDG achievement. The Framework includes an exclusion list: nuclear, hydropower projects with less than 30-megawatt capacity, biomass/biofuels projects that compete with food production and that adversely impact biodiversity and soil carbon, and forest conversion-linked agriculture are not considered SDG-aligned (UNDP 2021a; IISD 2021).

25 Although SDG bonds lack a universal definition, UNDP China issued a Sustainable Finance Taxonomy in 2020 to provide definitions for SDG finance and key indicators. See Nedopil et al (2020).

Box 2.15: Success factors and challenges for sovereign thematic bonds

Factors behind feasibility:

- » Sovereign issuer has supporting policies and frameworks for SDG-aligned debt instruments.
- » Sovereign issuer has support from international nonprofit organizations or multilateral DFIs.
- » Sovereign issuer can collect data for post-issuance allocation and impact reporting.

Challenges:

- » Difficult to scale up private investment.
- » Sovereign issuer needs to have established standards and policies to measure outcomes.
- » Measuring, monitoring, reporting, and verifying project or programme performance is very challenging in developing countries.

FIGURE 2.12: Elements of thematic bonds

	Type of debt			Debtor characteristics			Creditor characteristics			Other	
	Main creditor type	Debt level	Debt trading below face value	Debtor has access to capital markets	Sustainable development plan developed	Sustainable projects for swap identified	MRV governance	All major participating creditors need to agree	Political buy-in or debt reorientation framework required	Requires debtor to meet eligibility criteria	Implementation support required
New issuance	Private	Low-high	No	Yes	Yes	No	Strong	No	No	No	Ideally
	Environmental benefits			Social benefits			Short-term debt relief			Long-term debt relief	

Source: Authors

2.2.4 State-owned-enterprise equity-for-nature or -climate swap

Domestic state-owned-enterprises (SOEs) may also raise sustainable finance from international capital markets that is counted as PPG debt. Domestic SOEs in Asia-Pacific LMICs have a particularly strong foothold in natural resource- and carbon-intensive sectors, such as mineral and fossil fuel extraction or electricity generation, respectively (Clark and Benoit 2022; IEA 2020). Thus, they are crucial players in the green transition to low-carbon and biodiversity-supportive economies because

they must reduce their emissions and destructive activities.

However, many SOEs in Asia-Pacific LMICs currently have high debt-to-equity ratios and consequently low credit ratings, which makes new borrowing more expensive or impossible.

A suggested solution calls for **injecting equity funding, for example from multilateral development banks, into SOEs in exchange for their implementing climate or nature-positive development strategies in the SOE country**, such as the early retirement of coal-fired power plants (Calhoun et al 2021; Nedopil et al 2022). Another possibility would be to establish equity investment vehicles financed by private and/or official international investors that would purchase specific assets of the SOE, such as a coal-fired power plant, with a contractual agreement that the SOE operator will use the funds to accelerate the plant's transition to renewable energy production. In either case, the equity injection would lower the debt-to-equity ratio and thus enable SOEs to raise finance on bond markets and through credit.

Both approaches should be combined with capacity building for improved governance and just transition elements. In the Asia-Pacific region a just-transition programme is being implemented by the Asian Development Bank, for example in Indonesia (ADB 2022a).

2.3 Synergies between debt reorganization treatments and instruments

Each treatment and instrument for reorganizing or issuing new debt is applicable in specific situations that have different underlying requirements and circumstances. Treatments and financial instruments may be combined to reduce debt-distress risk. Accordingly, the selection and application of a treatment or instrument depends greatly on the situation of the debtor country and its creditors. These include type of creditor, such as traditional, emerging or private, and whether the creditor has political buy-in for debt reorientation; debtor country characteristics, such as its debt level, carrying capacity, and whether the country has access to international capital markets and strong environmental governance, including relevant nature conservation plans and monitoring, reporting, and verification (MRV) systems in place; and whether an instrument has likely additional social or environmental benefits and suitably staggered maturities.

As an example of possible combinations, debt-service relief and concessional financing could be used to address urgent liquidity shortfalls to avoid a sovereign debt default and allow more time to negotiate a bond restructuring and raise new sustainable finance. In addition, debt-for-nature swaps could be combined with thematic or sustainability-linked bond issuance to raise funds to buy back higher-coupon bonds; this could free fiscal resources for targeted SDGs or environmental priorities if the country has a strong SDG commitment.

CHAPTER 3

The debtor's perspective: The potential to reduce and reorient debt to support climate-and-nature SDGs in the Asia-Pacific region

This chapter explores the potential for reorganizing and reorienting debt in three **Asia-Pacific debt-distressed or vulnerable middle-income countries**: Lao PDR, Pakistan, and the Small Island Developing States (SIDS) (Jensen 2022).²⁶ These economies have different creditor compositions, but share three important characteristics that apply to other Asia-Pacific LMICs:

- » High vulnerability to the effects of climate and biodiversity breakdowns.
- » National priorities that include nature conservation, protection, and restoration.
- » A readiness to move forward with pertinent debt reorganization treatments and debt-for-nature swaps.

In **Lao PDR**, debt service in 2022 represented around \$1.2 billion, primarily due to infrastructure loans, debt obligations consume more than half of the government's revenues (World Bank 2022f; UNCTAD 2022a).

In **Pakistan**, structural inefficiencies have combined with the socioeconomic impacts of the COVID-19 pandemic, rising inflation, and commodity price shocks, further increasing pressures on its current account. These external debt-sustainability risks were aggravated by devastating floods that caused an estimated \$30 billion or more of loss and damage in 2022 and reduced the year's projected GDP growth by about 2.2 percent (World Bank 2022a).

Similarly, the COVID-19 pandemic suspended tourism and most other revenues in all **Asia-Pacific SIDS**; pandemic restrictions worsened fiscal challenges caused by the geographic and climatic vulnerabilities that affect large parts of the islands' small economies. For example, Cyclone Pam in 2015 displaced about 65,000 people in Vanuatu and resulted in \$450 million in economic losses, about 65 percent of the country's GDP (Government of Vanuatu 2015). Because of similar circumstances, several other Asia-Pacific SIDS have been identified as at "high risk of distress" (UNDP 2023).

In the following section, we present an abbreviated debt-profile summary for each country,

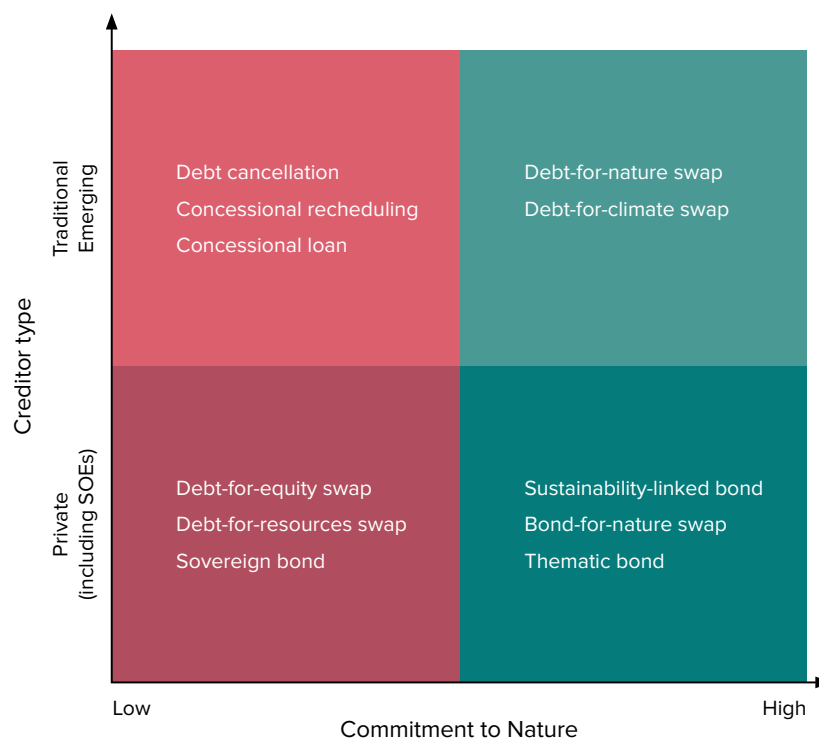
26 Even though the Asia-Pacific SIDS compose a heterogenous group of LMICs in terms of economic size and strength, here we refer to a group of seven of them as one country for illustrative purposes. The seven include those recorded in the World Bank IDS (2022) database: Fiji, the Maldives, Papua New Guinea, Samoa, the Solomon Islands, Tonga and Vanuatu.

including its creditor composition, debt-service projection, and recent credit rating. Since a debt reorganization may include new debt, we point out challenges for new bond issuance that assumes a credit rating equivalent to Fitch’s CCC- for illustration purposes. We briefly recapitulate the country’s biodiversity challenges and show how debt-for-nature swaps could constitute part of a broader debt reorganization and reorientation package.

These key elements are summarized in Figure 3.1, which shows debt treatments and instruments that sovereign debtors could explore according to the type of creditor and the sovereign’s level of commitment and capacity to protect nature. For the latter, we would assign a high degree of commitment (right side) to a country that has or could develop, for example, clear and concrete plans to conserve nature and a strong and well-established MRV system. In such cases, nature-conditional instruments like debt-for-nature swaps or thematic bonds could be appropriate. On the other hand, a low degree of commitment or capacity (left side) would call for instruments without any nature-SDG conditionality, such as debt-for-resources swaps or unconditional debt relief.

In the case of both Lao PDR and Pakistan, in light of the high concentration of their PPG external debt held by emerging and traditional creditors, the set of options to explore sits in the upper half of the diagram. For the Asia-Pacific SIDS, considering their diverse local contexts in terms of indebtedness, type of creditors, economy size, and market access, all instruments and treatments would be viable.

FIGURE 3.1: Key debt treatments and instruments for Lao PDR or Pakistan (upper half) or the SIDS (all)



Legend: Red = Non-nature-aligned debt reorganization and financing instruments.
Green = Nature and climate-aligned instruments

Source: Authors



3.1 Lao PDR could lessen debt distress and reorient financing to benefit biodiversity

Lao PDR appears to have potential to engage with its bilateral creditors on a debt reorganization package. There has been interest in understanding the operational aspects of instruments like debt-for-nature swaps. Lao PDR has already prepared sustainable development plans that include additional forest protection projects, and it has the support of implementing agencies, including UNDP.



An actual debt-for-nature swap operation would require Lao PDR to strengthen its creditor engagement. Creditors would need to be willing to participate in such a reorganization and define their criteria for eligibility and other conditions (Swanson et al 2022). In addition, Lao PDR would need to further strengthen its MRV systems and their governance to help ensure that the nature project delivers the desired outcomes. Figure 3.2 summarizes the elements that would compose possible Lao PDR debt reorganization and reorientation arrangements.

FIGURE 3.2: Lao PDR: Summary of debt reorganization and reorientation elements with a focus on including debt-for-nature



Type of debt			Debtor characteristics				Creditor characteristics			Other
Main creditor	Level of debt	Debt trading below face value	Debtor has access to capital markets	Sustainable development plan developed	Sustainable projects for swap identified	MRV governance	All major participating creditors need to agree	Political buy-in or debt reorientation framework required	Debtor meets eligibility criteria	Implementation support available
Bilateral DFI	High to very high	N/A	N/A	Yes	Yes	Strong	No	Yes	Yes	Yes
Bilateral or Multilateral DFI	Very high			✓	✓	?	✓	?	?	✓



Environmental benefits

Social benefits

Short-term debt relief

Long-term debt relief

Source: Authors

3.1.1 Lao PDR debt profile

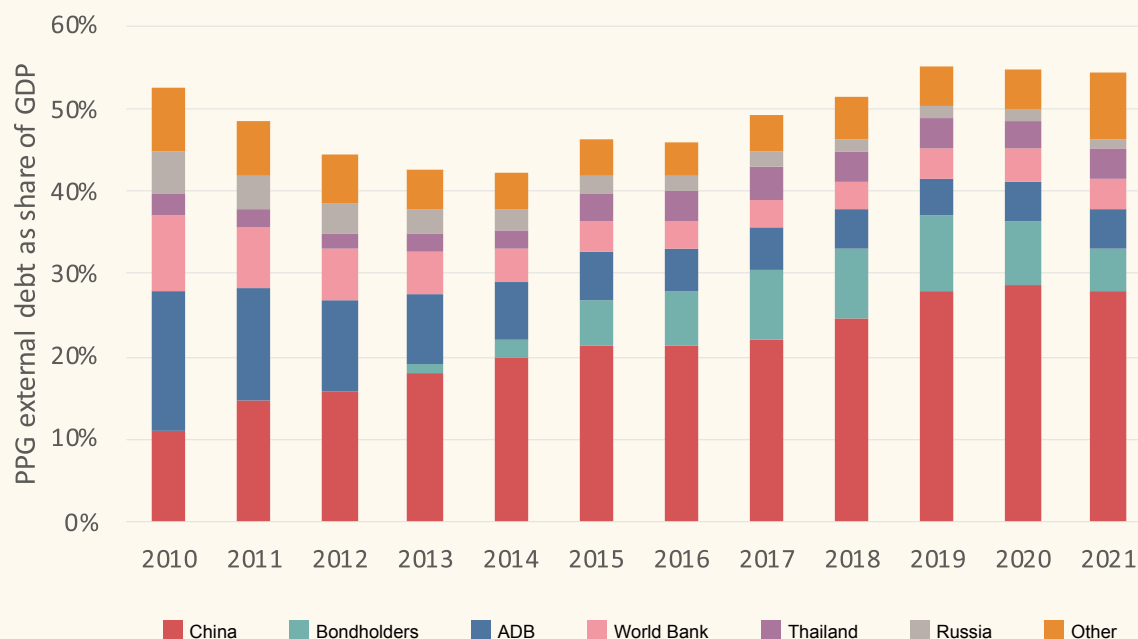
Lao PDR has been identified as a debt-vulnerable economy (UNDP 2023): in 2021, total external debt stock reached 97.1 percent of GNI, a level considered high relative to the country's small lower-middle-income economy. Lao PDR also faces serious liquidity challenges: its 2021 debt service was around \$1.25 billion, about 7 percent of that year's GDP and over half its fiscal revenue (Government of Lao PDR MOF 2021). In addition, a shortage of foreign currency reserves with only \$1.48 billion in 2021 (World Bank 2022g) and a sharp depreciation of the Lao kip (LAK) exacerbate the situation.

Lao PDR innovatively issued Thai baht bonds for the first time in 2013. When the country was later priced out and excluded from the larger international capital markets, it again raised debt on the Thai baht bond market. In May 2021, the Thai Rating and Information Service downgraded Lao PDR's credit rating to BBB- with a negative outlook, reflecting deterioration in the country's fiscal position, execution risks of the government's liquidity management plan, and uncertainty about the country's recovery prospects (TRIS Rating 2021). In August, the World Bank (2021) noted that "total public debt in Laos has reached critical levels, jeopardizing macroeconomic stability."

In summary, in 2021, Lao PDR recorded PPG external debt of \$10.3 billion, nearly 55 percent of the country's GDP (Figure 3.3). The country owed more than half of its PPG external debt to emerging creditors; in particular, 50.9 percent to China and 6.4 percent to Thailand. Multilateral official creditors held about 16 percent and bondholders about 10 percent (Figure 3.3a).

In 2023, half of Lao debt service is projected to go to China, partly for official and quasi-official concessional loans, and 10.8 percent to bondholders (Figure 3.4), representing 3.6 percent and nearly 1 percent of Lao GDP, respectively (Figure 3.4a).

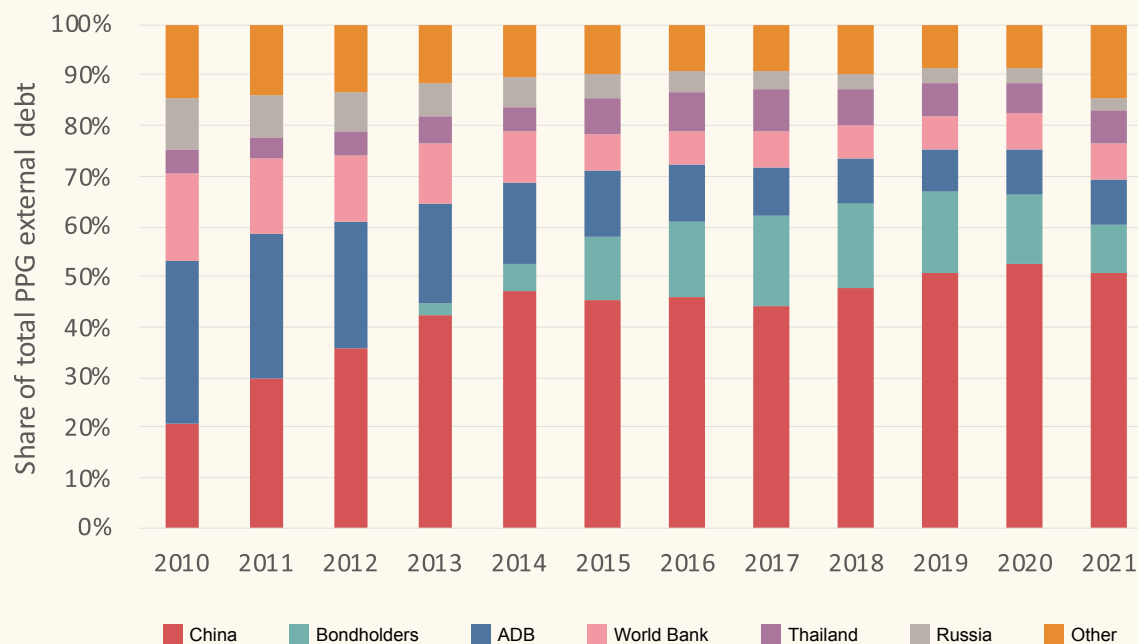
FIGURE 3.3: Lao PDR major creditors by share of PPG external debt, 2010-2021 (% of GDP)



Note: China, Thailand, Russia and Others include bilateral official and nonofficial debt stocks.

Source: Authors based on World Bank IDS (2022)

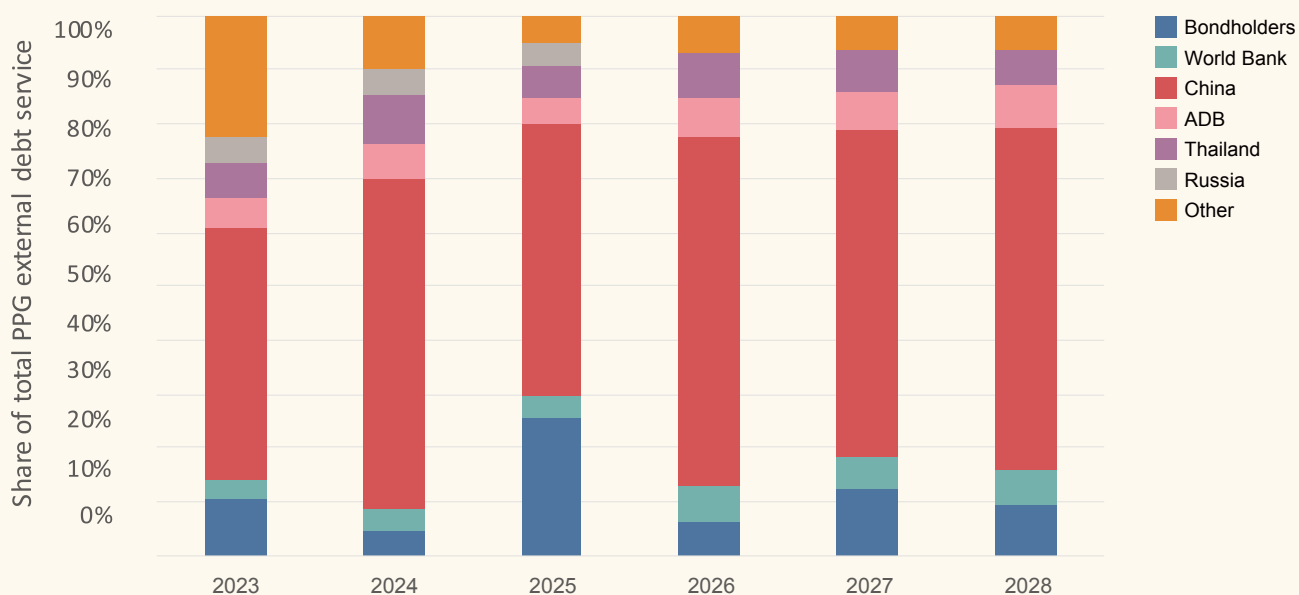
FIGURE 3.3a: Lao PDR major creditors by share of PPG external debt, 2010-2021 (%)



Note: China, Thailand, Russia and Others include bilateral official and nonofficial debt stocks.

Source: Authors based on World Bank IDS (2022)

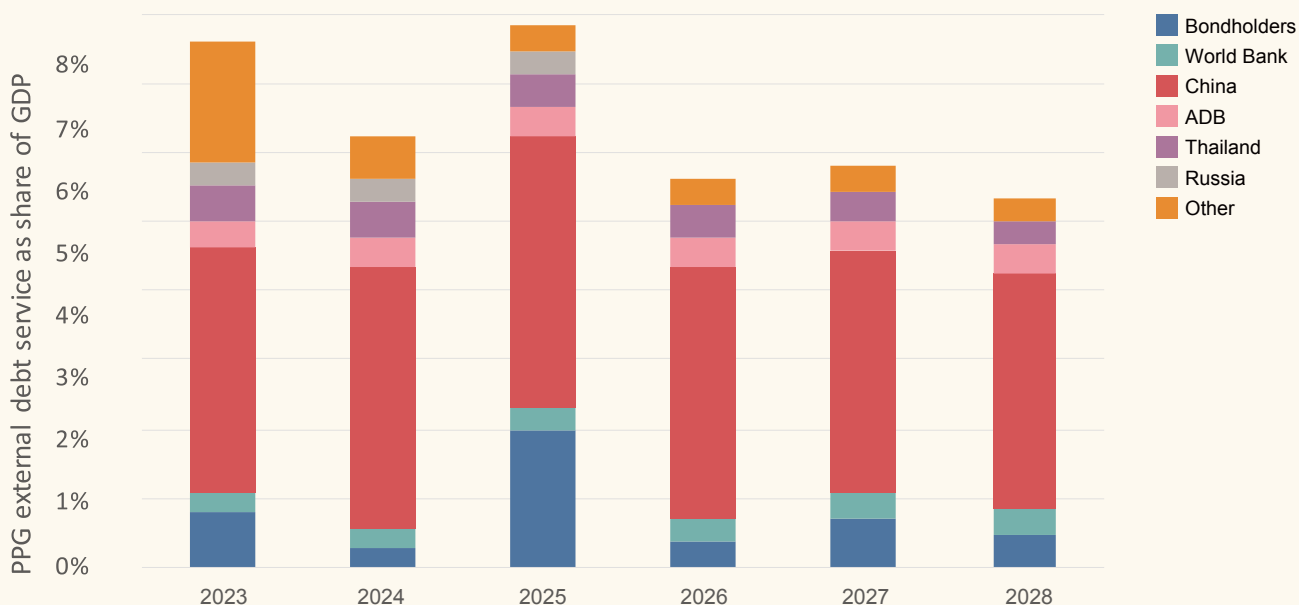
FIGURE 3.4: Lao PDR major creditors' share of PPG external debt service, 2023-2028 (%)



Note: China, Thailand, Russia and Others include bilateral official and nonofficial debt stocks.

Source: Authors based on World Bank IDS (2022)

FIGURE 3.4a: Lao PDR major creditors' share of PPG external debt service, 2023-2028 (% of GDP)



Note: China, Thailand, Russia and Others include bilateral official and nonofficial debt stocks.

Source: Authors based on World Bank IDS (2022)

3.1.2 Lao PDR faces biodiversity challenges and lacks financing for nature

Located in one of the world's ten most important regions for biodiversity, Lao PDR serves as a home to some of the biologically richest and most endangered species of plants and animals.

The country exploits this biodiversity and nature's so-called goods and services to generate revenues that reduce poverty, secure livelihoods, and underpin a greener economic growth model (World Bank 2020).

Yet, the country's biodiversity is at risk: in 2022, Lao PDR ranked 149th out of 180 countries on the Environmental Performance Index of climate change performance, environmental health, and ecosystem vitality (Yale University 2022). The cost of environment degradation exceeded 7 percent of GDP in 2013 (UNCTAD 2022a). As noted earlier, Lao PDR has little to no fiscal space to protect, conserve, or restore its essential biodiversity, even as climate change, illegal logging, wildlife trade, infrastructure development in and around protected areas, and agriculture and settlement expansion destroy forest fauna, soils, woodlands, and other natural assets (World Bank 2020).

In an effort to stem the destruction, the government has established national protected areas (NPAs) across four ecologically diverse regions: the Northern Highlands, Annamite Range, Indo-Chinese karst landscapes, and Mekong plain (UNDP 2021). It has also articulated a vision for the country's green growth that includes specific biodiversity management and forest conservation targets, described under the 9th National Socio-Economic Development Plan (NSEDP) for 2021-2025 (Government of Lao PDR 2021).

However, a lack of financing for nature preservation or restoration means that Lao PDR faces a high risk that its natural assets and nature-dependent economic growth will decline, eventually resulting in a vicious cycle of high debt burden and deteriorating nature.

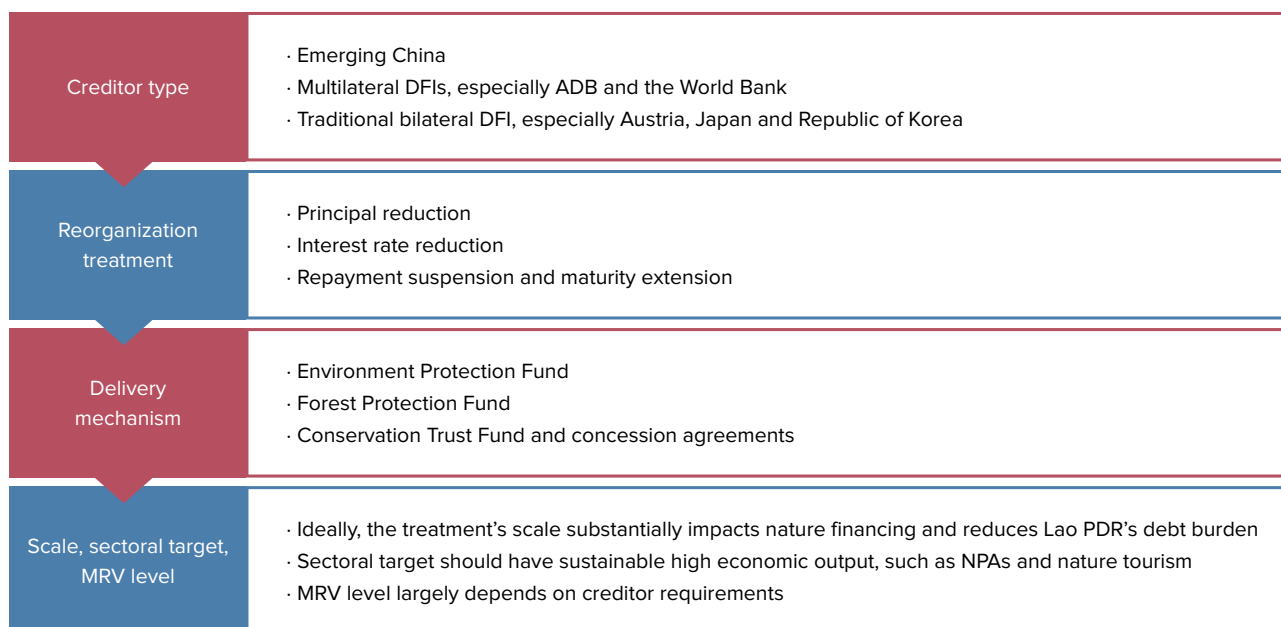
3.1.3 Lao PDR could convert and reorient some of its debt through debt-for-nature swaps

Lao PDR has established an interministerial working group to study the feasibility and design of a possible debt-for-nature swap transaction, with assistance from UNDP for the identification of issues and scalable projects. Figure 3.5 sets out the implementation considerations and design options, including the particularly important choice of creditor-partner(s), as discussed below. Among Lao PDR's major creditors, the following may be of interest:

- » **Multilateral creditors:** The vast majority of multilateral lending to Lao PDR has been made on concessional terms, primarily from the ADB (\$904 million) and the World Bank International Development Association (IDA) (\$672 million) for a total of nearly \$1.58 billion (Government of Lao PDR MOF 2021). However, to work with these multilaterals on debt relief, Lao PDR most likely would need to request support from them and the IMF in line with the requirements of debt-relief mechanisms like HIPC, DSSI and the Common Framework (see Box 2.4 and Box 4.1). However, the government's previous declination to participate in the ADB HIPC initiative (ADB 2012), and its more recent lack of engagement with IMF and G20 debt-relief initiatives, such as the DSSI have been interpreted as a preference to negotiate directly with emerging or traditional creditors.

- » **Emerging creditor China:** As of 2021, Chinese creditors held \$5.23 billion of Lao PDR’s debt, including \$3.695 billion worth of official low-interest concessional loans (Government of Lao PDR MOF 2021). Studies have shown that negotiations have been ongoing and that 2020 to 2022 debt-service deferrals have amounted to around 8 percent of Lao PDR’s GDP (World Bank 2022h). Since China holds the largest share of Lao PDR’s PPG external debt, a debt-for-nature-swap with a Chinese creditor could potentially help alleviate some of Lao PDR’s debt and nature distress. For example, all or part of an official concessional sovereign loan, such as the loan contracted from the Export-Import Bank of China (CHEXIM) in 2016 for the Laos-China Railway Project (World Bank 2020a), could theoretically be converted into a debt-for-nature swap.
- » **Other emerging and traditional bilateral creditors:** Lao PDR has entered into bilateral loan agreements with Austria, Japan, the Republic of Korea, the Russian Federation, and Thailand. All but Thailand are Paris Club members, which means that their loans to Lao PDR are eligible for commonly agreed Paris Club debt-relief treatments in addition to single-creditor debt reorganizations. Compared to China’s, these loans are relatively small in scale; Russia, for example, held about \$248 million as of 2021, and Thailand about \$653 million.²⁷ Nonetheless, since some of these creditors have previous experience with debt-for-development swaps,²⁸ they could pool knowledge and funding, which could scale-up bilateral debt reorganizations and reorientations into a multi-donor initiative.

FIGURE 3.5: Elements and design options for a Lao PDR debt-for-nature swap



Source: Boland (2021)

27 Authors based on World Bank IDS (2022).

28 For example, Japan and the Bill & Melinda Gates Foundation jointly supported debt-for-polio prevention in Nigeria in 2018 (Sampathkumar 2018), and Russia and the World Food Programme launched a \$40 million debt-for-food security project in Mozambique in 2017 (WFP 2017).

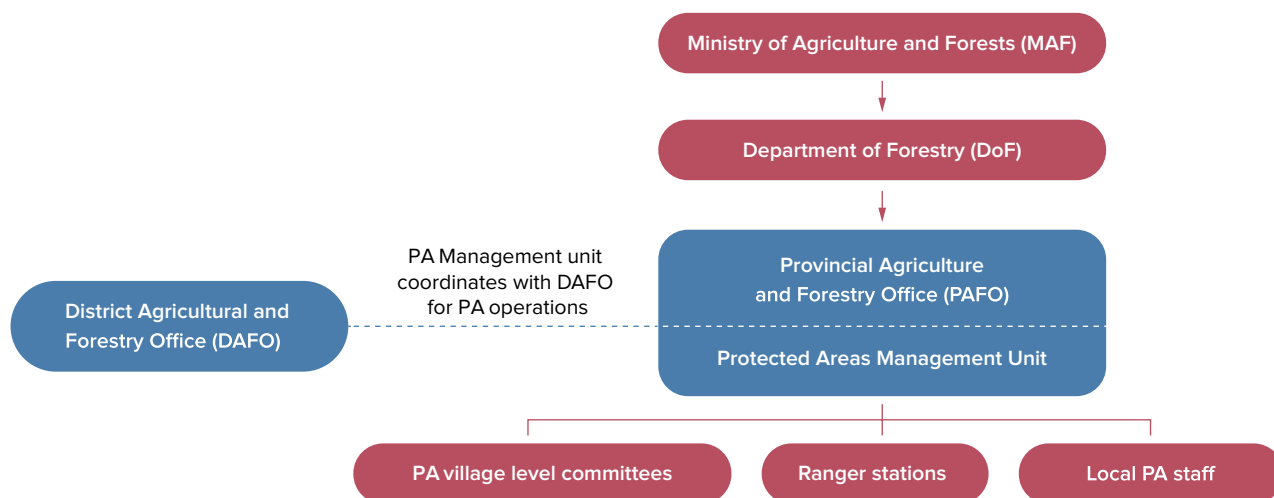
Given Lao PDR's apparent preference to negotiate bilaterally, and China's projected high share of Lao debt service (Figure 3.4a), we will use China as an example of how Lao PDR and China could design a debt reorganization package that might include a debt-for-nature swap that would effectively reduce Lao PDR's debt burden and achieve improved environmental outcomes. In these hypotheticals, we assume China might be willing to modify its lending regulations to accommodate debt relief and debt-for nature swaps in light of the potential for leveraging even more international resources that could increase the concessionality of the debt reorganization. We illustrate this possibility with a landmark project that symbolizes their bilateral relationship: the Laos-China Railway Project. Among the options, three types of debt-relief treatments could be applied individually or in combination, with the goal to use the savings for projects like nature conservation:

- » **Forgiveness of all or part of loan principal:** Lao PDR's PPG borrowings from China for the Laos-China Railway Project total approximately \$1.5 billion, composed of \$1.06 billion loaned to a Laos-China joint venture company, and a \$480 million low-interest concessional loan from CHEXIM to the government of Lao PDR with an interest rate of 2.3 percent and a five-year grace period (World Bank 2020a, 20). Forgiving, for example, 10 percent of CHEXIM loan principal would relieve the Lao PDR sovereign debt burden by \$48 million and reduce annual debt service payments by more than \$1.1 million (Boland 2021).
- » **Reducing the interest rate:** Further reducing the concessional interest rates could create significant debt service savings. In the case of the Laos-China Railway Project, for example, reducing the combined loans' interest rate by 0.2 percent would save \$3 million per year over the course of the loans.
- » **Rescheduling debt service payments:** An extended grace period for loan repayment would create fiscal space for a few years. However, rescheduling principal payments could increase the total amount to be repaid if foreign-exchange risks are not mitigated. The Lao PDR government should evaluate whether these currency risks are offset by the short-term benefits of improved fiscal capacities. For example, extending the Laos-China Railway Project CHEXIM loan grace period for 10 additional years could save Lao PDR up to \$11 million per year.

These and other debt reorganization arrangements can be used in conjunction with one another, for example, by using a debt-for-nature swap to forgive part of the loan principal and extending the term for the remaining principal. If the swap agreement does not include a conversion of the remaining principal and interest into local currency or include an exchange-risk guarantee, the Lao PDR government could, for example, negotiate a fixed amount of interest for the new loan term and then pay the interest portion of the debt service in local currency into a local nature-conservation trust fund to fund local conservation projects. Doing so would eliminate exchange-rate risk on the interest portion of the debt obligation.

Once Lao PDR and its creditor(s) agree on the amount of debt to be swapped and the financial contribution to nature conservation or restoration to be made, the exact mechanism for delivery of the agreement largely depends on the Lao PDR government's budget allocation framework for protected areas at the central and local government levels (Figure 3.6).

FIGURE 3.6: Lao PDR government management structure and funding flow for national protected area financing



Note: PA = protected area **Source:** Boland (2021)

The Lao PDR government could also use savings realised from a reorganization that applies debt-for-nature swaps to replenish or establish environmental trust funds, including the Environment Protection Fund (EPF), funded by multilateral donors since 2005, and the Forest Protection Fund (FPF), which is authorized to collect and mobilize revenues from forestry activities, the use of forest resources, and contributions from foreign and other domestic sources (Government of Lao PDR 2014; UNDP 2021). Alternatively, a fund could be established and used to channel funding deriving a specific debt-for-nature swap, but that usually requires the involvement of a third-party international nongovernmental organization (NGO) and a local conservation organization that can manage a conservation concession (Boland 2021).

Other debt-for-nature swap design options to be considered include the expected scale of the swap and debt-relief and the nature targets to be achieved. The latter require considering the level and ways the nature project will be monitored and reported, which largely depend on the outcomes agreed between specific creditors and the Lao PDR government.

3.2 Pakistan could reduce debt-service obligations and reorient financing to bolster SDGs

Pakistan is confronted with high sovereign debt risk due to increasing debt service and repayment requirements. As a highly climate vulnerable country, Pakistan needs to urgently

address environmental challenges for climate adaptation and mitigation, nature protection, and other development challenges including health, education, and employment.

As the debt pressure increases, further debt reorganization arrangements may need to emphasize longer-term debt relief while effectively contributing to the country’s sustainable development agenda. As Pakistan’s access to international capital markets narrows due to its declining sovereign credit rating, bilateral official loan debt-for-development or -nature swaps with major creditors, including China, could be relevant. Figure 3.7 summarizes the key elements that would compose possible Pakistan’s debt reorganization and reorientation arrangements.

FIGURE 3.7: Pakistan: Summary of debt reorganization and reorientation elements with a focus on including debt-for-nature swaps

Type of debt			Debtor characteristics				Creditor characteristics			Other
Main creditor type	Debt level	Debt trading below face value	Debtor has access to capital markets	Sustainable development plan developed	Sustainable projects for swap identified	MRV governance	All major participating creditors need to agree	Political buy-in or debt reorientation framework required	Debtor meets eligibility criteria	Implementation support available
Bilateral DFI	High to very high	N/A	N/A	Yes	Yes	Strong	No	Yes	Yes	Yes
Bilateral or Multilateral DFI	High	Yes	?					?	?	

Environmental benefits

Social benefits

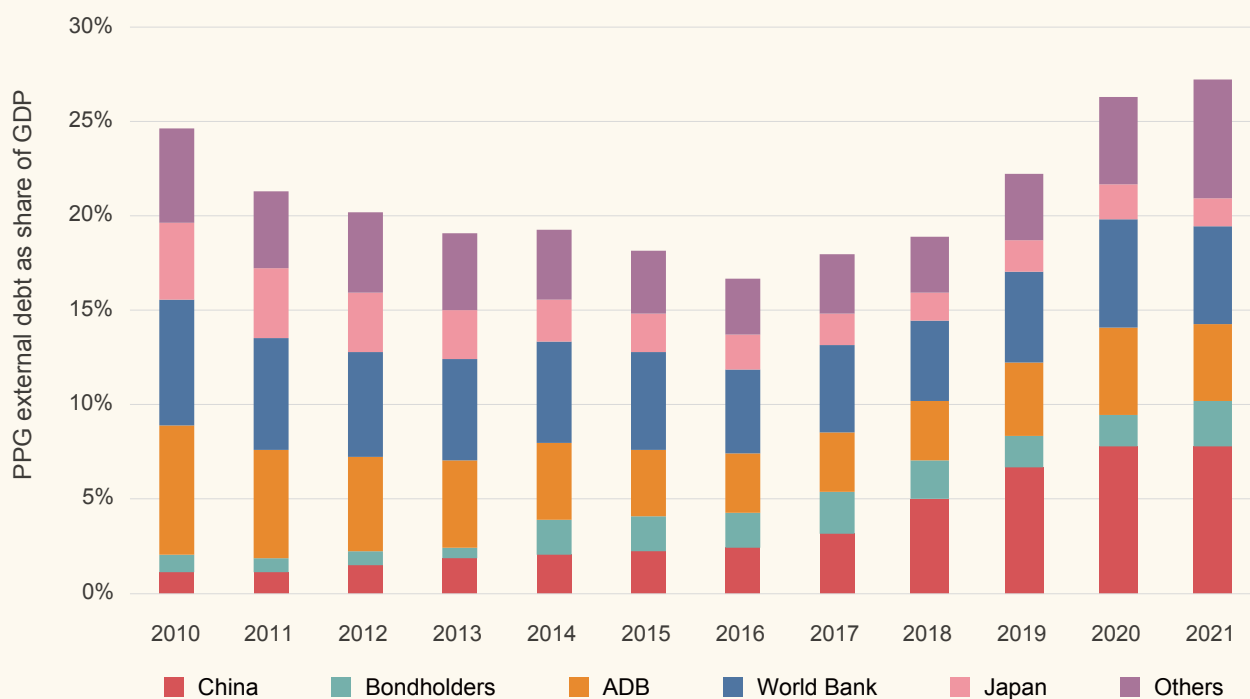
Short-term debt relief
 Long-term debt relief

Source: Authors

3.2.1 Pakistan debt profile

In 2021, Pakistan’s PPG external debt stood at \$94.7 billion, about 27 percent of GDP (Figure 3.8). It is primarily held by official multilateral creditors (33.8 percent), including the World Bank IDA (19.3 percent) and ADB (14.5 percent). In addition, emerging creditor China holds 28.9 percent of Pakistan’s PPG external debt, holdings that rose from \$7.6 billion in 2016 to \$27.4 billion by 2021, equivalent to 7.9 percent of Pakistan’s GDP (Figure 3.8). In addition, Pakistan also has a currency swap facility with China to the tune of \$4.5 billion (USIP 2023).

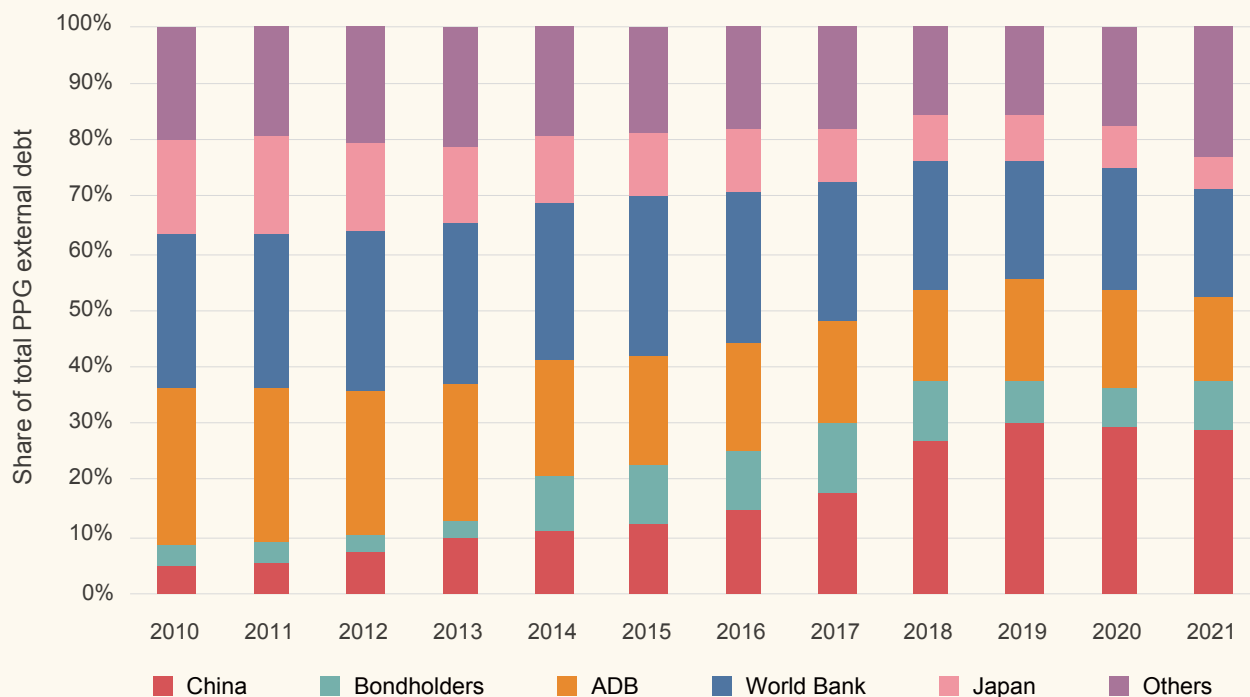
FIGURE 3.8: Pakistan major creditors by share of PPG external debt, 2010-2021 (% of GDP)



Note: China, Japan and Others include bilateral official and nonofficial debt stocks.

Source: Authors based on World Bank IDS (2022)

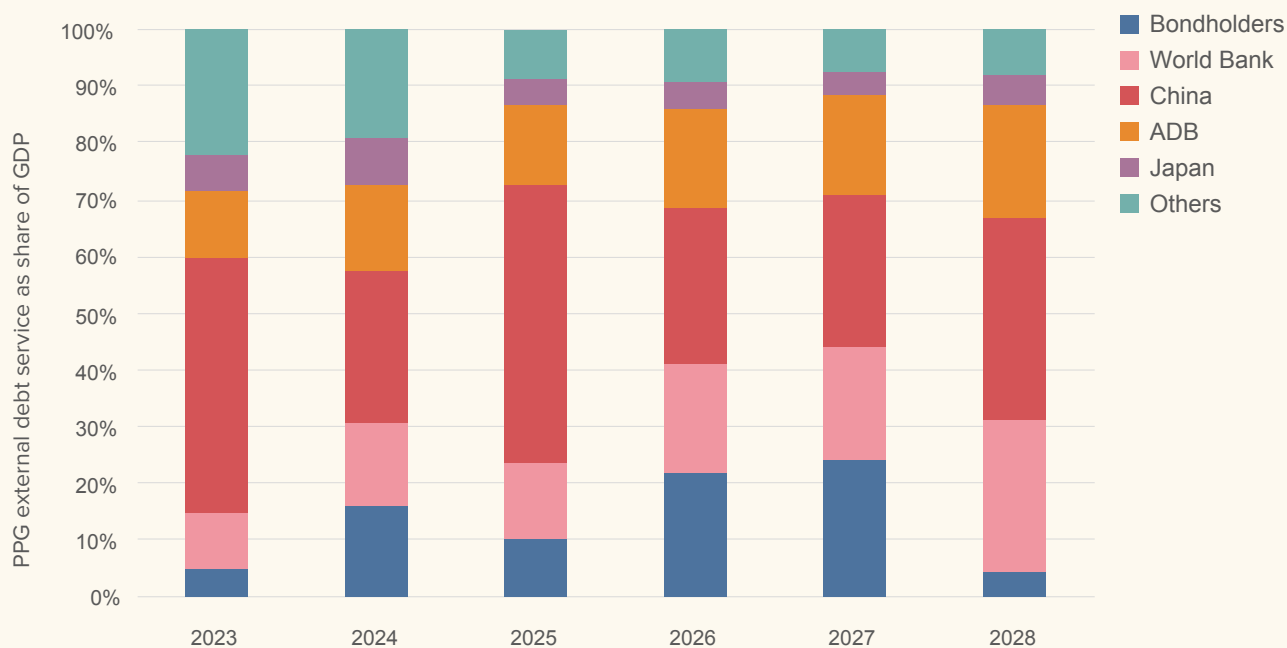
FIGURE 3.8a: Pakistan major creditors by share of PPG external debt, 2010-2021 (%)



Note: China, Japan and Others include bilateral official and nonofficial debt stocks.

Source: Authors based on World Bank IDS (2022)

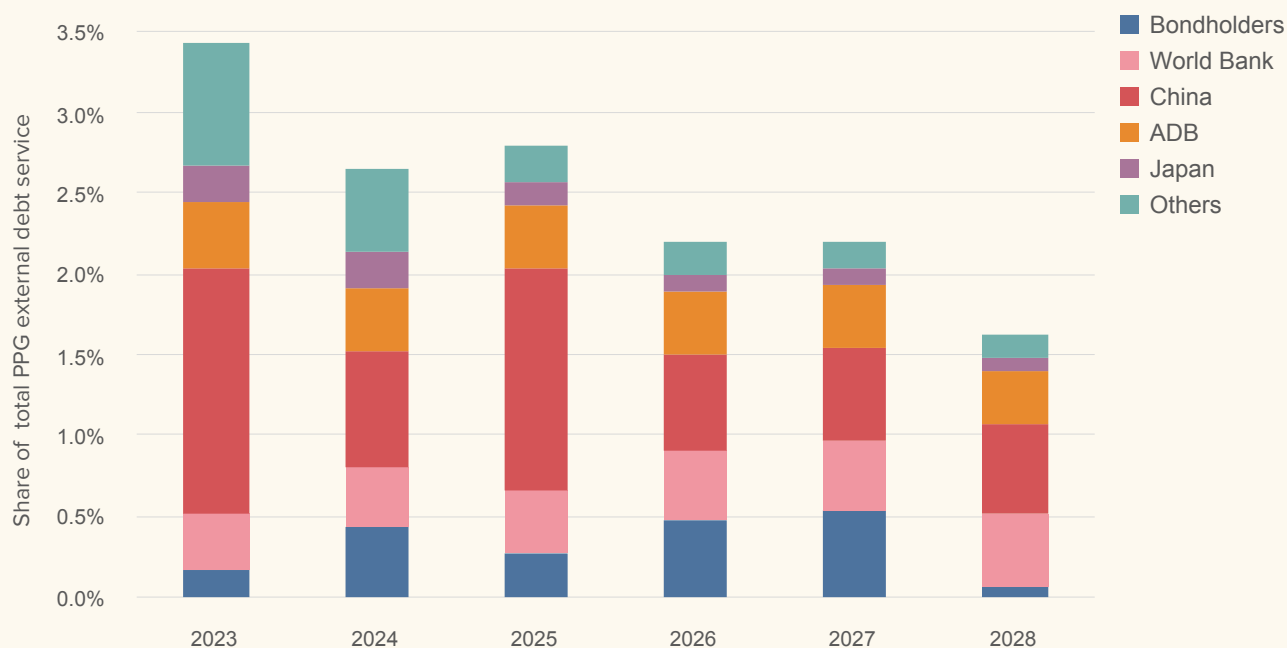
FIGURE 3.9: Pakistan major creditors' share of PPG external debt service, 2023-2028 (%)



Note: China, Japan and Others include bilateral official and nonofficial debt stocks.

Source: Authors based on World Bank IDS (2022)

FIGURE 3.9a: Pakistan major creditors' share of PPG external debt service, 2023-2028 (% of GDP)



Note: China, Japan and Others include bilateral official and nonofficial debt stocks.

Source: Authors based on World Bank IDS (2022)

Despite a seemingly sustainable PPG external debt-to-GDP ratio of less than 30 percent, Pakistan’s PPG external debt service consumed 26.2 percent of export earnings in 2021 (World Bank IDS 2022). The increasingly large share of PPG external debt held by China, and the retirement of other debts, means that China will be owed the largest share of Pakistan’s debt-service payments from 2023 through 2028 (Figure 3.9 and Figure 3.9a).

The deterioration in Pakistan’s economy for reasons discussed earlier led a credit rating agency, S&P Global Ratings, to downgrade Pakistan’s long-term economic outlook to “negative” in July 2022 (Dawn 2020). In December of the same year, S&P Global Ratings lowered its long-term sovereign credit rating on Pakistan to “CCC+” from “B-”, while keeping the outlook stable (Bloomberg 2022). In October 2022 another credit rating agency, Moody’s Investor Service, had downgraded Pakistan’s local and foreign currency issuer rating and senior unsecured debt rating to Caa1 from B3, citing increased government liquidity and external vulnerability risks (Moody’s 2022). In February 2023, Moody’s further downgraded Pakistan’s credit rating by two notches to Caa3 amid international loan negotiations (Moody’s 2023). These downgrades greatly constrain Pakistan’s ability to raise new funding or refinance debt from private investors at affordable costs.

3.2.2 Pakistan faces climate, nature and health challenges, and lacks financing for development priorities

Although Pakistan emits less than 1 percent of global greenhouse gases, from 2000 to 2019, **the Global Climate Risk Index ranked it as the eighth highest country affected by climate change** (CSIS 2021), not least because most of the population lives near the Indus River, an area prone to severe flooding, and because agriculture – a sector highly impacted by extreme weather events – is the largest employer with 37.4 percent of the workforce in 2021 (Government of Pakistan 2022). For these and other reasons, the Government of Pakistan prioritizes climate-change mitigation and adaptation policies and programmes, allocating PKR 9.6 billion (about \$40 million) to its Climate Change Division under the PKR 900 billion (for 2022-2023) Public Service Development Programme (PSDP), which also includes PKR 100 billion in foreign aid (Shadid 2022; Government of Pakistan 2022b).

Pakistan also cooperates with international partners to restore its ecosystems and improve climate resilience. Three important initiatives include the Ten Billion Tree Tsunami Project, launched in 2019 with support from the United Nations Environmental Programme; a 2022 allocation of PKR 100 million (\$460,000) to a project that will transform the Islamabad Zoo into a wildlife conservation zone; and a project to restore mangrove ecosystems in coastal areas led by the International Union for the Conservation of Nature (IUCN) (UNEP 2021; 2021a).

3.2.3 Pakistan's reorientation of sovereign debt: SDG-aligned debt swaps

Pakistan has actively engaged with official multilateral and official and emerging bilateral creditors in reorganizing some of its debt. For example, Pakistan participated in the 2020-2021 G20 DSSI initiative and in 2022 secured an immediate disbursement of SDR 894 million (equivalent to about \$1.1 billion) from the IMF's Extended Fund Facility (EFF) (Mangi et al 2022). In addition, Pakistan saw a DSSI agreement on \$132 million rolled over (rescheduled for a longer term) by the United States, which also suspended debt service on an additional \$4 million (Shahzad 2022). Among other suspensions and reschedulings in 2022, China rolled over a \$4.5 billion loan that had been due in March, and injected \$2.5 billion in State Administration of Foreign Exchange (SAFE) deposits to prop up Pakistan's foreign exchange reserves (Business Standard 2022). Pakistan also received a \$700 million loan from China in February 2023 while benefitting from a \$1.3 billion loan rollover as of March 2023 (Bloomberg 2023).

While these initiatives mostly did not include SDG elements, Pakistan has experienced debt-for-development and -SDG swaps with traditional creditors in debt reorganization packages. Pakistan's past arrangements include:

- » The Pakistan-Canada Debt-for-Education Conversion Initiative (2005-2011) converted CAD 449.6 million of official development assistance loans into a local currency grant to improve quality of basic education by strengthening the public-teacher training institutions (Government of Canada 2020).
- » Pakistan-Germany debt-for-health and other swaps in 2005 and 2010 cancelled a total of EUR 166 million of debt on condition that Pakistan invested a portion of that amount in education, infrastructure and health (The Global Fund 2018; Mir 2017).
- » Pakistan-Italy debt swaps agreed in 2001 as part of a multi-creditor Paris Club arrangement cancelled about \$85 million, or 50 percent of Pakistan's debt to Italy in exchange for Pakistan expenditures on Afghan refugee-related projects, and set up a debt-for-development swap for the other 50 percent (about \$100 million) in 2009 in exchange for Pakistan investing in health, education, agriculture and basic infrastructure (Government of Pakistan MEA n.d.).
- » A Pakistan-Norway debt-for-development swap converted EUR 20 million worth of loan repayment obligations into a grant in 2006 to direct financing to rehabilitation and reconstruction in earthquake-affected areas (ADB 2006).
- » A Pakistan-Belgium debt-for-development swap in 2007 cancelled about EUR 10 million of debt conditional on Pakistan transferring equivalent funds into ADB's Pakistan Earthquake Fund (PEF) (ADB 2007).

These initiatives potentially set favourable conditions for negotiating similar treatments in the current situation.

Thus, Pakistan could explore new opportunities to use debt-for-nature swaps with the following creditors (UNDP 2019):

- » The **Paris Club members** named above that have already executed debt-for-SDG swaps, as

well as the Netherlands and the United Kingdom. In particular, Italy has established a debt-relief-for-development-and-poverty-reduction legal framework, and Germany works with the Global Fund Debt2Health Initiative (see Box 2.7).

- » **China**, promoting green bonds and overseas investment for sustainable projects, might support debt-for-nature or -climate swaps in a reorganization of concessional loans made to Pakistan for China-Pakistan Economic Corridor (CPEC) infrastructure projects. The modalities of such a transaction may be structured in accordance with China’s preference for bilateral arrangements and through Chinese partner organizations.

Pakistan could use the debt-service savings or grant funding from such conversions to support climate resilient and sustainable development programmes for flood recovery and reconstruction for the poorest districts of Sindh and Baluchistan provinces and in the Newly Merged Districts (formerly known as Federally Administered Tribal Areas [FATA]); it could also support nature through its Ten Billion Trees Tsunami Project or other nature conservation projects. Governance, transparency and accountability concerns can be addressed by using an intermediary entity and multilateral technical advisory partners.

3.3 Asia-Pacific Small Island Developing States (SIDS) are particularly vulnerable to debt and environmental distress

In this report, we treat seven small island developing states (SIDS) in the Asia-Pacific region – Fiji, the Maldives, Papua New Guinea, Samoa, the Solomon Islands, Tonga and Vanuatu – as a proxy for all Asia-Pacific SIDS and discuss them both singly and as a group for the purpose of comparison with other economies. While they differ in size, all Asia-Pacific SIDS economies were in “high” or “moderate” debt distress according to the IMF-World Bank DSA published in August 2022 (IMF 2022). However, that evaluation is thought to be an underestimation because it only considers debt-repayment capacity without taking into account the SIDS’ financial needs or risks linked to climate vulnerability and structural income inequality. In 2021, most of SIDS PPG external debt-to-GDP ratios exceeded a relatively high 20 percent, with some states recording much higher ratios: the Maldives (57.1 percent), Samoa (45.3 percent), Vanuatu (43.0 percent) and Tonga (39.6 percent) (World Bank 2022d).

Asia-Pacific SIDS could benefit from debt reorganizations in single or multi-creditor arrangements that include debt-for-climate or -nature swaps or, depending on the strength of their economy, new financing via thematic and sustainability-linked bonds. These instruments “could be superior to grants when structured in a way to make the climate commitment senior to debt service” (Chamon et al 2022). Importantly, debt obligations with a high rather than a low interest rate should be swapped (see Box 2.9). These instruments could also be superior in specific circumstances, such as those associated with both high debt distress risk and large costs for non-climate-or-nature-conditional debt restructuring, if they materially reduce both debt and environmental risks – the latter of which impact long term economic risks (Chamon et al 2022).

Figure 3.10 summarizes the elements that would compose possible Asia-Pacific SIDS arrangements to reorganize, reorient and/or raise debt financing.

FIGURE 3.10: Asia-Pacific Small Island Developing States: Summary of debt reorganization, reorientation and raising elements with a focus on including debt-for-nature swaps

Type of debt			Debtor characteristics				Creditor characteristics			Other
Main creditor type	Debt level	Debt trading below face value	Debtor has access to capital markets	Sustainable development plan developed	Sustainable projects for swap identified	MRV governance	All major participating creditors need to agree	Political buy-in or debt reorientation framework required	Debtor meets eligibility criteria	Implementation support available
Bilateral DFI	High to very high	N/A	N/A	Yes	Yes	Strong	No	Yes	Yes	Yes
Private thematic bonds	Low-high	No	Yes	Yes	No	Strong	No	No	No	Ideally
Bilateral or Multilateral DFI	High to very high	?	?	✓	✓	?		?	?	✓

✓ Environmental benefits
 ✓ Social benefits
✓ Short-term debt relief

✓ Long-term debt relief

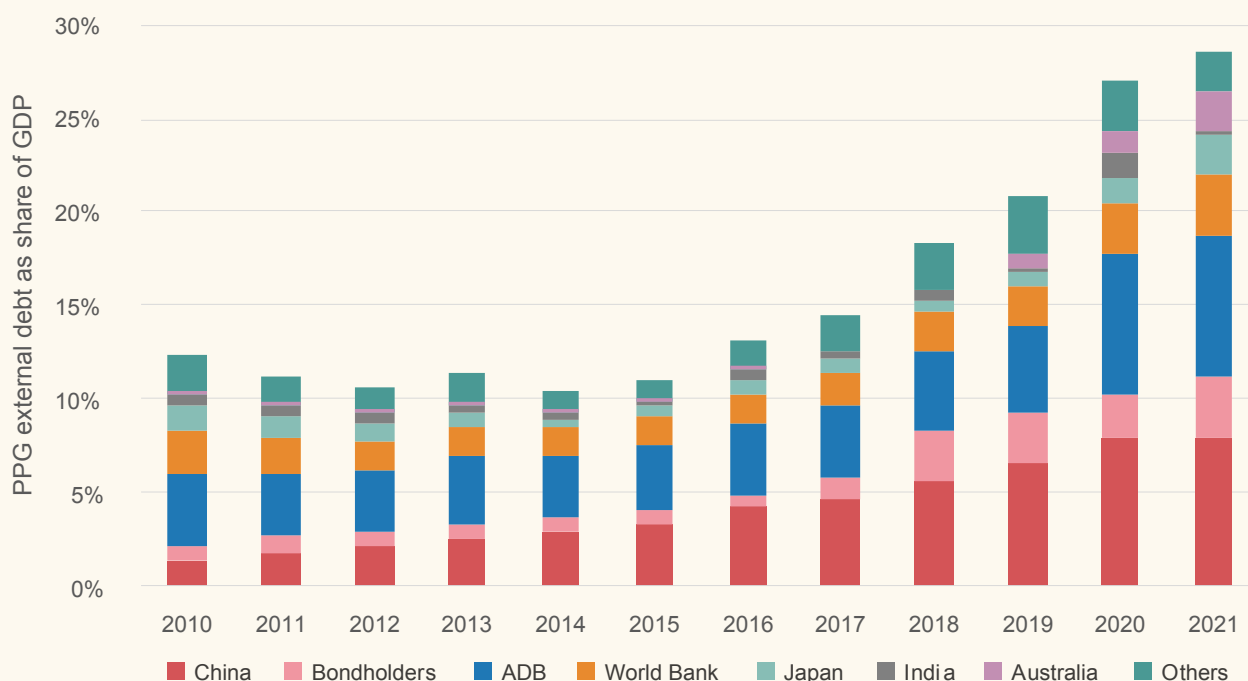
Source: Authors

3.3.1 Asia-Pacific SIDS debt profile

Given their scarce domestic resources, the Asia-Pacific SIDS²⁹ have traditionally relied on official multilateral and bilateral grants and lending to finance economic growth, infrastructure, and climate resilience. In general, as a share of SIDS' GDP and as of 2021, traditional multilateral creditors had provided the most loans (10.7 percent), with the ADB recording the largest share, followed by China (7.9 percent). Bondholders accounted for 3.4 percent, while other major creditor categories (Paris Club creditors, emerging creditor India) each accounted for less than 3 percent of lending (Figure 3.11). Since 2016, all major creditors, including bondholders, saw their collective SIDS debt stock steadily increase to nearly 35 percent of GDP in the aggregate average (Figure 3.11a).

29 The group of Asia-Pacific SIDS discussed as one country in this section are recorded in the World Bank IDS (2022) database and include Fiji, the Maldives, Papua New Guinea, Samoa, the Solomon Islands, Tonga and Vanuatu.

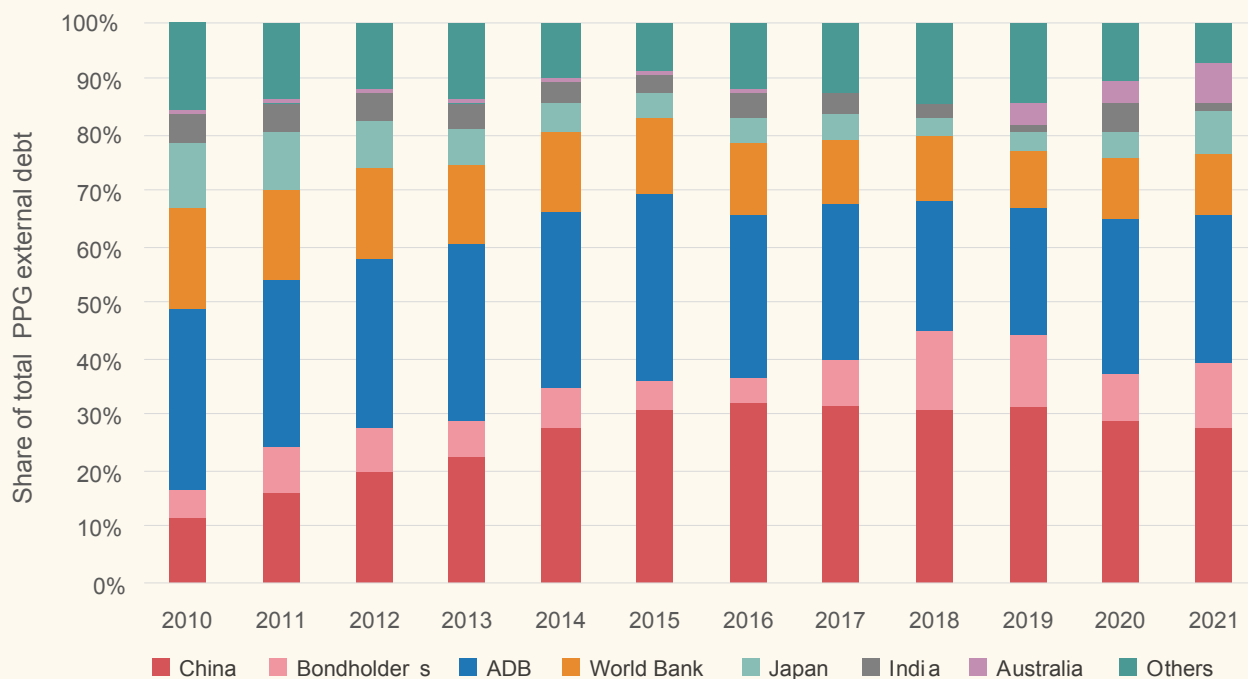
FIGURE 3.11: Asia-Pacific Small Island Developing States major creditors by share of PPG external debt, 2010-2021 (% of GDP)



Note: China, Japan, India, Australia and Others include bilateral official and nonofficial debt stocks. The SIDS include Fiji, Maldives, Papua New Guinea, Samoa, Solomon Islands, Tonga and Vanuatu.

Source: Authors based on World Bank IDS data (2022).

FIGURE 3.11a: Asia-Pacific Small Island Developing States major creditors by share of PPG external debt, 2010-2021 (%)



Note: China, Japan, India, Australia and Others include bilateral official and nonofficial debt stocks. The SIDS include Fiji, Maldives, Papua New Guinea, Samoa, Solomon Islands, Tonga and Vanuatu.

Source: Authors based on World Bank IDS (2022)

FIGURE 3.12: Asia-Pacific Small Island Developing States major creditors' share of PPG external debt service, 2023-2028 (% of GDP)

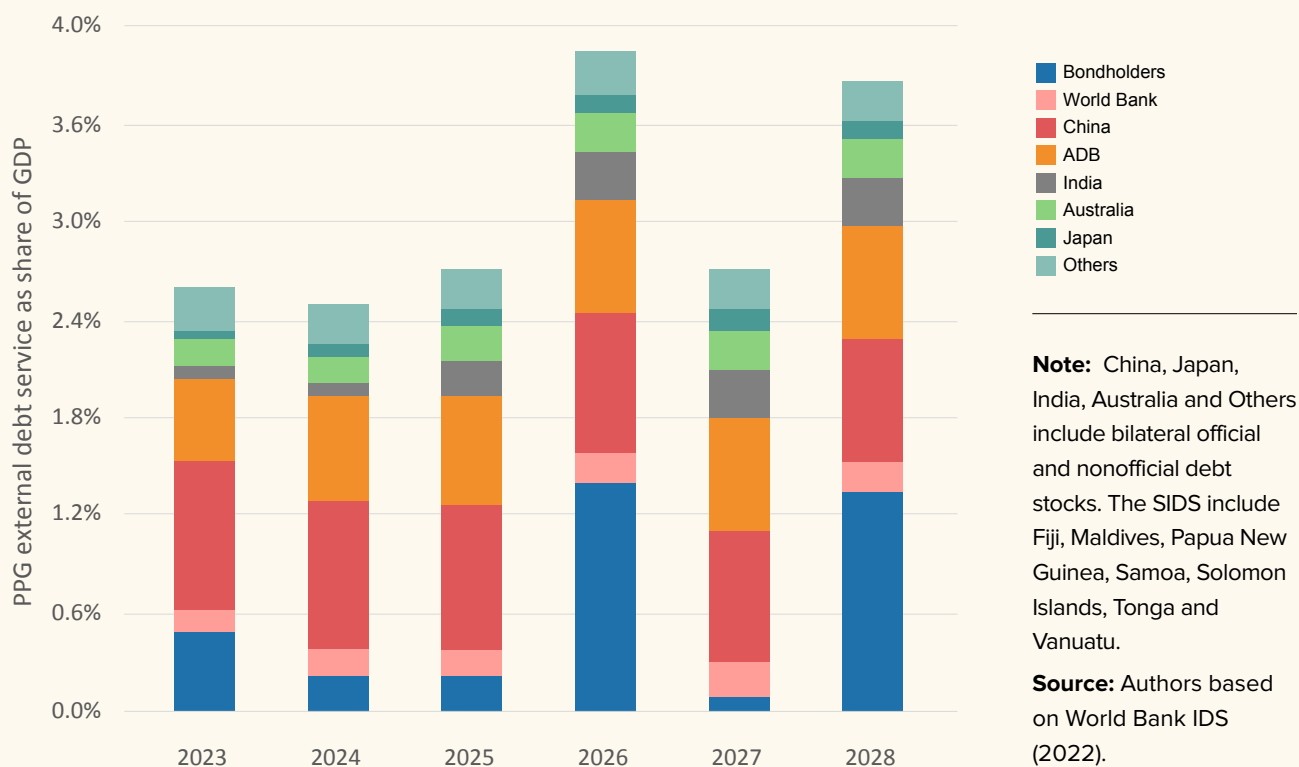
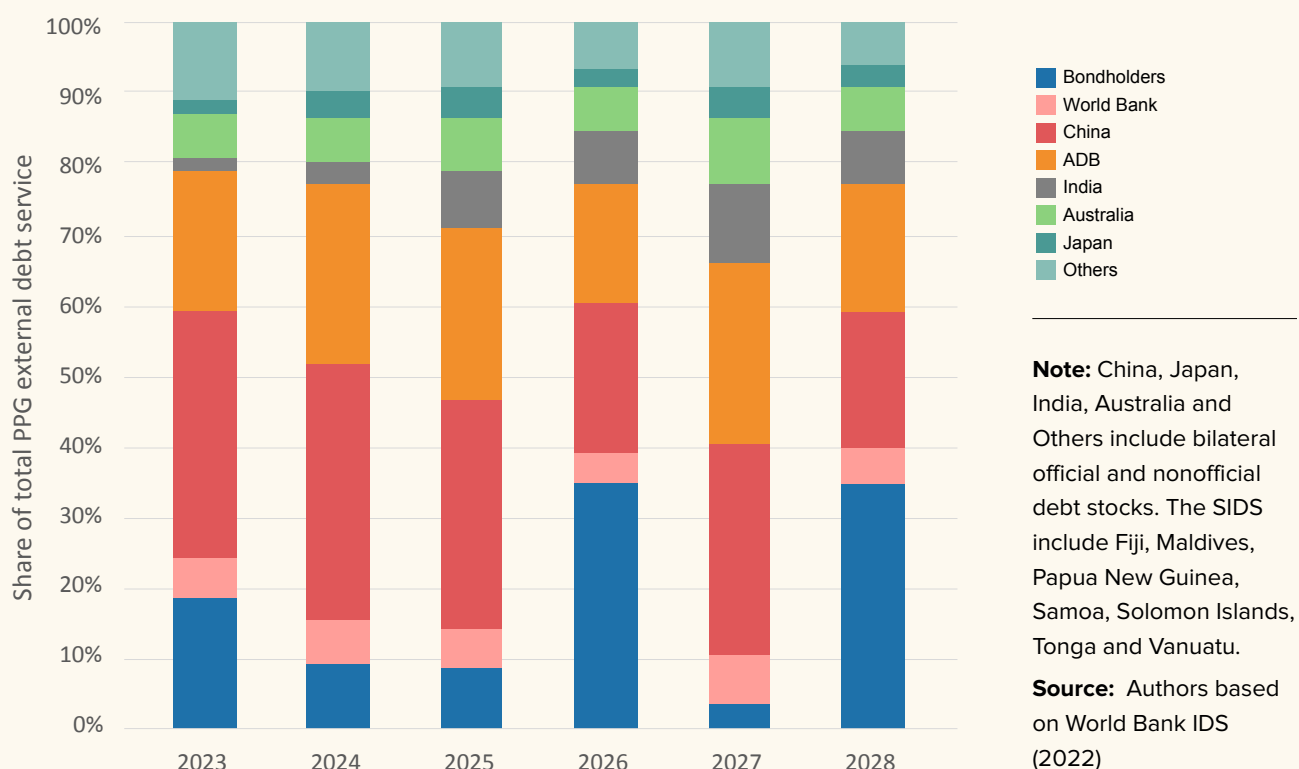


FIGURE 3.12a: Asia-Pacific Small Island Developing States major creditors' share of PPG external debt service, 2023-2028 (%)



In detail, according to the World Bank (2022d), by the end of 2021, the largest holders of PPG external debt for each Asia-Pacific SIDS ranked as follows:

- » **Fiji's** largest creditors were the ADB (37.3 percent), followed by the World Bank (26.9 percent) and China (18 percent).
- » In the **Maldives**, emerging creditors China, India, and Saudi Arabia held 44.4 percent, 4 percent, and 4 percent respectively of the debt stock, more than the traditional bilateral creditors (11 percent). Bondholders composed the second-largest creditor group, accounting for 27.5 percent of total PPG external debt.
- » In **Papua New Guinea**, major creditors included ADB (37.4 percent), China (18.3 percent), and Paris Club member Australia (14.4 percent).
- » In **Samoa**, China was the largest creditor with 42.3 percent of total PPG external debt stock, followed by the World Bank (28.3 percent) and ADB (19.2 percent).
- » In the **Solomon Islands**, the largest creditors were ADB and the World Bank IDA (44.8 percent and 33.1 percent respectively), followed by Paris Club member Japan (15.5 percent).
- » **Tonga's** largest creditor was China (60.4 percent), followed by the World Bank (23.4 percent) and ADB (14 percent).
- » **Vanuatu's** biggest creditor was China (47.6 percent), followed by the World Bank (23.7 percent), Paris Club member Japan (16.4 percent) and ADB (12.2 percent).

To service this PPG external debt over the next six years, it is estimated that the Asia-Pacific SIDS will need to allocate at least 2.5 percent of annual GDP in 2024 and up to 4.1 percent of annual GDP in 2026 (Figure 3.12), the latter higher percentage driven by a steep rise in bondholder obligations (Figure 3.12a).

3.3.2 Asia-Pacific SIDS face the intertwined challenges of climate, nature and economic shocks

Even though the Asia-Pacific SIDS count among the V20 and rank among the countries most vulnerable to climate change, as discussed earlier, climate and debt distress in these island nations have been treated as separate issues. As done elsewhere, traditional multi- and bilateral creditors have made climate finance available through grants, but such financing has proven and remains insufficient.

The need for climate and nature finance is great. In 2021, the IMF estimated that the Pacific Small Island Developing States (PSIDs),³⁰ which include all Asia-Pacific SIDS, should invest about 9 percent of GDP annually on average for climate adaptation under a risk-intolerant strategy. The strategy

30 The Cook Islands, Federated States of Micronesia, Fiji, Kiribati, Nauru, Niue, Palau, Papua New Guinea, the Marshall Islands, Samoa, the Solomon Islands, Tonga, Tuvalu, and Vanuatu.

would aim to build coastal-protection infrastructure that limits average economic losses to less than 0.01 percent of GDP (IMF 2021).

Scarce grant funding cannot meet that need alone and, as discussed earlier, recent traditional multi-creditor debt-relief mechanisms like the DSSI and the Common Framework for PSIDS aim to alleviate emergency needs and have no direct linkage to environmental resiliency or climate and nature policies or programmes. And while the new IMF Resilience and Sustainability Trust (RST) aims to help vulnerable LMICs build resilience to external shocks, including climate shocks, it only became operational in October 2022 and has yet to be fully funded (IMF 2022a). For these and other reasons, Asia-Pacific SIDS have called for their traditional and emerging bilateral creditors to step in and spearhead relevant debt reorganization, reorientation and sustainable finance treatments and instruments (V20 Presidency 2021).

3.3.3 Asia-Pacific SIDS could effectively integrate climate-and-nature commitments into debt relief or financing packages

In addition to negotiating immediate debt-service relief and concessional financing or grants from multilateral creditors, possibly with added climate or nature conditionalities to strengthen climate adaptation and environmental resiliency, **Asia-Pacific SIDS could consider bilateral debt-for-climate or debt-for-nature swaps**. Given the similarities between the Seychelles and the SIDS, the Seychelles trilateral official loan debt-for-nature swap case can serve as a yardstick and an inspiration (Box 2.6).

The Asia-Pacific SIDS are already equipped with some prerequisites for thematic bonds and debt-for-nature swaps, including sustainable development plans and priority geographic areas and concerns. In addition to those requirements, SIDS would need to overcome uncertainty around their public finance management and MRV capacities.

Creditor readiness may also come into play, particularly for emerging creditors like China that do not have a history of deploying debt-for-development swaps, or for Paris Club creditors Australia and Japan that do, but which have not yet included debt-for-nature swaps among their instruments. Creditor concerns would likely be alleviated by a close partnership between one or more SIDS with multilateral organizations that can provide technical assistance and contacts, such as UNDP, and those, like the World Bank and official European creditors, that have gained experience with debt-for-nature swaps in the Seychelles or elsewhere (see Box 2.6 and Box 2.10).

The stronger SIDS economies could also consider issuing sovereign sustainability-linked or thematic bonds to raise new sustainable finance directly. Countries with access to international capital markets and previous bond issuance experience, such as Fiji, Papua New Guinea or the Maldives, might also issue nature performance bonds. These offer a valid alternative to the debt-for-nature swap in creating a bridge between providers of financial capital and biodiversity-related aims and allowing for greater control as to the allocation of proceeds (Bankers without Boundaries 2022).

For Asia-Pacific SIDS with access to international capital markets, the concessionality (low cost) of existing debt and solid market standing might steer their choice of sustainable finance instruments toward new bond issuance rather than reorganizing a loan or bond through a debt-for-nature swap (Box 3.1).

Box 3.1: Concessionality and solid market standing favour Fiji issuing new debt rather than arranging a debt-for-nature swap

Fiji's public domestic and external debt rose from 48.4 percent of GDP in 2019, to 91.1 percent of GDP in 2022, of which 36.8 percent is owed to external creditors, including official multilateral creditors, Paris Club creditor Japan, emerging creditor China, and bondholders (Government of Fiji MOE 2022). Fiji's high vulnerability to climate change and need to finance biodiversity at the national level motivate the country to orient financing toward climate and nature policies and programmes, but a few factors make it difficult to use two debt reduction and reorientation instruments:

- » **Bilateral debt-for-nature swap.** Beyond the fact that neither China nor Japan has previously transacted debt-for-nature swaps, the concessionality of their loans to Fiji's government is likely to disincentivize Fiji from swapping them, particularly in the case of Japan's highly concessional terms and its legal restrictions on swaps. In the case of China, CHEXIM loans represented 12.8 percent of Fiji's PPG external debt in fiscal year 2022. CHEXIM's standard concessional loans terms set a 2 percent interest rate, 5–7 year grace period, and 15–20-year maturity (Rajah et al 2019).
- » **Sovereign bond-for-nature swap.** Presently, Fiji's bonds are trading at a premium rather than a discount, and its cost of capital is not unsustainable. In such circumstances, a sovereign bond swap would not have much impact on debt sustainability, while swap transaction costs would be elevated compared with new issuance.

In this context, new issuance of sustainable, thematic bonds, where proceeds are dedicated to predefined, blue, green and/or social projects may be a valuable pathway to expand debt for sustainable development. As a key first step, the government launched the Fijian Sustainable Bond Framework at COP27 in November 2022. The Framework is the first of its kind developed by a SIDS, based on taxonomy for green, blue and social projects, paving the way for Fiji's first-ever sovereign blue bond (Government of Fiji 2023).

CHAPTER 4

The creditor's perspective: The potential to reduce and reorient debt to support climate-and-nature SDGs in the Asia-Pacific region

Significantly reducing debt and climate-and-nature distress in low- and middle-income countries in the Asia-Pacific region will likely require single creditors to spearhead initiatives and multiple creditors to coordinate their actions. After having reviewed debt reorganization types and treatments, options to raise new debt targeted at environmental development agendas (Chapter 2), and opportunities to apply them in Asia-Pacific LMICs (Chapter 3), this chapter first briefly reviews some of the challenges that private and emerging and traditional creditors face in conducting single- or multi-creditor debt reorganizations, and reorientation treatments specifically targeted at addressing the dual crises of debt and environmental distress. The chapter also focuses on China as one of the largest and comparatively less-understood creditors to Asia-Pacific economies, briefly presenting China's overseas-lending history, governance, architecture and considerations.

4.1 Recent multi-creditor debt-relief mechanisms

In response to the most recent global debt crisis, sovereign debtors and creditors have engaged in debt reorganization and relief efforts through two major multi-creditor mechanisms (Box 4.1). Building on the DSSI (Box 2.4), the G20 in March 2020 launched the Common Framework for Debt Treatments to coordinate sovereign debt relief efforts between traditional, private, and emerging creditors such as China. In 2022, the G20 members also pledged to channel a portion of their IMF special drawing rights (SDRs) to LMICs, either directly, or through the IMF's Poverty Reduction and Growth Trust (PRGT), or through a new funding facility, the Resilience and Sustainability Trust (RST), to help vulnerable LMICs build resilience to external shocks and ensure sustainable growth (IMF 2009; 2023a).

Box 4.1: Recent multi-creditor debt-relief mechanisms

- » **Common Framework for Debt Treatments Beyond the DSSI:** G20 members provide debt treatments on a case-by-case basis upon voluntary requests from debtor countries. The Common Framework requires private creditors to participate on comparable terms to overcome collective action challenges and ensure fair burden sharing. As of March 2023, only four countries, Chad, Ethiopia, Ghana and Zambia, had applied (IMF 2023b).
- » **Special Drawing Rights (SDR) allocation:** G20 members have pledged to redistribute part of their SDRs to LMICs, as nearly two thirds of the \$650 billion SDR August 2021 allocation went to developed countries (Government of Italy MEF 2021). A significant redistribution from each G20 creditor to vulnerable countries would be necessary to make a meaningful change. In this vein, China, for example, announced in August 2022 that it would grant \$10 billion of SDRs to IMF trust facilities to benefit African countries (MOFA PRC 2022).

4.2 General challenges around debt-relief negotiations

Creditors and sovereign debtors need to undergo often complex negotiations to reorganize sovereign debt, in order to ensure both sufficient transparency and the confidentiality of market-sensitive information.

Sovereign debtors can accelerate negotiations and improve engagement with their creditors through a better understanding of the challenges private (IMF 2021a) and other creditors face as they voluntarily participate in single- or multi-creditor sovereign debt-relief treatments.

Private creditors might see several challenges, including:

- » Lack of sufficient financial or non-financial incentives to forgive or write down debt.
- » Lack of information and preparation time because sovereign debtors that may fear sovereign credit-rating downgrades tend to not invite private creditors to the negotiating table until late in the process.
- » Anonymity of actual owners of bonds leads to an inability to include unknown bondholders in negotiations.
- » Weighing the value of participating in bond restructuring negotiations versus declining to participate in order to seek a full payout without making concessions (Ellis and Frost 2014).
- » Lack of capacity to engage in lengthy debt renegotiations and, in the case of reorganizations that include debt-for-nature swaps, the lack of technical capacity to engage in environmental sustainability-related negotiations.

Furthermore, all types of creditors – private, traditional, emerging – may be reluctant to engage in debt reorganizations for a variety of reasons, including:

- » Fear of hidden debt due to insufficient transparency about a debtor’s full financial situation and the risk of unfair treatment among creditors (Section 1.3).
- » Complexity of coordinating different interests, perspectives, and capacities among different types of creditors.
- » Difficulties in replicating the same debt reorganization treatment across different debtor and creditor contexts, resources, and capacities.
- » Wish of creditors, particularly traditional and emerging lenders, to avoid the moral hazard of sovereign debtors not bearing the primary responsibility for and consequences of poor borrowing and debt-management decisions.
- » Wish of creditors to avoid the risk of significant debtor demands for reorganizations that the creditors would be unable to accommodate.

The next section discusses how sovereign debtors can engage with creditors to address the challenge of reducing debt and reorienting it toward climate and nature considerations.

4.3 Integrating nature and SDG priorities in debt-relief negotiations

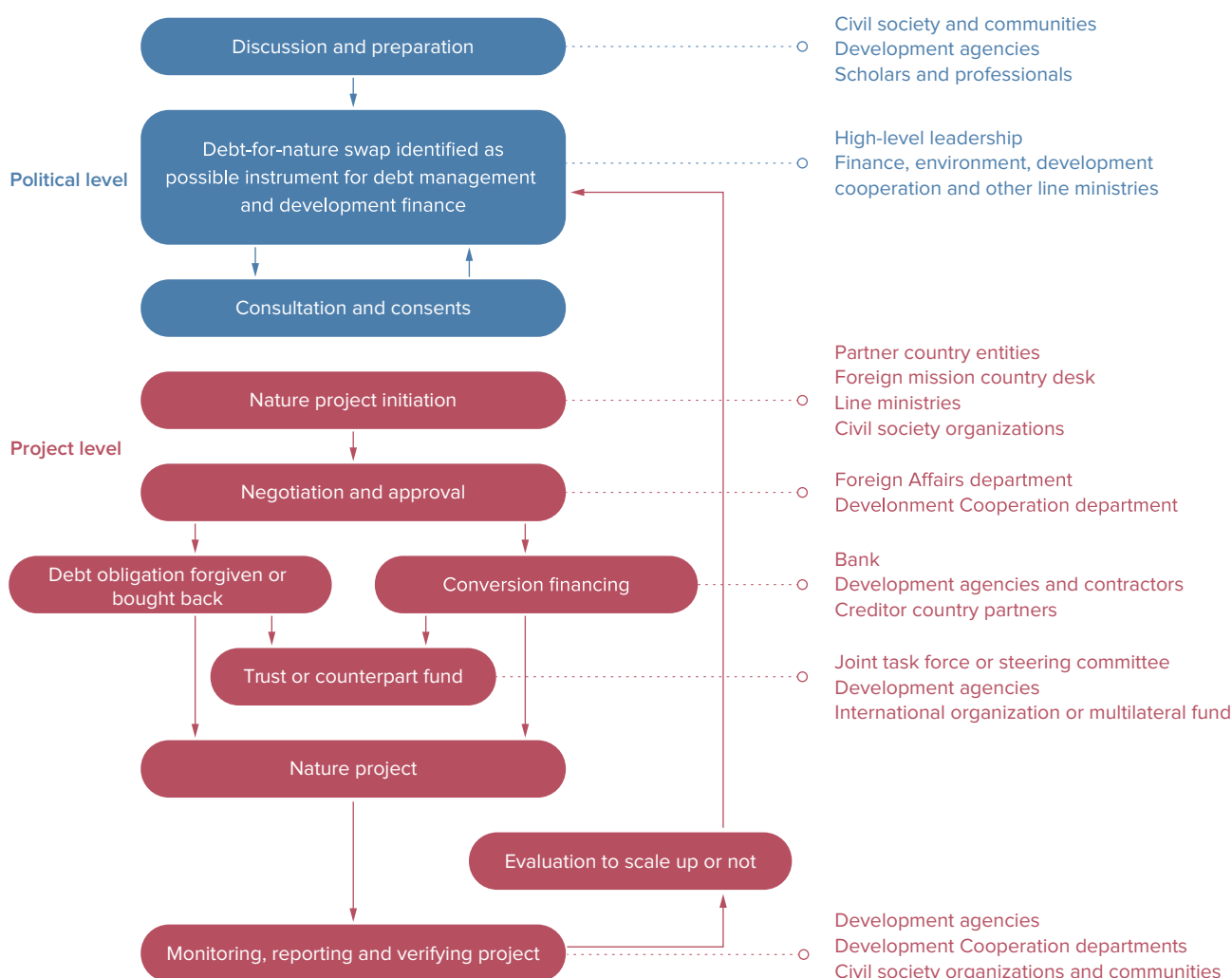
Adding debt-reorientation ambitions to improve environmental or broader SDGs outcomes further complicates debt-relief negotiations. Since an official loan debt-for-nature swap typically includes a debt-relief component, such as a grant or principal or interest forgiveness, the swap instrument should be discussed and included in negotiations soon after the sovereign debtor initiates (calls for) relief.

The debt-reorientation part of a loan reorganization generally has similar phases, regardless of the specific circumstances of each debtor and creditor (Figure 4.1).

The first step **on the sovereign debtor’s side** should be to designate a specific team authorized to negotiate with all creditors, including private creditors, on behalf of the sovereign. At the same time as debtor government discussions and negotiations are taking place, domestic civil society organizations and communities should be involved to give the negotiation legitimacy.

This is particularly the case for debt-for-nature swaps, where nature-conditionality clauses may impact lives and livelihoods in specific regions or across groups of people. This means the sovereign debtor needs to have the capacity to manage multiple entities during negotiations. The negotiating team also needs to be able to discuss the advantages and disadvantages of various nature-aligned debt instruments and understand creditors’ concerns and considerations.

FIGURE 4.1: Debt-for-nature swap negotiation steps and stakeholders



Source: Authors

Once a debt-for-nature swap or other nature-positive debt relief agreement is made, the negotiating team or its delegates should work closely with creditors and citizen-stakeholders throughout the nature-project identification and implementation phases and cooperate in steering its execution.

The first step **on the bilateral creditor's side** is to obtain strong support for debt reorientation agreements from high-level politicians, pertinent government ministries and relevant civil society organizations.

Creditors that have not yet integrated the concept of reorienting debt to nature and the SDGs in their debt management practices will need to use policy research and advocacy to raise domestic policymakers' awareness of and knowledge about its benefits. In such cases, civil society, development agencies, international organizations, and scholars can be important sources of additional nudges and voices.

Next, one or more creditor line ministries need to properly evaluate the debtor country's readiness for nature-project implementation. Since reorienting debt to nature-related priorities is a cross-sectoral issue, agreements may need to be discussed and approved by multiple ministries, such as foreign affairs, development cooperation, finance, and environment, and national budget or congressional committees, among others.

A creditor-country's foreign mission country desk also plays a less-discussed but important role. It is possible that the sovereign debtor could be unaware of the possibility of reorienting debt, or reluctant to discuss debt relief. It could also be that the desk officer is unwilling to follow up on project proposals, which may hamper reorientation negotiations. In these cases, experienced international professional organizations can be of help. Their participation can bolster confidence in and the legitimacy of negotiations among creditors and debtor-country stakeholders.

To further support the negotiations and implementation of a debt-for-nature swap, other participants may be included, as discussed in Section 2.1.3(ii): third parties that can provide concessional financing or fund bond buybacks; DFIs or insurers that can provide currency, credit, and/or political risk guarantees; underwriters for bond issuance; and technical partners for project MVR and implementation, among others. Finally, once a debt-for-nature swap or other debt-reorientation contract is agreed, it is often the highest levels of the creditor country's leadership that announces its contribution to sustainable finance and development to the press.

Once the negotiations are completed, the sovereign debtor and relevant creditors might take the following actions after executing a debt-for-nature swap or similar agreement to increase trust and ensure transparency:

- » Implement a professionally managed MRV system to keep high-level decision makers informed about debt-relief and development impacts, including whether certain practices should be scaled up or phased out.
- » For each swap instrument, the sovereign debtor should open a dedicated trust fund or an assignment account with clear budget allocations and withdrawal records.
- » With the consent of relevant creditors, the sovereign debtor should appoint a full-time nature-project director to oversee the trust fund or assignment account expenditures and investments.
- » With relevant creditors, the sovereign debtor should establish a joint-management or steering committee for each swap agreement to approve projects, annual plans, and review financial and nature-performance audits. The committee could be co-chaired by a creditor country's economic affairs department official and swap-agreement sponsors.
- » Through quarterly or biannual meetings or publications, the sovereign debtor should inform all stakeholders (creditors, sponsors, citizens) about the nature-project's progress and invite public comments from them.

4.4 China's potential role in debt relief and reorientation arrangements

China is the fifth-largest creditor to Asia-Pacific LMICs after bondholders, traditional multilateral DFIs, and Paris Club member Japan. China is the largest creditor to Cambodia, Lao PDR, the Maldives, Pakistan, Samoa, Tonga, Vanuatu (see Chapter 1). Compared to traditional creditors, China sometimes follows different governance modalities for debt and often commits financing through different types of entities. Understanding these modalities and entities is crucial for setting potential partners' – both co-creditors and debtors – relevant expectations.

In the following section, we describe the history and evolution of China's sovereign lending and its governance. This information aims to improve understanding of Chinese overseas lending and thus help sovereign debtors and other creditors effectively engage with China in single or multi-creditor debt reorganization and reorientation initiatives.

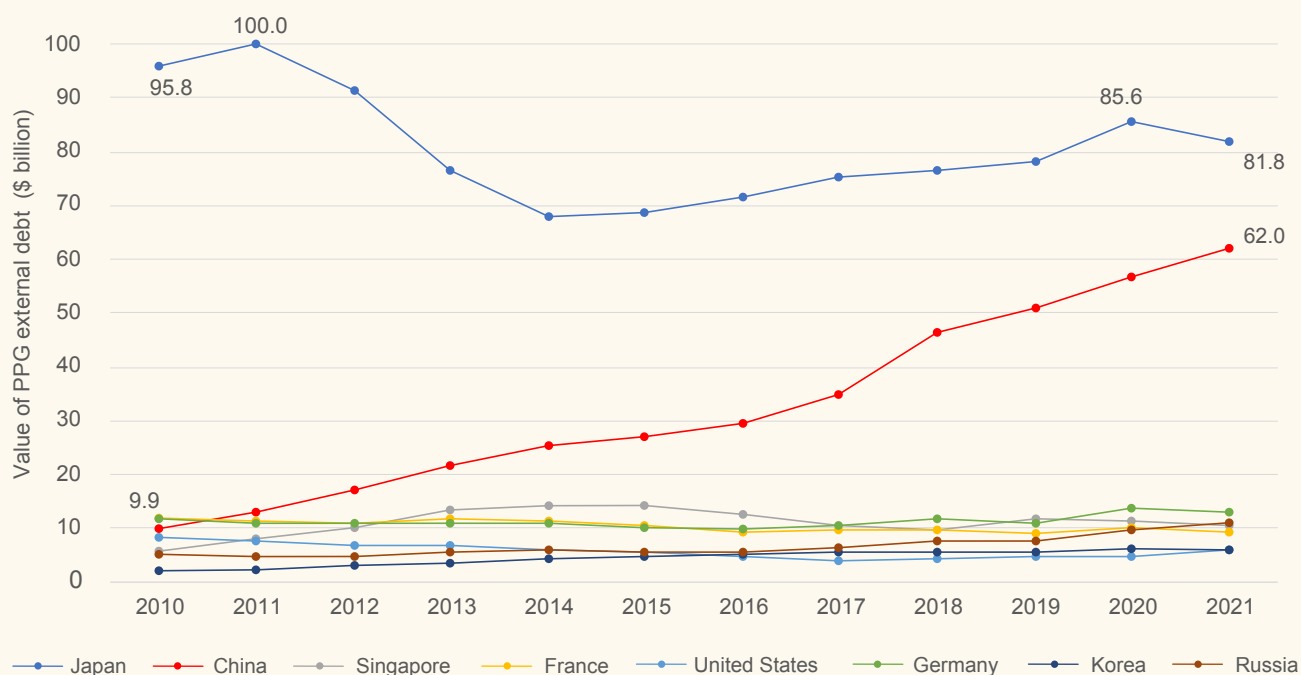
4.4.1 China as an emerging creditor in the Asia-Pacific region

China gained a significant share of Asia-Pacific LMIC debt during its relatively recent increase in overseas lending. In the 1950s, China only provided zero-interest loans to then-socialist countries for infrastructure construction. Starting in 1984, China established state-owned policy banks and state-owned commercial banks (SOFIs), which do the majority of China's official and commercial overseas lending today. China provided its first low-interest concessional loan in 1995. Between 2010 and 2021, China's overseas lending to 18³¹ Asia-Pacific LMICs increased more than sixfold, from \$10.1 billion to \$62 billion (Figure 4.2).

As of 2021, China's largest sovereign debtors in absolute volumes include Pakistan, with about \$27.4 billion in reported debt; Sri Lanka with about \$7.2 billion, Bangladesh with \$5.3 billion, and Lao PDR with \$5.2 billion. China's largest holdings in terms of the debtor country's debt-to-GDP ratio include Lao PDR (28 percent), the Maldives (25 percent), and Tonga (24 percent) (Figure 4.3).

31 Six of the 24 Asia-Pacific LMICs covered in this paper do not owe sovereign PPG debt to China: Afghanistan, Bhutan, India, the Solomon Islands, Thailand, and Timor-Leste. The 18 countries that do are Bangladesh, Cambodia, Fiji, Indonesia, Iran (Islamic Republic of), Lao PDR, the Maldives, Mongolia, Myanmar, Nepal, Pakistan, Papua New Guinea, the Philippines, Samoa, Sri Lanka, Tonga, Vanuatu and Viet Nam.

FIGURE 4.2: China's decade-long rise in lending to 18 Asia-Pacific developing economies, 2010-2021 (current \$ billion)

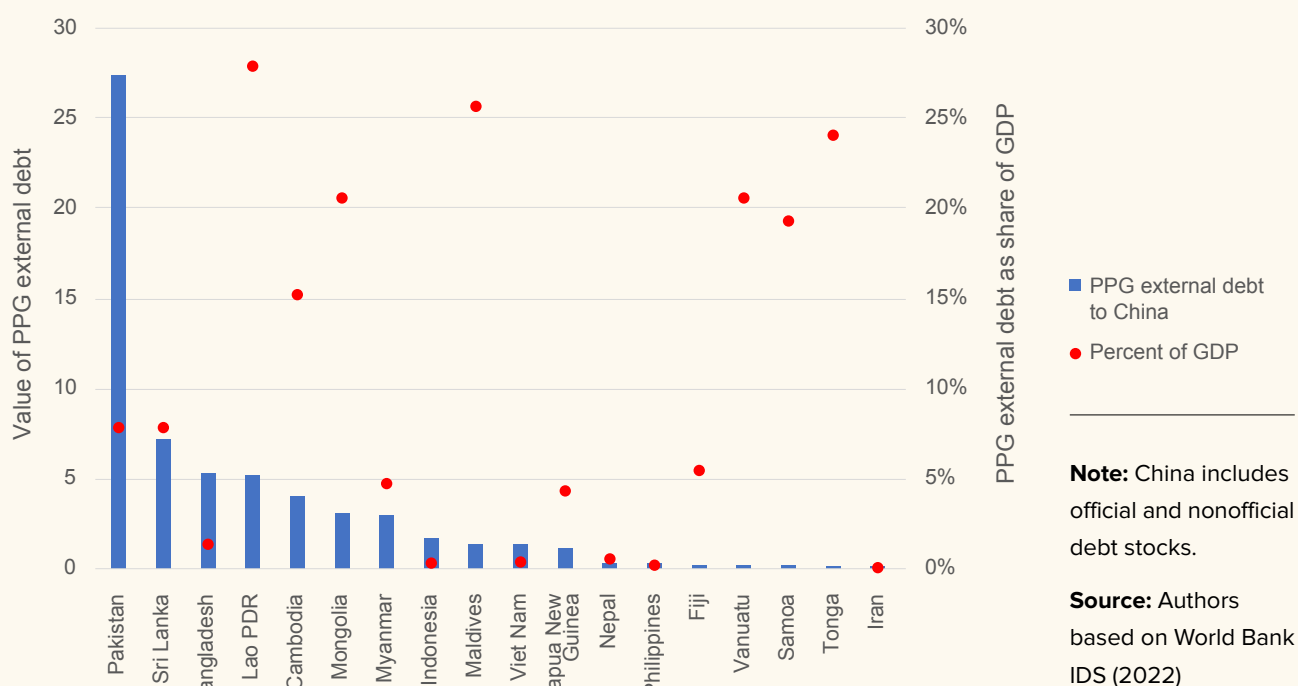


Note: Paris Club creditors = France, Germany, Japan, Republic of Korea (Korea), Russian Federation. Emerging creditors = China and Singapore. Data include official and nonofficial debt stocks.

The 18 countries: Bangladesh, Cambodia, Fiji, Indonesia, Iran (Islamic Republic of), Lao PDR, Maldives, Mongolia, Myanmar, Nepal, Pakistan, Papua New Guinea, Philippines, Samoa, Sri Lanka, Tonga, Vanuatu and Viet Nam.

Source: Authors based on World Bank IDS (2022)

FIGURE 4.3: China's PPG external debt stock as share of GDP for 18 Asia-Pacific developing economies, 2021 (current \$ billion)



Note: China includes official and nonofficial debt stocks.

Source: Authors based on World Bank IDS (2022)

4.4.2 China's potential for participation in debt reorientation arrangements

The choice of debt reorganization treatments and the adoption of innovative nature-positive instruments rest on a creditor's political willingness and efforts to address debt sustainability and sustainable development challenges.

While China has not yet participated in debt treatments that reorient debt to the SDGs or nature-positive programmes, there are increasing opportunities to provide additional financing for environmental sustainability, as well as participating in multilateral debt relief initiatives. Some of China's recent efforts in partner countries include:

- » **China's participation in the DSSI**, where Chinese suspended 63 percent of all debt service payments under the initiative between 2020 and 2021 (Brautigam and Huang 2023).
- » The **China-Africa Joint Declaration on Combating Climate Change**, announced at the 2021 8th Forum on China–Africa Cooperation Ministerial Level Meeting in Dakar, Senegal (MOFA PRC 2021).
- » The CNY 20 billion **South-South Climate Cooperation Fund** announced in 2015 (CIDCA 2018).
- » The CNY 1.5 billion **Kunming Biodiversity Fund**, launched in 2020 at the first-phase meeting of the UN Biodiversity Conference (COP15) (Reuters 2021).

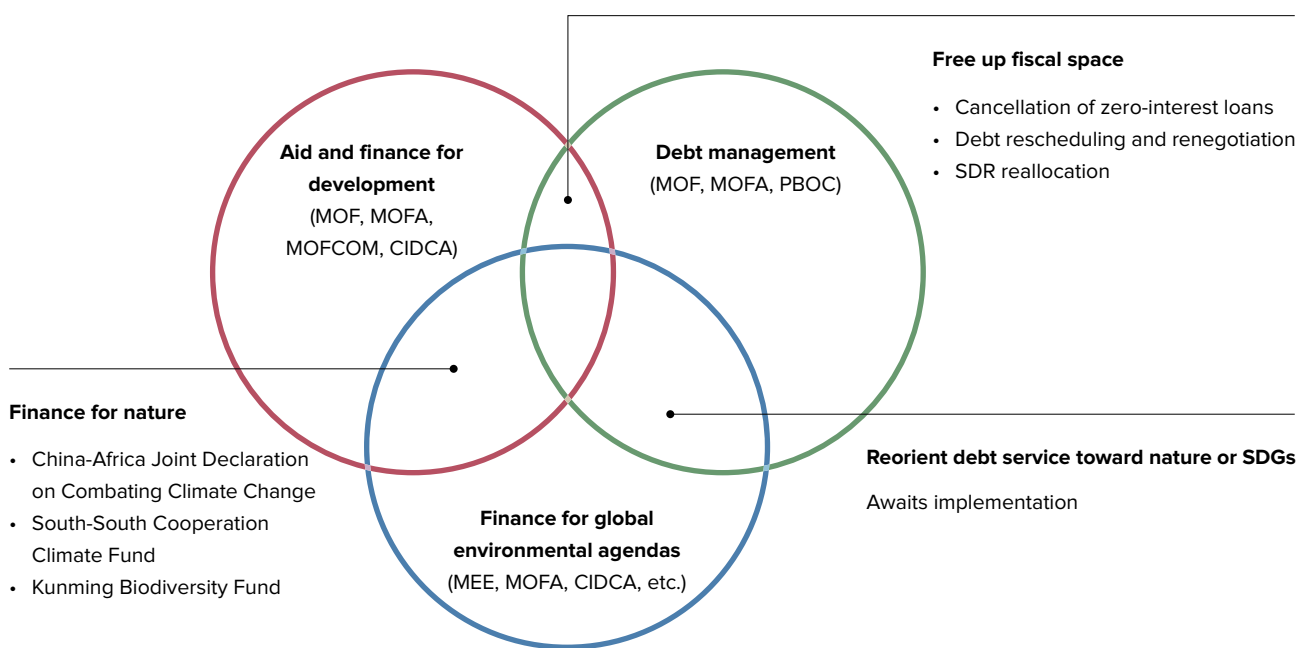
These initiatives are managed by different Chinese agencies and departments, as set out in the three spheres of action in Figure 4.4. The figure highlights where current responsibilities for providing sovereign debt relief and finance for development or aid could overlap with new instruments and initiatives, such as debt-for-nature swaps.

China's participation in debt relief and its commitment to finance climate and biodiversity programmes in partner countries indicates that it might be possible for China to reorient some of its sovereign debt stock towards nature in Asia-Pacific LMICs. So far, however, this option awaits further policy guidance and implementation, possibly due to the complexity of China's overseas-loan governance architecture, loan classifications and types of sovereign guarantees, and regulatory or capacity gaps. The successful reorientation of overseas loans would require improved cooperation between relevant Chinese agencies and a greater capacity for internal coordination.

The key entities include the China International Development Cooperation (CIDCA) as well as the Ministry of Finance (MOF), the Ministry of Foreign Affairs (MOFA), the Ministry of Commerce (MOFCOM), and the Ministry of Ecology and Environment (MEE). Additional entities may include agencies such as the State Administration of Foreign Exchange (SAFE), and China Banking and Insurance Regulatory Commission (CBIRC)³²; the central bank, People's Bank of China (PBOC); SOFIs such as the Export-Import Bank of China (CHEXIM), China Development Bank (CDB), Industrial and Commercial Bank of China (ICBC); and SOEs. For a description of where each SOFI sits on the spectrum of China's official, commercial and quasi-official commercial creditors to overseas sovereigns and companies, see Figure 4.5.

32 China has announced that the CBIRC will be replaced by a new national financial regulatory administration. Details on how this may impact mandate for debt relief and reorientation should follow (Xinhua 2021)

FIGURE 4.4 China's spheres of responsibility for sovereign debt reduction and reorientation



Source: Authors

4.4.3 Typology of China's overseas lending

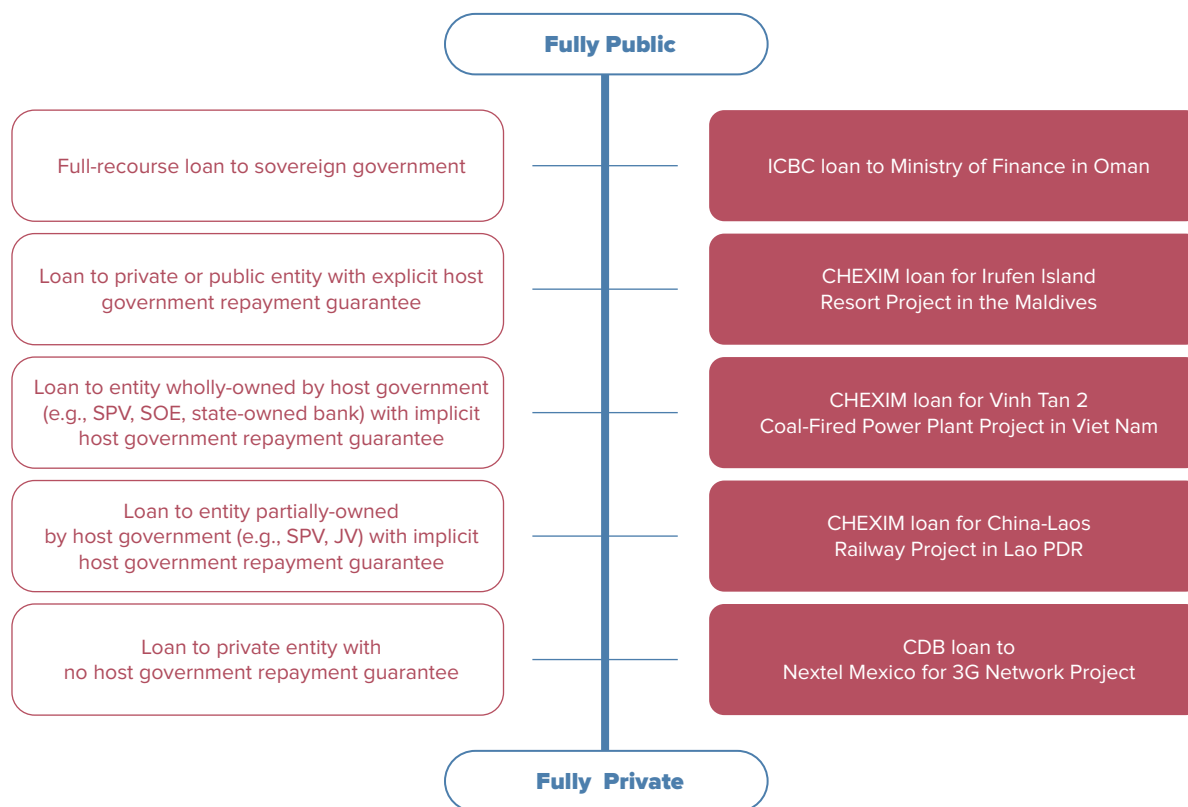
China's overseas loans and credits can be classified along a spectrum of full to no sovereign PPG liability and fully official to fully private (Figure 4.5). The characteristics that determine where a loan sits on the spectrum include the price of the debt, i.e., whether terms are concessional or market-rate (commercial)³³; and the purpose of the loan, i.e., whether it is intended to serve as official foreign aid similar to official development assistance (ODA) (OECD 2023), or to serve fully commercial purposes.

Chinese SOFIs, such as CDB or ICBC, can make a commercial loan to a sovereign government and receive an explicit public repayment guarantee. China's loans to the sovereign's SOEs should also count as PPG external debt, but might be harder to track. At the other end of the spectrum, Chinese SOFIs can also lend to overseas private-sector entities, including for infrastructure construction, without any level of sovereign guarantee. Between these two extremes, Chinese loans require

33 Note: 'Commercial loans' in the Chinese context means market-rate loans as opposed to below-market-rate concessional loans. These commercial loans are provided by both China's policy banks (CDB and CHEXIM) and its SOFIs; traditional creditors would understand them as nonofficial private loans. In other words, the Chinese definition of 'commercial loan' is broader than usual because it refers to both categories of loans in IDS glossary terms: (1) "commercial loan sub-group within the private creditor" under PPG external debt or (2) "commercial loan sub-group within the private creditor" and fall under non-PPG external debt (World Bank 2022i).

varying levels of explicit or implicit³⁴ sovereign guarantees. For this reason, sovereign debtors, as well as creditors in a multi-creditor reorganization, need a clear understanding of the sovereign liability exposures.

FIGURE 4.5: Official Chinese overseas sector lending on the ‘public liability’ spectrum



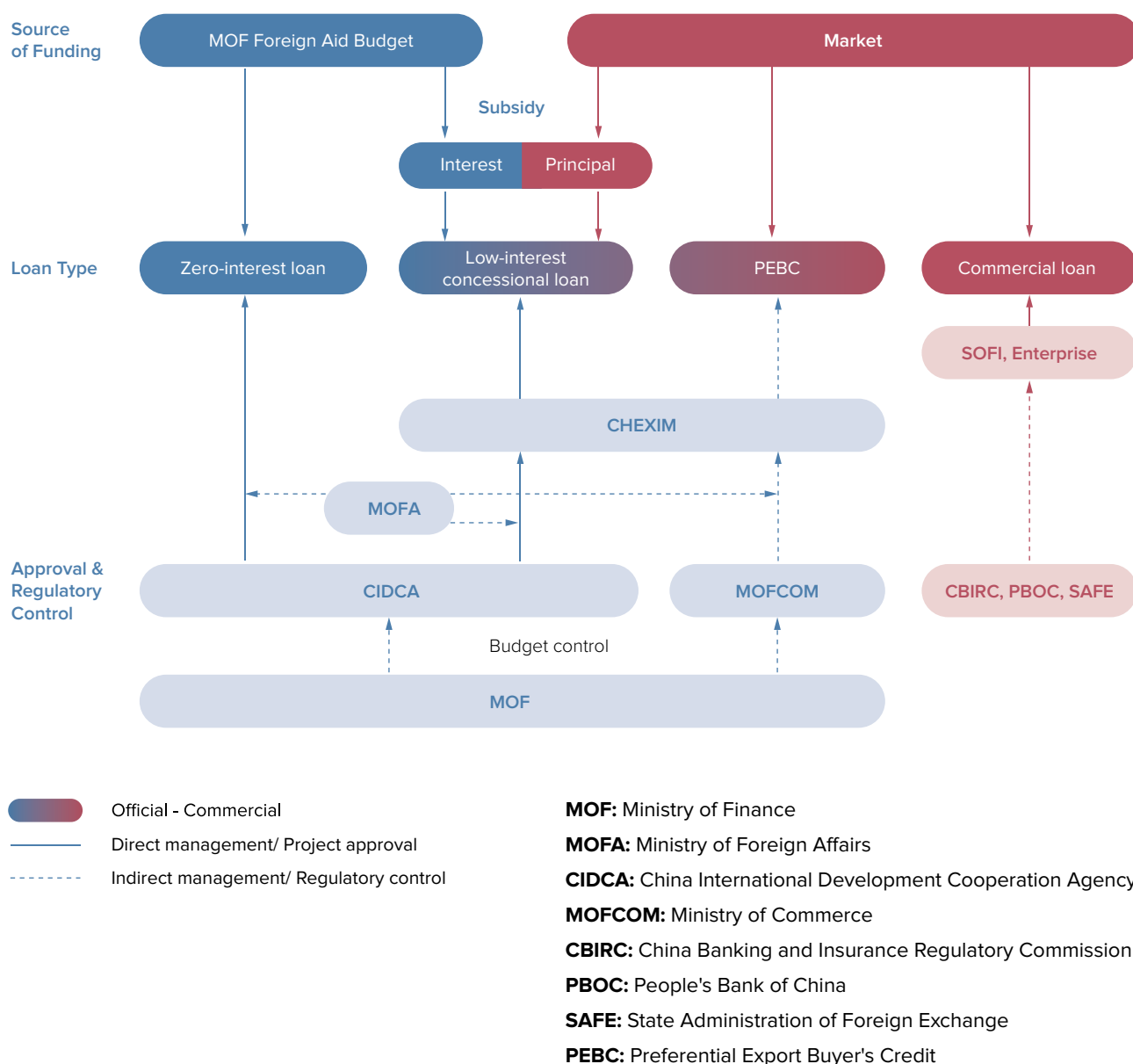
Note: SPV = special purpose vehicle; JV = joint venture.

Source: AidData’s Banking on the Belt and Road report (Malik et al 2021)

From China’s domestic governance perspective, the main distinction in loan classification is the source of the capital for the loan, namely domestic or international capital markets or the government’s foreign aid budget. Depending on its source of capital, each type of loan is administered by a different entity or department within an entity (Figure 4.6).

34 Although an implicit sovereign guarantee does not require the debtor country to account for such loans as PPG debt, it does lessen the risk of default.

FIGURE 4.6: China's overseas-loan governance architecture



Source: Authors

Notably, the same entity can make different types of loans. For example, while only CHEXIM can provide official concessional loans overseas that count as development assistance, CHEXIM also provides export credits that do not count as assistance, even though they may support China's overseas development policy purposes. CHEXIM can also issue overseas commercial loans at market rates. Other Chinese SOFIs, like CDB and ICBC, and SOEs cannot issue official aid loans. However, they can provide non-official overseas market-rate commercial loans that carry a sovereign guarantee and support China's overseas development policy purposes in a quasi-official way. The SOFIs and SOEs can also provide fully private overseas commercial loans for wholly market purposes.

Based on differences in capital source and purpose, Chinese overseas loans comprise four types: zero-interest loan, low-interest³⁵ concessional loan, preferential export buyer's credit (PEBC), and market-rate commercial loan. Table 4.1 presents a summary of each loan type's characteristics and contribution to China's foreign aid expenditure.

Table 4.1: China's four types of overseas loans and their characteristics (all countries)

	Zero-interest Loan ⁽ⁱ⁾	Low-interest Concessional Loan ⁽ⁱ⁾	Preferential Export Buyer's Credit (PEBC) ⁽ⁱⁱ⁾	Market-rate Commercial Loan ⁽ⁱⁱ⁾
Interest rate	0%	2-3%	2-3%	LIBOR plus 1-4%
Concessional	Yes	Yes	Yes	No
Maturity in years (minimum-maximum or average)	4-40	15-20	15-20	15
Part of foreign aid	Yes	Yes	No	No
Source of funds	MOF	Domestic debt market	Domestic + international debt markets	Domestic + international debt markets
Issuing entity	CIDCA through CHEXIM	CIDCA through CHEXIM	CHEXIM	CHEXIM, CDB, SOEs, SOFIs
Subsidy	MOF	MOF	None	None
Currency	CNY	CNY	USD	USD
Volume	CNY 11.3 billion (\$1.6 billion) (2013-2018) 4.18% of China's foreign aid	CNY 131.1 billion (\$19 billion) (2013-2018) 48.52% of China's foreign aid	\$22.5 billion (2016-2018 net disbursement) ⁽ⁱⁱⁱ⁾	Unknown
Eligible for Cancellation?	Yes	No	No	No

Source: Authors based on (i) SCIO PRC (2021); (ii) Gelpert et al (2021); and (iii) Kitano (2019)

35 Note: In translations to English and conceptually in their treatment, China makes a distinction between zero-interest loans and concessional loans, even though the term 'concessional' normally applies to both in English. For this reason, we have added 'low-interest' to this category of concessional loan to distinguish it from the even lower zero-interest concessional loan category.

1. Zero-interest loan

By the 1980s, zero-interest loans accounted for over 70 percent of China's foreign assistance and supported many large infrastructure construction projects, such as the Tanzania-Zambia Railway (MOFA PRC n.d.). In the 1990s, the percentage of zero-interest loans issued declined as China began offering low-interest concessional loans. China provided CNY 11.3 billion (about \$1.6 billion) of zero-interest loans from 2013 to 2018, which represented **around 4 percent of China's foreign assistance**; the remaining went to grants (47.3 percent) and low-interest concessional loans (48.5 percent) (Table 4.1) (SCIO PRC 2021).

In addition to being interest-free, the loans also include a 'no compelled repayment' (不逼债, *bu bi zhai*) condition. Accordingly, their maturity can be extended under special circumstances, or the principal and any arrears can potentially be forgiven. The earliest recorded mention of that possibility comes from the first Forum on China–Africa Cooperation Ministerial Level Meeting in 2000. At present, only zero-interest loans can be forgiven.

MOF funds the loans through its foreign aid budget, the source of funds for grants and contributions to multilateral development banks. **CIDCA** oversees approvals for projects that qualify for zero-interest loans, primarily the construction of social infrastructure, such as schools and hospitals. Since China sees loan forgiveness as a diplomatic gesture, **MOFA** plays a key role in forgiveness decisions and usually announces them to the press.

2. Low-interest concessional loan

China first approved the use of another type of concessional loan as a foreign aid instrument in 1995. Low-interest concessional loans are financed by **CHEXIM** with capital raised on China's domestic market (2018a). **MOF** subsidizes the difference between the concessional interest rate (normally 2-3 percent per annum) and the benchmark rate set by the **PBOC** for domestic capital-market loans with longer than five-year repayment periods.

Since CHEXIM raises funding for low-interest concessional loans from China's domestic capital markets with a requirement to repay the money, it seeks projects and creditors that guarantee repayment in turn. According to CHEXIM's 1996 guide, Interim Measures for Handling the Foreign Concessional Loan Business of the Chinese Government, **"the interest and principal of a [low-interest] concessional loan are not eligible for forgiveness"** (EXIM 2016, article 6.4).

CIDCA also manages low-interest concessional loan approvals and oversees project implementations once CHEXIM provides financing. **In the event of default, CHEXIM leads debt-reorganization negotiations to reschedule the debt service.**

3. Preferential Export Buyer's Credit (PEBC)

CHEXIM also provides a preferential export buyer's credit (PEBC) to an overseas importer. This medium- and long-term financing facility aims to promote Chinese goods and services exports. CHEXIM raises funding for PEBCs on international capital markets, which allows for lower funding costs and thus preferential lending terms without the need for a government subsidy. Notably, a PEBC is often U.S. dollar-based, while a low-interest concessional loan is often CNY-based (Table 4.1).

China’s foreign-aid management system sometimes refers to the PEBCs and low-interest concessional loans as “two concessional” (两优, *liang you*): both can be considered quasi-official instruments when they serve a policy purpose. However, only low-interest concessional loans qualify as foreign aid, while China categorizes PEBCs as commercial credits with concessional terms (Table 4.1).

Since a PEBC does serve China’s foreign economic cooperation policy like an official development finance instrument, even though China does not categorize PEBCs as official lending, PEBC policy planning, regulatory framework, and annual budget are overseen by central government entities, including **MOFCOM, MOF** and **MOFA**. **CHEXIM** is the only entity that issues PEBCs. CHEXIM collaborates with the state-owned China Export & Credit Insurance Corporation (**Sinosure**) on the project and lending terms and in negotiations because Sinosure provides trade-credit insurance against political, commercial, and credit risks to Chinese exporters (CECIC n.d.).

4. Commercial loan

As noted earlier, China’s private entities (private banks and enterprises), SOEs and SOFIs, including official public policy banks (CHEXIM, CDB), provide commercial loans to developing countries and overseas SOEs. Thus, although official creditors provide some of these loans, the lending terms and conditions resemble commercial transactions (Horn et al 2021). The exact terms vary by debtor country, debtor entity, and project. The average interest rate of Chinese commercial loans between 2000 and 2019 was LIBOR plus 1 to 4 percent and the maturity was 15 years (Gelpern et al 2021).

China generally views all these commercial loans as authorized by the issuing entity and government agencies do not directly dictate or regulate these loans, except as required for prudential financial regulation, foreign-exchange management, and asset preservation. Relevant regulatory oversight is provided by the PBOC, National Development and Reform Council (NDRC), China Banking and Insurance Regulatory Commission (CBIRC), the State Administration of Foreign Exchange (SAFE).

4.4.4 Analysis of China’s potential for debt reduction and reorientation in Asia-Pacific LMICs

Taking into account the complex and overlapping governance architecture, loan types, and purposes of China’s overseas lending, the following sections consider how the four main types of Chinese loans could be reorganized and reoriented to support nature-and-climate SDGs.

In general, the enabling conditions and challenges for reorganizing and reorienting debt described in Chapter 2 also apply to China’s overseas loans. Notably, China has not announced any specific priorities, policies or ambitions for engaging in any form of reorganization that reorients debt toward nature- or SDG-aligned projects or programmes. While China considers debt-sustainability issues when addressing the debt crisis in LMICs, when offering avenues for debt renegotiation, it fears debtor-country moral hazard and wishes for fairness and coordination between creditors (Zin 2022).

1. *Bilateral official and quasi-official loan debt-for-nature swap possibilities*

- **Zero-interest loan forgiveness and reorientation**

Potentially all zero-interest loans, including those made to Asia-Pacific LMICs, could be forgiven, ideally with a conditionality that the sovereign debtor reorients all or part of the cancelled amount toward nature-positive programmes or projects.

Currently, China only cancels zero-interest loans to countries in severe debt or economic distress. China could consider expanding eligibility to include countries experiencing less severe debt crises in exchange for commitments to nature-positive investments. This would allow China to mobilize resources in support of its bilateral and regional pledges to “step up support” for green development in developing countries (MOFA PRC 2021a) and to support partner countries in their SDG attainment efforts.

Box 4.2: Benefits and challenges of a bilateral official zero-interest-loan debt-for-nature swap from a Chinese perspective

Benefits:

- » Interministerial coordination is less complex because a smaller group of domestic decision-makers are involved, potentially making the decision process more efficient.
- » Alignment with China’s commitments to support international development and global environmental governance.
- » Enhances China’s reputation globally and with local partners.
- » Potential to leverage more stakeholders as multi- and bilateral DFIs follow China’s lead.
- » Deeper connections with developing country partners through an upgraded relationship, from creditor-debtor to development partners with shared interest.
- » No or low additional national budget input.

Challenges:

- » Higher preparation and coordination costs than a simple cancellation because of the bilateral and interdepartmental negotiations necessary to agree a nature-positive commitment.
- » Potential conflict with China’s ‘no condition attached’ principle which is embedded in China’s foreign assistance since 1964 and known as one of the Eight Principles for Economic Aid and Technical Assistance to Other Countries (Government of China 1964). This principle was re-affirmed in the 2021 China-Africa Partnership White Paper as one of the “five lines China will not cross” (SCIO PRC 2021a). Since a debt-for nature swap attaches a condition to debt forgiveness, such a swap must prove it does not violate this principle. One way to ensure alignment with the principle would be for the sovereign debtor or its agent to request a nature-conditional zero-interest loan cancellation.

To link zero-interest loan forgiveness with development priorities, such as nature conservation, the debtor country could transfer the equivalent in local currency of all or part of

the amount of debt cancelled to a new local development-cooperation trust fund or assignment account, or into an established international trust fund such as the Kunming Biodiversity Fund, China-UN Environment Trust Fund, or UN Multi-Partner Trust Fund. The trust fund would then support (bilateral) nature-positive development cooperation in the debtor country. Box 4.2 summarizes the benefits and challenges of such arrangements from a Chinese perspective.

- **Low-interest concessional loan interest debt-for-nature swap**

As seen earlier, China’s MOF subsidizes CHEXIM to provide low-interest concessional loans. **MOF could provide additional subsidies so that CHEXIM could further reduce the interest rate – possibly to zero percent – and require the sovereign debtor to reorient the savings to funding nature-positive policies and programmes** or to a domestic or international nature-positive trust fund, possibly one jointly founded with China. Box 4.3 summarizes the benefits and challenges of such a concessional-interest debt-for-nature swap arrangement from a Chinese perspective.

Box 4.3: Benefits and challenges of a concessional interest debt-for-nature swap from a Chinese perspective

Benefits are similar to those in Box 4.2 plus:

- » Larger volume and higher potential to relieve debt pressure: From 2013 to 2018 China provided low-interest concessional loans worth \$19 billion (Table 4.1) with an average interest rate of 2.2 percent. One year’s worth of interest payment on this amount is \$418 million.

Challenges are similar to those in Box 4.2 plus:

- » Further investments from MOF for China’s foreign aid budget would be required to subsidize the interest-rate discount.
- » No precedent to learn from.

- **Low-interest concessional loan or PEBC debt-for-nature swap**

Like an interest rate reduction, the principal of low-interest concessional loans and PEBCs, particularly when their purpose is policy-driven, could be reduced and converted into debt-for-nature swaps. In this scenario, **CHEXIM would forgive all or part of the loan principal and some of China’s foreign-aid budget would be reallocated to CHEXIM to compensate the bank’s loss.** Some or all of the forgiven amount of principal would be reoriented by the sovereign debtor to nature-and-climate SDG-aligned policies and programmes.

For the principal of either instrument to be included in a debt-for-nature swap arrangement, **various Chinese government ministries and departments would need a higher than usual level of coordination.** These include entities responsible for the government budget, foreign aid, commercial loans, bank regulation, and foreign affairs, along with CHEXIM. It would also require a change in banking and possibly other regulations so that the SOFI could forgive all or part of the principal. Box 4.4 summarizes the benefits and challenges of such arrangements from a Chinese perspective.

Box 4.4: Benefits and challenges of a bilateral official loan or PEBC debt-for-nature swap from a Chinese perspective

Benefits:

- » Greater potential for debt relief and development financing since overseas low-interest concessional loan volumes greatly surpass zero-interest loan volumes.
- » Much greater positive reputational impact for China.
- » Strong policy signal for China's engagement in debt sustainability and the 2030 Agenda for Sustainable Development.

Challenges:

- » More complex inter-agency coordination and negotiation required because each relevant Chinese government entity, including the development cooperation department, finance ministry, and policy bank would bear some losses, possibly prolonging domestic negotiations.
- » Government entities do not have direct power over the disposal of low-interest concessional-loan or PEBC principal. Even if government entities approve and endorse a debt reorientation arrangement, the endorsement is likely to be non-binding.
- » Since the volume of low-interest concessional loans is much larger than that of zero-interest loans, the national treasury would need to subsidize debt reduction and reorientation arrangements, which may trigger negative domestic public opinion and anti-forgiveness pressure.
- » No precedent to learn from.

2. Commercial loan debt-for-nature or -climate swap possibilities

Compared to CHEXIM and its official lending from the Chinese central government, other SOFIs have more flexibility and autonomy over their loans and engagement in debt reorganizations. However, unlike official lenders that might be willing to bear losses in exchange for enhanced SDG outcomes, wholly commercial lenders primarily aim to preserve assets and increase revenue, so they may lack incentives to forgive and reorient sovereign loans.

That said, to reorient Chinese commercial loans, a Chinese SOFI or private lender could directly engage in a debt-for-nature or -climate swap negotiation for a loan made to an overseas Chinese or local SOE, cancelling all or part of a loan that finances, for example, polluting or nature-damaging infrastructure in exchange for a climate or nature commitment from the overseas SOE, as described in Section 2.1.4(i). Such a commitment could take the form of an investment in debtor-country nature conservation or an environment-improvement programme using local currency, or, for broader impact, a donation to a domestic or international nature-positive NGO.

However, doing so **would be complicated because most Chinese commercial lenders are state-owned and would require a top-down policy or state approval** to conduct a commercial loan debt-for-nature or -climate swap in order to avoid liability for asset losses or failures to successfully conduct projects. Box 4.5 summarizes the benefits and challenges of a commercial loan debt-for-nature swap arrangement from a Chinese perspective.

Box 4.5: Benefits and challenges of a commercial loan debt-for-nature swap from a Chinese perspective

Benefits:

- » Larger loan volume implies significant potential for debt relief impact.
- » Mitigates SOFI's debt risk by reducing the potential for defaults and bad debts.
- » Positive reputational enhancement for SOFI in overseas markets, among global investors, and among pro-environment Chinese public.

Challenges:

- » SOFI commitment to SDGs or ESG normally not strong enough to compensate for the asset loss.
- » No clear policy signal or precedent to learn from.

In the case of a Chinese SOE that wants to refinance a standard loan, buyback standard bonds, or issue new SDG-aligned bonds in order to replace or issue new debt with thematic bonds or sustainability-linked instruments, CHEXIM, CDB, or the export-insurance company, Sinosure could provide support by providing credit enhancements, such repayment, political risk, or other guarantees like the U.S. International Development Finance Corporation did for bonds issued by The Nature Conservancy as part of a trilateral sovereign bond debt-for-nature swap in Belize (see Box 2.9). At present, China has given no policy signal to SOFIs in either direction.

Table 4.2: Sovereign debtor's Chinese negotiation interlocutors and strategies for debt relief and reorientation treatments

Type of loan	Responsible entity(s)	Possible engagement strategy for sovereign debtor
Zero-interest loan	Ministry of Foreign Affairs, CIDCA, CHEXIM	Ask CIDCA and MOFA for an interest-free loan cancellation in exchange for reorienting the savings.
Low-interest concessional loan	Ministry of Finance, CIDCA, CHEXIM	Ask CIDCA, MOF, and CHEXIM to provide further concessionality on a CHEXIM loan, such as an interest-rate or principal reduction in exchange for reorienting the savings.
Preferential Export Buyer's Credit	Ministry of Commerce, Ministry of Finance, Ministry of Foreign Affairs, CHEXIM	Ask MOFCOM, MOF, and/or MOFA and CIDCA to secure credit principal or interest forgiveness and from CHEXIM in exchange for reorienting the savings.
Commercial loan	SOE, SOFI, SAFE, Sinosure, Ministry of Finance, Ministry of Commerce	Ask CHEXIM and Sinosure to provide credit or other risk insurance to refinance loans or bonds at lower rates.

Source: Authors

Based on this chapter’s analysis, **engagement strategies with China should take into account the type of loan to be reorganized and the Chinese government entities responsible** for possibly providing an avenue to reorient loans towards nature-positive priorities and programmes. Table 4.2 summarizes the Chinese interlocutors and their overlapping responsibilities. For example, CIDCA and MOF would be involved in any zero-interest loan reorganization and ambition to reorient the debt obligation.

CHAPTER 5

Conclusion and recommendations

Many Asia-Pacific LMICs are facing the dual challenges of sovereign debt distress and climate and biodiversity breakdowns. Global shocks like the COVID-19 pandemic, wars and conflicts, high inflation, and environmental disasters only add to their distress. Debt reorganization is urgently needed in several Asia Pacific LMICs for them to sustain their economic and human development and attain the SDGs. However, sharp increases since 2010 in the holdings of bondholders and emerging creditors, including China, have made the Asia-Pacific LMIC creditor composition and debt-reduction negotiations more complex.

Given the urgency to bolster environmental and economic resiliency among Asia-Pacific LMICs, this report looks at additional, primarily bilateral means to manage sovereign debt distress and reorient financing toward nature-positive outcomes. It has shown how traditional official and private creditors have deployed debt-for-nature or -climate swaps and other SDG-aligned instruments as part of single or multi-creditor debt-reorganization packages, sometimes with the participation of an experienced third party. In the most recent cases, the sovereign debtor obtained at least some debt relief and, in the case of Belize, a higher sovereign credit rating. While the scale of such swaps has risen significantly in recent years, their contribution to debt reduction remains modest, so stakeholders need to be realistic about the extent of the instrument's impact on debt sustainability as they address climate and nature challenges.

This report has presented rationales and possible roadmaps for applying debt-for-nature swaps in a selection of Asia-Pacific economies - Lao PDR, Pakistan, and the SIDS - outlining how emerging creditors, such as China, could join other creditors in integrating debt-for-nature swaps in their debt-management approaches. This report has also shown how sovereign borrowers have used – or could use – nature and climate-aligned instruments to raise new sustainable financing, such as through thematic bonds, sustainability-linked bonds, concessional loans with a nature conditionality, and other means.

This report distils four recommendations that Asia-Pacific sovereign debtors and creditors can use to replicate or improve successful debt-for-nature initiatives and avoid some of the challenges. We recommend that :

1. **Creditors and sovereign debtors should exercise caution when choosing between or combining debt-relief treatments and instruments to ensure that they are suitable for the sovereign debtor's specific situation and the creditor's interests and *modus operandi*.**

Decisive factors include:

- » The type or mix of creditors: traditional multi- or bilateral, emerging, and/or private.

- » The creditor's political will and ability to engage in debt relief and/or reorientation treatments.
- » The sovereign debtor's readiness to negotiate a climate or nature SDG-aligned instrument, such as a debt-for-nature swap or thematic bond, which means having a nature-positive plan, preselected projects, and KPIs in place.
- » The urgency of the sovereign debtor's debt situation and whether there is adequate time and fiscal space available to research the relative costs, respond to stakeholder questions, and explore the implications of nature-aligned debt contracts.
- » The sovereign debtor's capacity to implement a nature-aligned debt contract, such as having MRV systems in place.
- » The sovereign debtor's ability to borrow loans from traditional or emerging lenders.
- » The sovereign debtor's ability to issue bonds on international capital markets.

2. Asia-Pacific sovereign debtors should be prepared to understand and negotiate the implicit and explicit conditions of each type of creditor as they pertain to debt relief, debt-for-development swaps, debt-for-nature conversions, or new sustainable finance:

A. Traditional bilateral creditors:

- » **To reduce debt**, traditional creditors – all Paris Club members – have experience with a shared framework for debt-relief treatments. Most have experience with SDG-aligned conversions such as debt-for-nature or other SDG swap instruments, and with converting foreign currency-denominated loans into local currency. However, each creditor country has specific eligibility criteria for potential debtor partners, such as a country's income level, type of debt, or debt-service to export-earnings ratio. Each creditor country may also have unique processes for implementing debt-for-nature swaps, or a specific framework, such as budget caps or preferred project types, or rules about whether debt-for-nature swaps can be deployed in a reorganization.
- » **For new financing**, traditional creditors have extensive experience issuing grants and concessional loans with SDG-aligned conditionalities, and in providing credit enhancements for SDG-aligned loans. Bilateral DFIs can also support sovereign- or third-party-issued thematic or sustainability-linked bond issuance by providing credit enhancements or guarantees for credit, political, currency and other risks, and make credible introductions to private-sector bond underwriters.

B. Private creditors, specifically bondholders:

- » **To reduce debt**, some but not all bondholders have experience in participating in multi-creditor sovereign-debt restructurings and will forgive or write off debt if the level of distress requires it. They may also agree to sell their holdings of standard sovereign eurobonds, particularly if the bonds are trading below face value, thereby indirectly facilitating the instruments' conversion into nature-aligned financing.
- » **For new financing**, bondholders may purchase new issues of thematic or other nature-aligned bonds to meet their ESG targets, burnish their reputation, or avoid climate-related litigation. Sovereign debtors seeking to either convert standard

sovereign bonds or issue new nature-aligned bonds should establish a strong relationship with an international nature-conservancy organization for assistance in structuring a bond with nature protection, conservation or restoration commitments. Such organizations can also provide financing in the form of loans and/or grants to fund a standard bond buyback or an endowment for nature-program implementation. They can also make credible introductions to private-sector bond underwriters.

C. Emerging creditors, specifically China:

- » **To reduce debt**, China has a clear policy framework and extensive experience in forgiving zero-interest loans, mostly to African countries so far. However, it has not yet established a forgiveness policy or framework for other types of Chinese overseas loans, or for converting all or part of a loan's principal or interest into a nature-aligned instrument like a debt-for-nature swap. China does, however, have a stated interest in supporting sustainable development, biodiversity, and the climate, which has the potential to be an influential factor in decision-making on loan-forgiveness or other policies following a request from a sovereign debtor.

Asia-Pacific economies aiming to engage with China should build a solid understanding of Chinese overseas loans and lending governance by:

- » Learning about the four loan types and their issuer, governing authority(s), explicit or implicit purpose, and explicit or implicit level of sovereign guarantee.
- » Identifying contacts and access points in and across various governing departments to discuss and evaluate China's engagement strategy and reduce the risk that China perceives a moral hazard in the event of a loan reorganization and reorientation arrangement.
- » Proactively requesting that all or part of a loan obligation be reoriented toward a nature-positive outcome, because China generally adheres to a policy of non-interference with nonfinancial aspects of its lending.

3. Asia-Pacific sovereign debtors should prepare for negotiations to (re)orient debt by developing a clear plan for the implementation of a debt-for-nature swap or other nature-aligned instrument and related projects in line with their national priorities. This includes identifying and engaging with:

- » Relevant officials within their own government, such as the ministries of finance, environment, resources, foreign affairs, and others.
- » Local citizens who may be affected by a debt-for-nature swap contract, such as those living in or earning their livelihood from what may become a protected area.
- » Relevant local civil society organizations that represent communities and/or that can contribute nature-management or other capacities to a nature-positive project.
- » Experienced international institutions to assist with pre-agreement research, negotiation strategies, technical questions, and financing analyses and terms.

- » Relevant international nature-focussed civil society organizations to assist with identifying, financing, implementing, MRV, and/or overseeing the swap-committed project. This may include managing a local project trust fund if funding is not delegated to an international entity.
- » Private-sector bankers and DFIs for the provision of financing, guarantees and/or advice on setting up a trust fund for the nature-positive project, and bond underwriters in case of a new issuances. Market-sensitive information needs to be managed carefully to avoid pre- or post-agreement credit-rating downgrades.

4. Creditors should play an active role in helping Asia-Pacific economies manage sovereign PPG external debt and environmental and climate risks by significantly expanding the scope for debt reduction and reorientation arrangements, and by making more extensive use of state-contingent debt instruments in their lending.

A. Bilateral creditors should:

- » Accelerate deployment of their debt-relief and reorientation frameworks on official loans and financing flows, in alignment with their development priorities.
- » Provide credit enhancements to Asia-Pacific sovereign or relevant third-party bond issuers in exchange for climate benefits or nature protection.
- » Participate in the equity of overleveraged state-owned enterprises in debtor countries to facilitate their access to bond markets in exchange for making nature-positive, low-carbon investments and transitions.
- » Evaluate and deploy other pertinent non-traditional nature and climate SDG-aligned instruments and arrangements mentioned in this report.
- » China, as a key emerging creditor, has an important opportunity to make a significant contribution to debt-relief and reorientation arrangements in Asia-Pacific LMICs and support partner countries' development priorities, while also demonstrating a strong commitment to international environmental agendas.

B. Multilateral creditors should:

- » Play a particularly important role in coordinating multi-creditor debt-reorganization negotiations and encouraging the inclusion of mechanisms and instruments that reorient debt obligations to nature-positive outcomes.
- » Continue to provide debt relief, new financing, and credit enhancements.
- » Increase their support for debt-for-nature swaps and similar instruments while widening their scope of action.
- » Incentivize sovereign debtors to design nature-positive policies and programmes.
- » Finance programmes to enhance sovereign debtors' ability to negotiate debt reorganizations that include a nature-positive instrument and/or commitment.
- » Provide credit enhancements for nature-aligned sovereign and relevant third-party bond issuance.

- » Participate in the equity of overleveraged state-owned enterprises in debtor countries to facilitate their access to bond markets in exchange for making nature-positive, low-carbon investments and transitions.

C. Private creditors should step up their participation in Asia-Pacific LMIC debt reorganization and reorientation arrangements, including by purchasing and holding nature-aligned sovereign- and related third-party-issued bonds.

By following through on these four recommendations, Asia-Pacific LMICs and their creditors can address debtor economies' vulnerabilities to climate and biodiversity breakdowns even as the countries face other potential global shocks and crises. Since the traditional architecture and instruments for debt relief, particularly debt-service rescheduling, appear insufficient in scope and power to resolve the increasingly urgent dual crises of debt and environmental distress, this report has shown how SDG- and nature-aligned instruments – particularly debt-for-nature swaps – could be applied as part of a debt-relief package in single or multi-creditor arrangements, or could serve as a means to raise new sustainable finance. The timely and deft deployment of such instruments could provide new momentum as well as some of the finance needed to meet global and regional ambitions to advance the SDGs.

Appendices

Appendix 1: Relative benefits of debt-for-nature swaps

Table A1.1: Relative benefits of debt-for-nature swaps versus some other debt-reduction treatments

	Debt-for-resources swap	Debt-for-equity swap	Debt-for-nature swap	Nature performance bonds	Debt forgiveness	
Benefits for sovereign debtor	Lowers debt service obligation	+	+	+	+	
	Reduces debt level	+	+	+	+	
	Presents no moral hazard / expectation of future debt relief	+	+	+	-	
	Provides stimulus for extra employment	0	0	+	+	0
	Benefits economic development	0	0	+	+	0
	Supports locally owned investments	-	-	+	+	0
	Increases local tax revenues	0	0	+	+	potentially
	Provides green development benefits	0	0	+	potentially	0
	Reduces pressure to use resources and grow economy to repay debt	0	0	+	potentially	+
	Relatively easy to implement	0	0	-	0	+
	Health benefits, such as due to reduced air pollution	0	0	+	potentially	0
Benefits for creditor	Reduces sovereign debt risk	+	+	+	+	+
	Investment or economic benefits	+	+	potentially	+	0
	Signals a commitment to mobilize resources for development and SDG achievement, and forges partnerships	0	0	+	potentially	potentially
	Long-term economic stability and relationships	-	-	(+)	+	+
	Protects nature or climate	0	0	+	potentially	0

Source: Authors

Appendix 2: Four national policy frameworks for SDG-aligned sovereign debt swaps

Germany.³⁶ Germany has implemented far more debt-for-development swaps than other Paris Club members (Berensmann 2007). During the 1992 UN Conference for Environment and Development, Germany announced a Deutsche Mark (DM) 50 million debt-for-nature initiative, which later grew into a EUR 150 million per year debt-for-development swap facility. From 1992 to 2010, Germany launched 72 debt-for-development swap initiatives with 21 countries. Germany restricts these swaps to ODA loans and the pool of eligible countries to low- and medium-income countries that have a sovereign debt problem: Germany follows HIPC rules and benchmarks for high and unsustainable indebtedness. It also considers whether a parastatal agreement is in place. As of 2022, 24 countries were eligible for a debt-for-nature swap, including Asia-Pacific countries.

Table A2.1: Selected cases of Germany’s debt-for-development swaps

Debtor country	Year	Development sector/Program	Debt amount
The Philippines	1995	Community forest program	DM 3.8 million
Jordan	2006	Water sanitation, education and poverty reduction	EUR 213.6 million
Indonesia	2002	Education, teacher training and construction of learning centres	EUR 25.6 million
	2021	Health; Debt2Health program with the Global Fund	EUR 50 million
Pakistan	2008	Health	EUR 40 million
Sri Lanka	2021	Resilient and sustainable systems for health (RSSH) programmes	\$16 million

Sources: Cases for Pakistan, the Philippines and Jordan extracted from Buckley (2009); case for Indonesia extracted from Cassimon et al (2021); case for Sri Lanka extracted from The Global Fund (n.d.).

France: At the 1999 G7 Summit in Cologne, France made a commitment to debt cancellation that went beyond HIPC Initiative by launching a debt-for-development initiative known as the Debt Reduction-Development Contract (C2D). The French government does not refer to their C2D program as a debt-for-nature swap, but the net result of lower debt obligations and funds made

36 The information for Germany and each other country has been excerpted from Global Financial Markets Center (2022).

available for environmental protection is the same. C2D contracts are essentially bilateral aid grants that have as one of their central aims the 100 percent reduction of France's concessional loans with highly indebted poor countries (HIPCs). France allows C2D contracts for official development assistance loans for economic development.

Currently, France has C2D agreements with 18 debtor countries: 13 have successfully repaid all the debt and five still have contracts underway. The total financing mobilized amounted to EUR 5.4 billion. The C2Ds were mainly conducted in partnership with African or Latin American countries and dedicated to infrastructure (30 percent of total C2D funding), vocational training (17 percent), and agriculture (13 percent). The C2Ds represents one-sixth of the debts that France has cancelled. Particularly after the Paris Club's collective debt cancellations in the early 2000s, C2D volumes overtook France's conventional debt relief contracts and represent a significant channel for France's debt relief efforts (Boccanfuso and Paolo 2011).

Japan: In 2011 and 2014, Japan carried out debt-for-health swaps aimed at polio eradication with Nigeria and Pakistan for two concessional 0.2 percent loans of \$65 million and \$76 million, respectively, under the framework of its partnership with the Bill & Melinda Gates Foundation (Dawn 2011; Sampathkumar 2018). When Nigeria and Pakistan demonstrate that they have met the agreed polio immunization coverage targets, the Foundation will assume and repay the countries' Japanese loans for them.

United States: Under the Enterprise for the Americas Initiative (EAI), which is specifically for Latin America, and under the Tropical Forest Conservation Act (TFCA)³⁷ (U.S. Congress 1998), bilateral debt restructuring agreements have emerged as the principal form of debt-for-nature swaps administered by the U.S. Under TFCA, the U.S. has authorized 20 bilateral debt swaps with 14 countries (Sheikh 1998). The enabling law for TFCA allows three forms of bilateral debt reorganizations: Debt Restructuring Agreements; Sovereign Debt Buy-Backs; and Third-party Subsidized Debt Swaps. Under all three, the existing debt contract is canceled and a new one is created. Additionally, depending on which arrangement is used, typically a Tropical Forest Agreement is created and interest payments for the loan principal are deposited in local currency in a Tropical Forest Fund or other form of conservation trust fund.

All TFCA transactions are legally binding and enforceable agreements when:

- » The U.S. Government and the debtor country sign a debt-restructuring agreement.
- » The U.S. Government and the donor NGO sign an agreement to transfer NGO's funds, and
- » The NGO and the debtor country sign a Tropical Forest Conservation Agreement.

The Enterprise for the Americas Initiative and TFCA have strict eligibility requirements for sovereign debtor participation, including the need for a democratically-elected government; an agreement with the U.S. on certain conditions related to terrorism, drug control, and human rights; and certain economic and investment agreements and structures, such as an International Bank

37 The 1998 Tropical Forest Conservation Act (TFCA) was retitled the Tropical Forest and Coral Reef Conservation Act (TFCCA) in 2019 after a reauthorization act added coral reefs.

for Reconstruction and Development (IBRD) loan or equivalent; and other macroeconomic and investment agreements with the IMF or the U.S.

Under both the Enterprise for the Americas Initiative and TFCA, only certain kinds of U.S. loans are eligible, including USAID Foreign Assistance Loans, Commodity Credit Corporation Loans for developing countries to import U.S. agricultural products, U.S. Export-Import Bank Loans for foreign importers of U.S. goods and services, and Food for Peace Loans for agriculture.

Appendix 3: Multilateral financing mechanisms

Table A3.1: Selected IMF and World Bank concessional financing mechanisms

Program(s)	How it works	Relevance to sustainable development in Asia-Pacific LMICs	Relation to sustainable development
IMF Rapid Credit Facility (RCF)	The Rapid Credit Facility (RCF) provides concessional, rapid and low-access financial assistance to low-income countries with urgent balance of payments need from, for example, commodity price shocks, natural disasters, and domestic fragilities. RCF has a zero-interest rate, a grace period of 5½ years, and a final maturity of 10 years (IMF 2023c).	Countries in the Asia-Pacific region that have received RCF assistance since the outbreak of the Covid-19 pandemic include Bangladesh (\$244 million), the Maldives (\$28.9 million), Mongolia (\$99 million), Myanmar (\$243 million), Nepal (\$214 million), Papua New Guinea (\$363.6 million), Samoa (\$22 million), the Solomon Islands (\$9.5 million) and Tonga (\$9.95 million) (IMF 2023e).	The RCF provides fiscal space that can be used to continue public support for sustainable development.
IMF Resilience and Sustainability Trust (RST)	The Resilience and Sustainability Trust (RST) helps low-income and vulnerable middle-income countries build resilience to external shocks and ensure sustainable growth, contributing to their longer-term balance of payments stability. It complements the IMF's existing lending mechanisms by providing longer-term, affordable financing to address longer-term challenges, including climate change and pandemic preparedness (IMF 2023a).	Low-income and vulnerable-middle income countries, including small states – about three quarters of the IMF's membership – are eligible for RST financing. This includes all PRGT-eligible low-income countries, all small states (population under 1.5 million) with per capita GNI below 25 times the 2021 IDA operational cut-off, and all middle-income countries with per capita GNI below 10 times the 2021 IDA operational cut-off.	The RST has clear relationship to environmental sustainability.

IMF Special Drawing Right (SDR)	A Special Drawing Right (SDR) is an international reserve asset, created by the IMF in 1969 to supplement its member countries' official reserves. To date, a total of SDR 660.7 billion (equivalent to about \$943 billion) have been allocated. This includes the largest-ever allocation of about SDR 456 billion approved on August 2, 2021. For foreign currency-strapped economies, SDR financing provides the immediate means to pay for vaccines and/or other health care investments, with the absence of refinancing risks imposed by conventional maturities (Kharas and Hwang 2021).	All countries receive SDRs according to their contribution.	SDRs, primarily provided through concessional loans and sometimes grants, mostly focus on economic recovery and do not necessarily have an explicit link to sustainable development.
IMF Catastrophe Containment and Relief Trust (CCRT)	The Catastrophe Containment and Relief Trust (CCRT) provides assistance grants to cover the immediately due debt service owed to the IMF in low-income countries struck by natural and/or public health disasters, with the aim to free up financial resources for vital health, social, and economic support (IMF 2023d).	Limited applicability (only applies to debt owed to the IMF) and eligibility (only available to countries that are eligible for concessional borrowing through the Poverty Reduction and Growth Trust (PRGT) and having a per capita income below the International Development Association (IDA) cutoff (\$1,205, or \$2,410 for small states). In the Asia-Pacific region, only the Solomon Islands has received grants totalling \$440,000 through the CCRT.	Provides fiscal space that can be used for continuing public support for sustainable development issues.
The World Bank development policy loan with a Catastrophe Deferred Drawdown Option (Cat DDO)	The Catastrophe Deferred Drawdown Option (Cat DDO) is a contingent credit line that provides immediate liquidity to IDA-eligible countries to address shocks related to natural and/or public health disasters. It becomes available after the drawdown trigger, typically the member country's declaration of a state of emergency (World Bank 2012).	Fiji, the Philippines and Tonga have received assistance through the Cat DDO.	Provides fiscal space that can be used to continue public support for sustainable development.

Source: Authors

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